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In the COVID-19 aftermath, Latin American exports towards China should continue to gain ground at the United States' expense

Executive summary

The trade relationship between China and Latin America has expanded considerably over the past two decades, gradually standing out (compared to the U.S.) as an important market for the region's exports. The reasons behind this sustained trend range from the difference in growth rates observed in the world's two largest economies to the trade policies implemented by the U.S. and Chinese governments in recent years. To analyze the trade relations with these two countries, this paper focuses on the trade in goods of the six largest economies in the region (excl. Mexico): Argentina, Brazil, Chile, Colombia, Ecuador and Peru. Indeed, Mexico was not included, as it historically has tight trade relations with the U.S., supported by their geographic proximity and the NAFTA trade agreement, which came into force in 1994 and was ultimately replaced by the USMCA in July 2020. That said, considering the six abovementioned countries, China overtook the U.S. in 2010 as the top destination for the group's exports. However, in terms of diversification, the composition of the export basket to both China and the U.S. is poor, as it is highly dependent on commodities (albeit relatively less so in the case of sales to the U.S.). In 2020, as the global economy was hit hard by the COVID-19 crisis, foreign sales - considering all six economies - fell by 8% year-on-year (YoY). In contrast, their exports to China expanded (+4% YoY), further increasing its significance as their main export destination.

Looking ahead, Latin American countries' foreign sales growth rates are expected to exceed their domestic demand expansion. This is because the region´s activity rebound should be lower than the global average, and more specifically than the Chinese and U.S. recoveries. Therefore, sales to China and the U.S. should post a bright performance in 2021. In terms of significance for Latin American exports, China should continue to gain ground over the U.S. Although President Joe Biden's inauguration in January 2021 has reduced the trade war rhetoric observed during his predecessor's administration, improving trade ties with Latin America is unlikely to be among his top priorities. Moreover, exports to China are more dependent on commodities, which bodes well in the context of strong commodity prices. Finally, the shift to a cleaner economic model is likely to play an important role in the U.S. and China in the coming years, implying higher demand for some metals, such as copper coming from Chile and Peru, favouring Latin American exports.

I - China has been catching up with the U.S. as a major market for LatAm exported goods, which are still poorly diversified

A) China´s increasing participation in exports

Considering the six largest Latin American economies (excl. Mexico) as a group, China overtook the U.S. as their main export market in 2010. Moreover, the Asian giant's significance continued gaining strength even after the end of the commodity price bonanza in 2014. Meanwhile, U.S. contribution to their exports remained fairly stable from 2010 to 2019. In fact, in recent years, China has registered greater growth momentum relative to the U.S., which could have contributed to the aforementioned trends. Moreover, the trends observed during the last decade are in line with the respective trade policies fostered by the world's two largest economies.

Regarding the U.S., their lagging share can be attributed to the lack of interest in digging into trade relations with Latin America, which became clearly more prominent during Donald Trump's term in office (2017-2021). His administration's focus on reducing the U.S. trade deficit with Mexico and China, as well as an overall lack of engagement with the region, have created a space that China has filled. Finally, the U.S.-China trade war under Trump also caused the transformation of some "export routes"[1] of the global agri-food sector (particularly soybeans), benefiting Latin American producers, like Brazil, to the detriment of U.S. producers. Currently, the U.S. has trade agreements with Chile, Colombia and Peru, while China has agreements with Chile and Peru (Argentina, Brazil and Ecuador do not have broad agreements with either of the two giants). In December 2020, Ecuador signed a first-phase agreement with the U.S., which aims to facilitate and improve the dynamics of trade. Similarly, in October 2020, Brazil and the U.S. signed an Agreement on Trade and Economic Cooperation. Neither involve tariff reductions **(Chart 1)**.

