As the Americas recover, ECAs play a larger role

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Even the most casual observer has to be pleasantly surprised by how quickly the Latin American market has rebounded from the global liquidity crisis.

Reflecting general improvements in macroeconomic factors, as well as relative political stability in the region, Latin American (LatAm) debt levels are lower than in many other parts of the world. Across the region, sovereign credit ratings are improving, with the most recent addition of Panama to investment-grade ranking and the upgrade of Argentina.

Moreover, region-wide GDP is showing steady and sustainable growth with Argentina, Chile, Brazil and Colombia leading with upwards of 4%-6% (compared to, for example, current GDP growth of 3% in the US).

The speed and robustness of recovery in Latin American markets are even more encouraging when one considers historical performance. Traditionally, following economic downturns, the region has tended to trail global recoveries by one or two basis points. That is not the case this time, in part because the crisis did not originate in this region, but rather, in the US and Western Europe. In addition, most Latin American markets today are managing their macroeconomic policies better than in the past.

Of course, with robust growth come apprehensions about inflation. But all indications are that the region's governments – notably, Brazil, Argentina, Mexico, Chile and Colombia – are committed to controlling such pressures. They are also becoming more active in managing their currencies to ensure a proper balance of trade flows. Capital inflows are being actively discouraged, and the region's top local banks have become the go-to liquidity providers.

ECAs provide support

While local banks now supply upwards of 65% to 75% of required corporate and sovereign debt, they can be limited by required loan tenor, especially for large public sector infrastructure financings. As a result, export credit agencies (ECAs) and multilateral agencies have come to the fore to fill any gaps in infrastructure funding.

That is the case, for example, in Brazil, which will host both the 2014 FIFA World Cup as well as the 2016 Summer Olympics; work is already underway there to beef up the country's infrastructure – airports, roads, stadiums. In Mexico, energy (especially alternative energy projects such as wind power) and transportation projects continue to be a high priority, requiring concomitant funding.

Funding for these infrastructure projects – as well as others in Colombia, Peru, Panama and the Dominican Republic – comes from a combination of public/private financings and in some cases explicit sovereign guarantees.

In addition, Agencies are being called upon as a steady, long-term source of capital and/or guarantees, especially in countries that are in less-than-robust economic health, or where required needs tap out market capacity. A number of agencies, in fact, are looking to support priority infrastructure transactions of emerging market sovereigns by obtaining explicit sovereign guarantees.

Both MIGA, a member of the World Bank Group and OPIC, an agency of the US government, offer non-honouring of sovereign guarantee programmes for lenders and investors for long term infrastructure projects. These agencies offer AAA credit enhancements to induce market participants to offer longer, more attractively termed financing, be it in the bank or the international capital markets.

Of course ECAs have historically played a significant role in the financing of LatAm capital expenditures in general, and infrastructure projects in particular. These projects tend to fall into one of two categories: transportation (such as roads, rails and ports) and power & energy. Of particular focus recently, in the latter area, is alternative energy. As the global trend toward clean, sustainable energy expands into the region, ECAs are supporting long-term financing for projects in the clean energy realm, whether it be wind, solar or other efficient methods of power generation.

In North America, alternative energy powers up

Recent ECA activity in North America has been nothing short of dramatic. Since the nadir of the global downturn, ECA financings have increased by an astonishing 83 percent. Much of this activity is focused on larger lessors in the aviation sector as well as large cruise lines. Both these sectors are tapping heavily into the ECA market for financing.

With the U.S. government looking to spur economic growth via infrastructure investment, another key area of focus in North America is alternative energy: nuclear power, energy efficiency and renewables. Citi, in fact, just closed on its largest-ever alternative energy deal: a $1.4 billion financing for an 845 MW wind farm in Oregon, the largest wind power project to date.

A third major ECA trade finance trend in North America is in supply chain finance, particularly for small and mid-sized businesses. In the US, this trend supports President Obama's goal of investing in small business operations. To that end, major trade banks are helping to finance the supply chains of US exporters.

Driven by the concerns and requests of large manufacturing companies, banks are providing financing to smaller 'mom and pop' suppliers who provide component parts to large manufacturers of industrial equipment, vehicles, and the like. An example, in partnership with US Ex-Im Bank, Citi has recently launched a new supplier finance programme guaranteed by US Ex-Im Bank to support agricultural/construction equipment manufacturer CNH.

Along with banks, agencies are turning their attention to injecting liquidity into small businesses. For instance, in addition to US Ex-Im Bank – which has been quite innovative in its use of ECA solutions to boost domestic business, with the dual focus on supporting exports – the World Bank Group's International Finance Corporation (IFC) is also looking to support the working capital needs of emerging markets suppliers by implementing a global supply chain finance programme.

Small-business supply chain financing programs will continue to expand, ensuring that large and small manufacturers alike can continue to build, sell and ship the products that fuel and sustain economic recovery in the US and the world.

Uncertainty is certain

As the economies of the Americas proceed in their collective recovery, the demand for agency financing solutions is expected to be strong but selective. The focus will continue to be on traditional industry segments such as aviation, shipping, power & energy, telecommunications, oil and gas. Simply because these industries are such large consumers of capital, they will continue to require ECA solutions.

In both the Latin American and North American markets, however, the watchword for 2011 is caution. The financial industry as a whole is, understandably, more circumspect than it was pre-crisis. Finance professionals are still pursuing deals, but they are being more judicious, exercising a greater degree of due diligence.

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In addition to lingering concerns regarding economic recovery, the horizon is further clouded by new financial regulations, specifically that of Basel II and its imminent successor, Basel III. The impact of these regulations on underwriting and pricing of trade finance deals (not to mention Agency financing) is as yet unknowable. But it bears closer examination as each facet of Basel regulations is rolled out.

One trend may be a permanent feature of the new bank lending scene. In light of new and changing regulatory rules, the days of sole leads with a large hold position on a bank's balance sheet no longer exists. Many banks are looking to work with partners to club and distribute assets to ensure market pricing and liquidity. You could be sure that more banks will be teaming up for the next big deal!

Finally, adding a substantial and potentially troubling new variable to the uncertain climate are recent and ongoing headlines from Europe (Portugal, Italy, Ireland, Greece, Spain) and the Middle East (Egypt, Tunisia, Yemen, Jordan). They continue to show us that political risk – and resulting economic risk – is always an unpredictable, moving target.

In short, the greater the level of uncertainty that persists in a marketplace, the greater the need for the stability of a solid bank and the guarantee of a strong ECA. In an economic landscape like this one, the need for both is expected to be as strong as ever. ■

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