LATIN LAWYER

Looking ahead

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Skadden Arps Slate Meagher & Flom partner Filipe Areno and counsel Hilel Pohulanik consider how the region's political and economic outlook will influence deal activity.

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There are long-term reasons to be optimistic about deal activity levels in Latin America. The region is in a cycle of economic recovery, stemming from higher commodity prices worldwide, stronger US growth and the end of the recession in Brazil (and possibly in Argentina, if the government is able to successfully navigate the current crisis). In the immediate future, however, the main challenges could come from a tightening of financial market conditions caused by faster-than-expected rate hikes and trade protectionism in the US, and an economic slowdown in China. In addition, political instability in Latin America, coupled with the effects of the ongoing corruption scandals in the region, could lead to temporary confidence shocks and delays in investments.

Brazil, as the largest economy in the region, has significant influence on deal activity in Latin America. At the end of 2017, we saw strong capital markets activity in Brazil, driven mostly by equity offerings. This momentum continued into the first quarter of 2018, but with debt offerings making up a higher percentage of the deals. In the second quarter, capital markets activity slowed significantly as the Brazilian election nears and the real devalues. If a market-friendly presidential election outcome is realised, we would expect markets to return to the high level of growth seen at the end of 2017, or even higher. With regards to M&A, an upward trend began in 2017 following signs that Brazil’s recession was ending, and continued into the first quarter of 2018, driven mainly by strong interest in local and strategic M&A deals. However, managing corruption issues, particularly with respect to successor liability and reputational risk, is still a challenge for international investors, especially US actors. We also expect M&A activity to slow to a degree in advance of the Brazilian election, but we should still see opportunistic M&A activity in the country driven by relatively low asset prices coupled with a US dollar appreciation. It is also expected that a pro-market new government would likely launch a new wave of privatisations, particularly in the energy and infrastructure sectors, to meet budget targets and reduce the fiscal deficit, which would certainly have a significant positive impact on M&A deal activity in the near and medium terms.

With a new market-friendly government in place, Chile gives us optimism. The election in November 2017 of President Sebastián Piñera, a businessman and former one-term president, has led to heightened interest in the country. President Piñera’s administration is expected to enact policy corrections in matters that have previously slowed the level of foreign investment and M&A activity. In line with these policy changes and raising commodity prices, the IMF estimates that Chile’s GDP growth in 2018 will be among the highest of Latin America’s top economies. We expect to see increased deal activity in Chile through 2018 and into 2019, particularly in the mining sector.

Argentina continues to keep us very busy but its economy is set for a slowdown. With diminished but still significant popular support, and facing fragmented political opposition in advance of the 2019 presidential election, President Macri's administration continues to maintain its pro-market reform efforts while prioritising infrastructure upgrades (at least until the cost-cutting announced in early May). However, domestic vulnerabilities, such as inflation and reliance on external financing to cover high fiscal deficits, make Argentina more susceptible to changes in market sentiment towards emerging markets. This was evidenced by the dramatic pressure on the Argentine peso that forced the country's Central Bank to increase its key interest rate more than 12% in the course of a week in late April and early May. As a result of these factors, Argentina is expected to experience, at most, modest growth in 2018, or even a contraction in GDP, according to a recent forecast, even if a deal with the IMF is reached. On the M&A front, the country saw significant activity in the first quarter and into the second quarter, highlighted by the *Raizen/Shell* and *Vista/Pelsa* deals. The third-quarter M&A pipeline for the country remains solid. There was also a notable number of public--private partnership bids for roughly $8 billion of toll road projects, and international oil companies have shown interest in Argentina's planned auction this year of offshore blocks for exploration and production. However, with investor confidence now fragile, overall deal activity levels for the balance of 2018 are difficult to forecast.

Activity in Mexico and Colombia has been hampered by political uncertainty, driven by presidential elections. While we continue to be very active in Mexico, and the country continues to draw interest from strategic investors, deal activity has slowed recently. This is likely driven by uncertainty over both the NAFTA renegotiation and the recent success of populist candidate Andrés Lopez Obrador in the July elections. Running on a left-leaning agenda, the anti-establishment candidate threatened to reverse or stall Mexico's energy liberalisation policies and scrap the $13 billion Mexico City airport project. With this backdrop of uncertainty, although Mexico has shown resilience in the headwinds coming from the US, it is unsurprising to see that the IMF estimates limited growth in the country's GDP for 2018. Before the presidential elections, the outlook for Mexico's energy sector was promising, as shown by the significant international interest raised by the deep-water basin oil blocks auctioned in late January. Meanwhile, the Colombian presidential elections in late May saw the election of right-wing candidate Iván Duque Márquez. Colombia has adjusted to commodity shocks and is expected to continue to experience economic recovery, although modest. It has also recently taken major steps towards structural improvements, such as signing a peace agreement with the main guerrilla group, the FARC, and launching the ambitious 4G programme to improve toll road infrastructure in the country. Implementation of these measures will be key.

The outlook for the rest of the region is mixed. In Peru, for example, the sudden change of government in March has dissipated some of the uncertainty that clouded the country's prospects earlier this year. This, coupled with other factors such as higher mineral prices, is reflected in the IMF's strong growth estimates for Peru. These forecast Peru as the leading growth country among Latin America's top economies. While there is little hope that government-driven infrastructure projects will resume this year, the country has seen some interesting M&A activity so far in 2018, including the *InRetail/Quicorp* deal, and more recently, Scotiabank's acquisition of 51% of Banco Cencosud. On the other hand, Venezuela is in its fifth year of recession and experiencing hyperinflation (so much so that is has been reported that five years of severance pay now buys a coffee there). We see no deal activity coming from Venezuela. Its government continues to make sporadic and delayed debt payments and is accumulating debt that is technically in default. While we see a limited risk of outright economic contagion to neighbouring countries, the influx of Venezuelans to Colombia and other surrounding countries is creating a migration crisis.

Overall, most of the region continues to recover, owing to an expanding economy. We expect that the increase in commodity prices, fiscal consolidation, strong consumer confidence and structural reforms will drive investor appetite and business opportunities. Countries will be differentiated based on election outcomes, institutional strength, sound macroeconomic policies and the impact of corruption investigations.