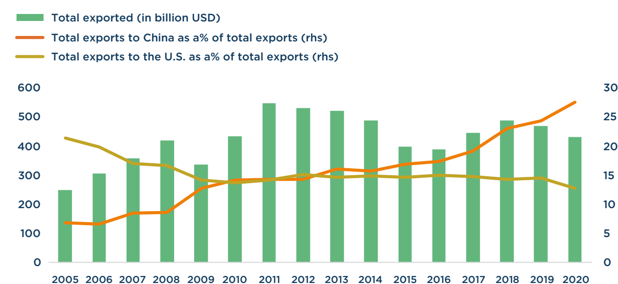
B) Latin America's poor export diversification towards China and the United States

The weight of goods exports in GDP diverges among the six selected LatAm countries. In 2020, Chile registered the highest participation of exports to GDP (29%), followed by Peru (21%), Ecuador (20%), Brazil (15%), Argentina (14%) and Colombia (11%). Moreover, the ranks of the U.S. and China in foreign sales vary from one country to another. China is the main market for Brazil, Chile, and Peru, while the U.S. is the major export destination for Colombia and Ecuador. Regarding Argentina, Brazil is the main buyer of goods, followed by the European Union (EU), China and then the U.S. Furthermore, in Brazil, Colombia and Ecuador, the EU is also the second main export destination, with the U.S. coming third in the former and China third in the latter two. It is also worth noting that the U.S. and China taken together receive over 50% of Chile's foreign sales and more than 40% of Brazil and Peru's exports. In fact, exports to the U.S. and China outweigh intraregional trade **(Chart 2)**.

Regarding their trade balance, all six countries but Ecuador moved from surpluses with the U.S. in the mid-2000s to deficits. Nonetheless, the imbalances are only relevant in the cases of Brazil and Colombia. Meanwhile, Ecuador maintained a surplus during the full 2005-2020 period. On the other hand, trade balances with China have been mixed. Colombia and Ecuador observed trade deficits with the Asian giant during 2005-2020 (the former observed a slight surplus only in 2020). Similarly, Argentina has also moved from an initial surplus to a deficit over the last 13 years. Conversely, Brazil and Chile have kept comfortable surpluses in the same period, with a significant increase for Brazil **(Chart 3 & 4)**.

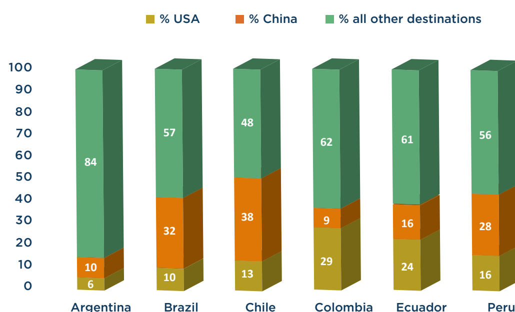
Latin America's export composition to China and the U.S. is poorly diversified overall and highly commodity dependent. This dynamic is even stronger for trade with China. Overall, exports of metals (40%), agri-food (35%) and energy (18%) account for 93% of the six countries' foreign sales to China. On a country-by-country basis, exports to China are heavily concentrated in agri-food

CHART 1
Latin America 6-major economies (excl. Mexico) annual exports



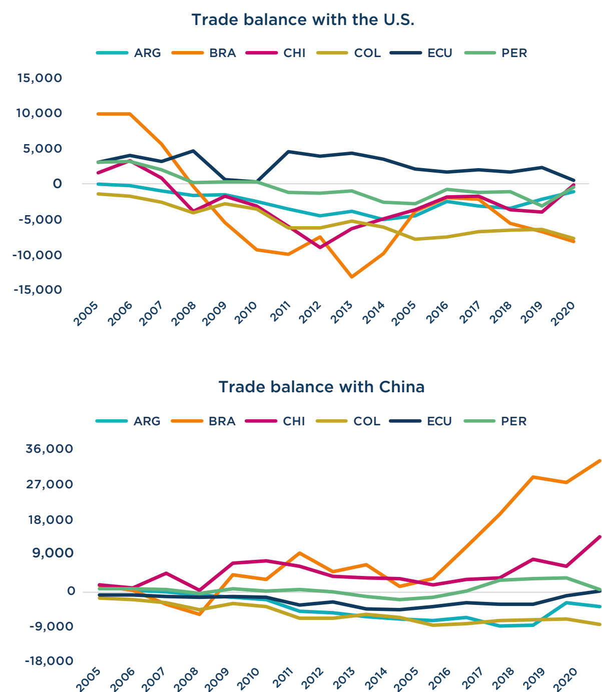
Sources: UN Comtrade and national statistical institutes, Coface

