ECONOMIC ANALYSIS

China: LatAm's lender of last resort?

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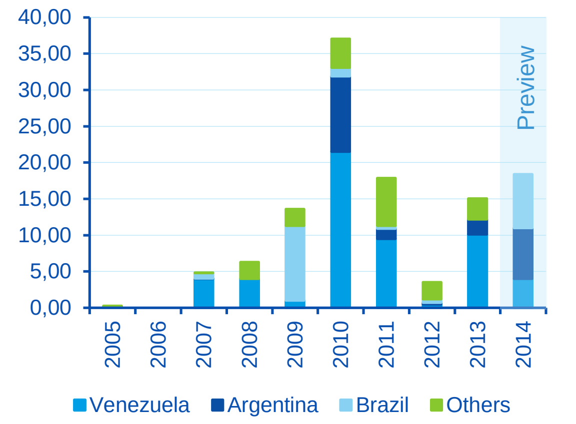
A surge in Chinese lending

Chinese President Xi Jinping visited Latin America (LatAm) following the conclusion of the 2014 BRICS Summit, held in Brazil on July 15-17. During the week-long visit, Xi met with the heads of states of Brazil, Argentina, Venezuela and Cuba. The visits took place against the backdrop of the Summit's most anticipated outcome; the decision to establish a US$ 50 billion BRICS New Development Bank (NDB), based in Shanghai.

Xi's visit was applauded by many observers as an unprecedented breakthrough in China-LatAm trade and investment relations. However, the truth is that China has been an important financial player in LatAm for a solid number of years. According to data gathered by the Inter-American dialogue, China provided loan commitments upwards of US$ 98 billion between 2005 and 2013 (Chart 1). The bulk comes from China's policy banks, such as the China Development Bank (CDB) and China Ex-Im Bank.

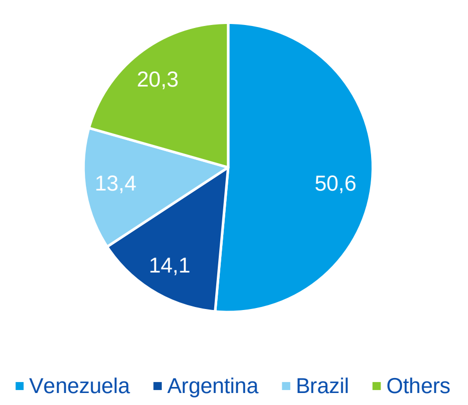
Nonetheless, Chinese lending in LatAm is highly concentrated by country (Chart 2). Over half of these loans went to Venezuela, followed by Argentina and Brazil, with the rest of LatAm accounting for slightly over 20%. The outcomes of Xi's recent visit confirm this trend, concluding with a number of bilateral lending agreements, primarily to support investments in the fields of energy and infrastructure (Chart 1).

Figure 1
Chinese lending to LatAm per year (US$ Bn)



Source: Inter-American Dialogue, media reports and BBVA Research

Figure 2
Total Chinese lending between 2005-2013



Source: BBVA Research

China the ultimate "lender of last resort"

The NDB, with an initial 50 billion US$ in lending, may have humble roots, but China's backing make it a serious alternative to traditional sources of finance such as the World Bank and the International Monetary Fund (IMF). China sits on an estimated 4 trillion US$ of foreign reserves (compared to a combined 1 trillion US$ from the rest of the BRIC members), making it the ultimate "lender of last resort" for US$ denominated loans in the region.

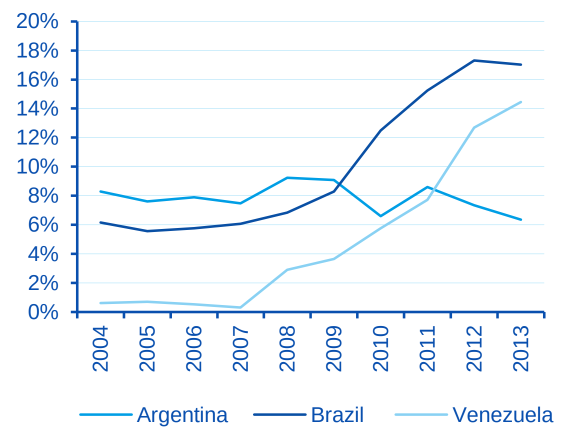
BRICS are in dire need of funding for infrastructure, a deficit of investment which some experts have placed at US$1 trillion annually beyond what is currently being financed (Bhattacharya and Romani, 2013). Failing to secure access to this funding will increase the risks of falling in the middle income trap, a scenario which is homologous with the rest of LatAm. China's fast rate of economic growth in the last decades, linked to high industrialization and infrastructure investments, gives it a comparative advantage when it comes to assisting these countries to overcome the middle income trap vis-à-vis the World Bank and the IMF, who often attach conditionality.

Counter-containment in the form of cash

As has been discussed above, China is notoriously selective with its recipients of loans. This makes economic sense in some cases, however, the surge in lending to these countries does not necessarily reflect economic principles (see our Economic Watch). A good example is Venezuela, whose exports to China accounted for approximately 3.5% of total GDP in 2013 (Chart 3). On the contrary, Mexico is one of the largest economies in LatAm yet was recipient to a modest 2.4 US$ billion in loans from China between 2005 and 2013.

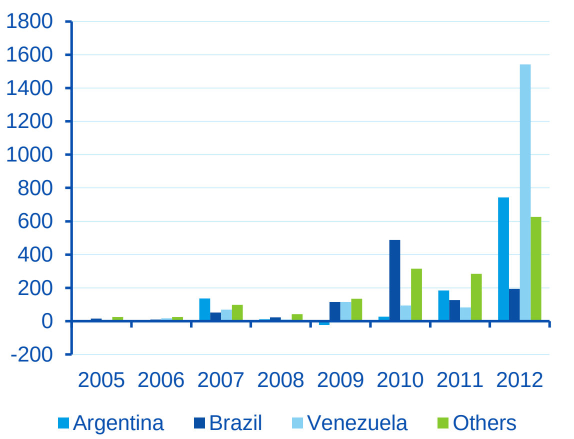
China's efforts in LatAm greatly resemble the United States' decision to pivot its foreign policy towards the Asia Pacific. Not surprisingly, Chinese lending seems to favor those countries that are aligned with its strategy in LatAm, a claim that is reinforced by Chinese outward direct investment (OFDI) figures in the region (Chart 4). In this context, the BRICS New Development Bank, underwritten by plush Chinese foreign reserves, may serve as an extension to bilateral lending agreements between China and its Latin American allies. The move will provide much needed financing, making use of economic and ideological fragmentations to boost Chinese interests in a region considered to be the "back-yard" of the United States. The bottom line is that whereas the outcomes of the recent visit by Chinese President Xi Jinping do not represent a breakthrough in China-LatAm trade and investment relations, they do formalize China's role as an alternative partner for development in the region, representing a clear shift away from US hegemony.

Figure 3
Exports to China as a percentage of GDP



Source: Haver and BBVA Research

Figure 4
Chinese FDI flows into LatAm



Source: UNCTAD and BBVA Research