CHART 2
2020 Export destination (%)



Sources: UN Comtrade and national statistical institutes, Coface

CHART 3 & 4
LatAm trade balance evolution with the U.S. and China (in million USD)

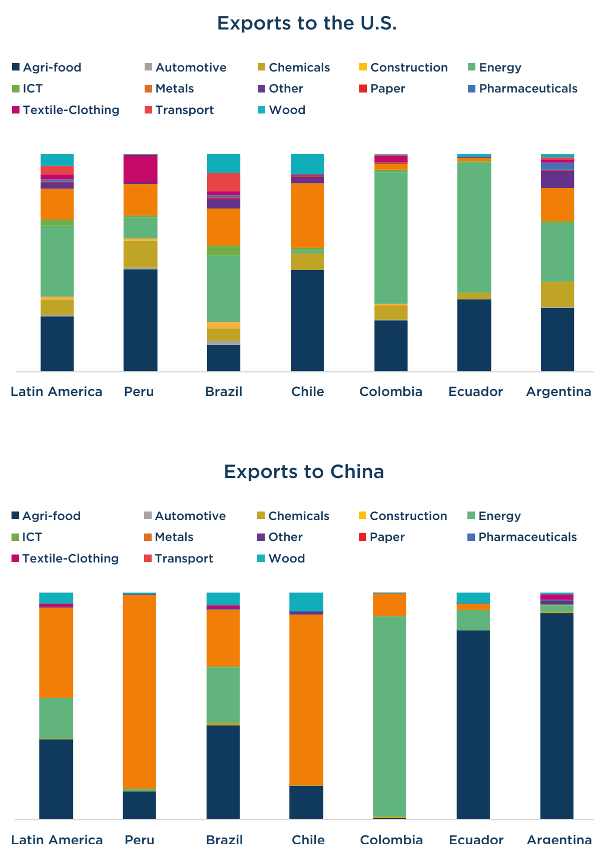


Sources: UN Comtrade and national statistical institutes

1 - Krause Patricia, Madelénat Erwan and N´Sonde Sarah "Global outlook for the agri-food sector within a protectionist environment", Coface Panorama, October 2019

in Argentina and Ecuador, metals in Chile and Peru, and energy in Colombia. Finally, Brazilian exports to China are relatively more balanced on this criterion. Regarding the U.S., while there is also a prevalence of the same three commodity groups, this dependence is relatively lower (72%) for the sample of countries. Moreover, diversification is relatively higher in Brazil and Argentina **(Charts 5 & 6)**.

CHART 5 & 6
Exports composition by sector (in USD revenue terms)



Sources: UN Comtrade, Coface

C) The COVID-19 shock's spillover effects on LatAm trade dynamics

The COVID-19 crisis, which erupted in the first quarter of 2020, also took a toll on global foreign trade in the early months of the health emergency. Latin America was clearly not immune to this impact. The six countries registered a drop of 8% YoY in total exports in 2020. Last year, exports to the U.S. were generally more impacted than those to China. While the former dropped by 19% YoY, the latter rose by 4%. Consequently, China and the U.S. were the destination for 28% and 13% of the group's exports in 2020, respectively.

The stronger resilience of exports to China was because its economy rebounded faster than the U.S. Moreover, the basket of goods exported to each market also played an important role, for instance, the high prevalence of agricultural exports to China. Demand for food, as an essential good, has proved resilient or even increased during the crisis. Additionally, China has also rebuilt its grain stocks in connection with the recomposing of its swineherd after the African Swine Fever outbreak (2017-2019). Regarding the high prices in the agri-food sector, taxes on grain exports levied by some countries (including Argentina) and cash transfers to the most vulnerable households by governments worldwide also bode well for them. This context prompted higher foreign sales revenues in USD terms.

II - China will maintain its compelling position for LatAm exports; no relevant export basket diversification in sight

A) LatAm exports set to outperform domestic demand in 2021

In 2021, Latin American countries' foreign sales are expected to outperform their domestic markets. The region's delayed COVID-19 vaccination, as well as the longer time taken to significantly flatten the curve of new cases and deaths, have hindered a full-fledged economic recovery relative to other markets that have experienced stronger progress in immunization. Furthermore, the increase in international commodity prices observed in recent months also represents a tailwind for the region as a major net exporter.

As illustrated below, average prices for iron ore, copper and soybeans all surpassed their yearly record levels between January and end September 2021. Iron ore is the most notable, as its year-to-date average price has surpassed the previous record high of 2011 by 9%. The strong Chinese demand and the current diplomatic tensions between China and Australia, the world's largest iron ore producer, have both contributed to the surge. This conjuncture bodes well for Brazil, the world's second largest iron ore producer, as its production has been recovering from the Brumadinho dam accident that occurred in 2019. Nevertheless, in May 2021, the Chinese government signalled a crackdown on what it called "excessive speculation" that had pushed up the price of iron ore. Moreover, since late June 2021, in an attempt to restrain carbon emissions, it has also conducted inspections on mills to check the implementation of cuts in steel capacity and output. This includes limiting production in heavily polluting plants and shutting down outdated blast furnaces. Furthermore, authorities in China have called on local mills to cut crude steel output in 2021, as a short-term mean to curb carbon emissions.

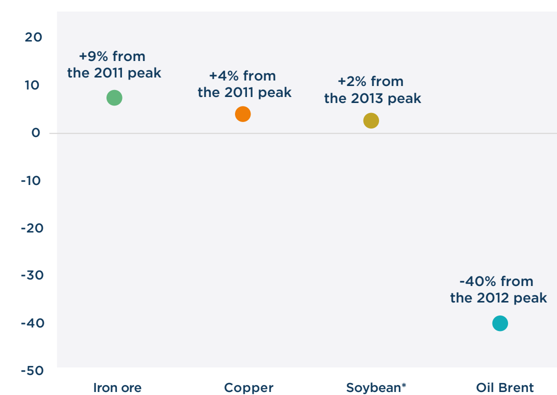
Finally, in mid-September, the liquidity crisis involving China´s second largest property company Evergrande further affected iron ore. Consequently, prices were trending strongly downwards from the highs observed this year, at the time of writing (albeit the year-to-date average quotation remains high). Despite these developments, the demand for Brazil´s iron ore could prove relatively resilient, as the push for decarbonization should boost demand for high-grade iron ore, thanks to its relatively fewer impurities and higher productivity. Iron ore with fewer impurities consumes less coke and therefore emits less carbon. Brazil is a major player in high iron content ores. That said, S&P Global Market Intelligence[2] signals that most of the Chinese seaborne supply growth should derive from brownfield expansions and restarts of capacity in Brazil (which were shuttered following the Brumadinho dam disaster).

As for copper, current price levels (4% above the 2011 record) benefit Chile and Peru, as the world's leading and second largest producers, respectively. Regarding agriculture, record price levels (exemplified here by soybeans) primarily benefit Brazil and Argentina. However, it is important to note that the consequent spike seen in domestic food prices led the Argentine government to impose a 30-day ban on meat exports in May 2021 to try containing domestic prices. After this period, meat packers reached a preliminary deal with the government that allowed them to partially resume beef exports. In end September, Argentine officials announced that restrictions on beef exports to China would be lifted on 4 October 2021. Overall, commodity prices should remain at historically high levels at least until the end of the year, as strong stimuli measures in major markets are unlikely to be significantly rolled back in the short-term.

Furthermore, although China has recently sold some of its commodity inventories and has raised the tone against possible speculation on the market, its objective is to avoid excessive and speculative price movements, not to neutralise market forces **(Chart 7 - Next page)**.

2 - Cecil, Ronald "Sluggish iron ore supply response could hamper China's decarbonization drive", S&P Global Market Intelligence, August 2021

CHART 7
Average commodity prices from January to 20 September 2021 relative to record-high annual average price (in %, 2000-2021)



**soybean series starts in 2006*
Source: Refinitiv Datastream, Coface

B) China will consolidate its position as a major destination for LatAm exports in the post-COVID-19 scenario

China should maintain its role - as a major destination for LatAm exports - relative to the United States. President Joe Biden's inauguration does not question this scenario. While his arrival in the White House eases the harsh anti-trade rhetoric seen during Donald Trump's term (2017-2021), he is unlikely to put the emphasis on deepening trade relations or pursuing new trade agreements. Until now, not even the trade tariffs on Chinese imports imposed by his predecessor have been lifted. Regarding Latin America, it is far more likely that the new U.S. administration will focus on dealing with the current strong migration flows from the Northern triangle (Guatemala, El Salvador and Honduras) and the implementation of the USMCA trade agreement with Mexico and Canada, which came into force in July 2020. However, it is noteworthy that the Asian giant's shift towards a consumption-oriented growth model at the expense of investments and exports, which has gained strength in recent years, requires fewer commodities overall. An IIF[3] study on China calculated the elasticity of the country´s commodity import volumes to GDP (i.e. the extent to which commodity demand rises when growth increases) during two periods: 2000-2008 and 2010-2019. It concluded that growth became less reliant on iron ore and oil imports post global financial crisis, while copper´s elasticity remained stable.

C) Some commodities will benefit from the development of green energy

Looking ahead, the divergent performances among commodities should persist, with the global green agenda gaining momentum and requiring more copper, lithium, etc. In March 2021, China announced its 14th five-year economic development plan at the National People's Congress (NPC), citing among priorities green development and a major shift in development approach, from capital accumulation and external markets to prioritising efficiency and consumption, with implications on strategically important sectors such as renewable energies. In fact, this trend is also expected to strengthen in major developed markets. For instance, U.S. President Biden has also called for comprehensive investment in electric vehicles (EV), renewable energies and the electric grid as part of a broad plan to bolster the U.S. economy while combating climate change.
As a reference, renewables, wind farms and solar panels require five times more copper than the volume needed for fossil fuels. In the case of EV, it requires four times more of the red metal than combustion engines. According to Bloomberg New Energy Finance (BNEF), EV global shares in total vehicles in 2025, 2030 and 2040 will reach 10%, 28% and 58% respectively, from 2.7% in 2020[4]. Moreover, EV-related demand for copper will grow by 9.9% each year during 2020-2050[5]. However, sector analysts note that new mine investments are required in order to avoid a supply crunch in the future. This conjecture brightens the outlook for the copper market in the upcoming years, hence some tailwind for Chile and Peru.
Nonetheless, the political environment in these two South American countries could minor the gains for locally operating mining companies. For instance, Chile´s Congress is currently discussing a bill to take advantage of the current copper windfall. An opposition-led proposal aiming to raise royalties in times of higher metal prices was approved in the Lower House in May 2021 and now stands in the Senate. It provides for a royalty base rate of 3% for metals, but there would be an additional progressive rate for copper, starting at 15% of additional income when prices stand between USD 2.00 and 2.50 per pound, and cresting at 75% over USD 4.00/lb. However, even if approved, the short-term impact would not be relevant. This is because a majority of miners have tax stability agreements in force, with roughly 50% of foreign miner agreements expiring in 2023, according to Fitch. Moreover, environmental issues are also expected to be discussed during the constitution rewriting process, including strengthening climate protection and water licenses to industries (notably to mining). Similarly, in Peru, the new president Pedro Castillo has also defended the increase of mining taxes to improve health and education, and reduce income inequality. He has also pledged to give local communities a greater role in the approval process for future extractive or infrastructure projects. On the same subject of benefits drawn from mining by hosting countries, the World Bank calculates mineral rents, expressed as a percentage of GDP, obtained from the difference between the value of production for a stock of minerals at world prices and their total costs of production[6]. This indicator is not high in Chile and Peru, at 1.6% and 1% in 2019, respectively. Such ratios, combined with the current high international prices and strong social tensions (notably triggered by the COVID-19 crisis), have contributed in emphasizing the discussion about increasing royalties in both countries.

3 - Lanau Sergi, Ma Gene and Feng Phoebe, "China´s Commodity Demand", IIF Economic Views, March 2021
4 - https://about.bnef.com/electric-vehicle-outlook/
5 - Aït-Yahia, Khalid "Will the electric vehicle metals boom last?", Focus Coface, July 2021
6 - Minerals included in the calculation are tin, gold, lead, zinc, iron, copper, nickel, silver, bauxite, and phosphate.

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