

Whither Latin American Capital Markets?

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Conferencia sobre Política Monetaria y Mercados
Financieros en América Latina
December 13, 2004
Universidad Torcuato Di Tella

Structure of Presentation

1. Motivation
2. Stock Market Development
3. Bond Market Development
4. Open Questions in Capital Markets

1. Motivation

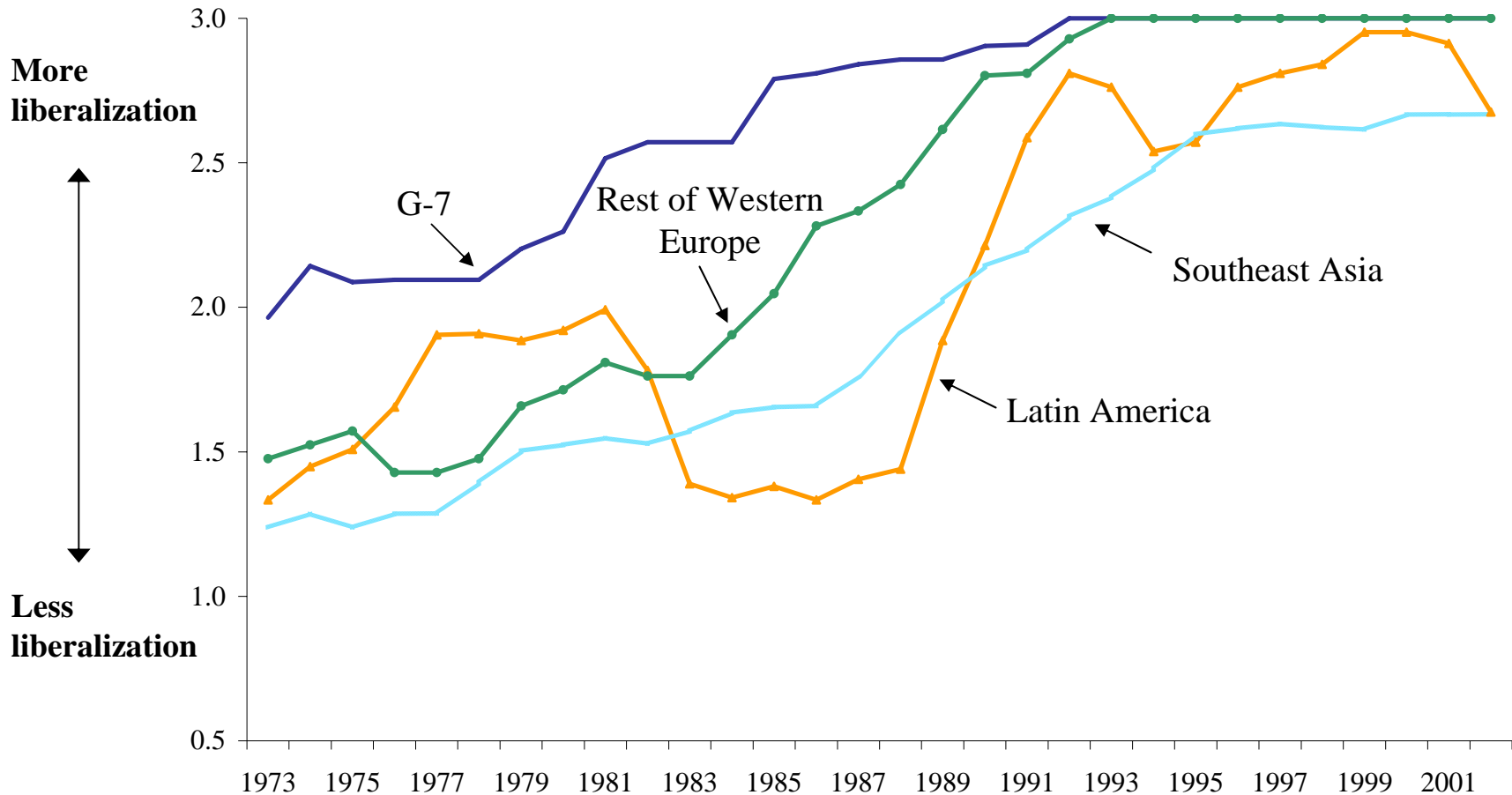
- ✦ Domestic capital markets in Latin America have under-performed other regions over the last decade...
 - Bank credit has not compensated for this under-performance
- ✦ ...despite the intense reform effort and high expectations
- ✦ But Latin America has been a leader in embracing global capital markets
 - International financial integration is not a detail

1. Motivation

✚ In this report

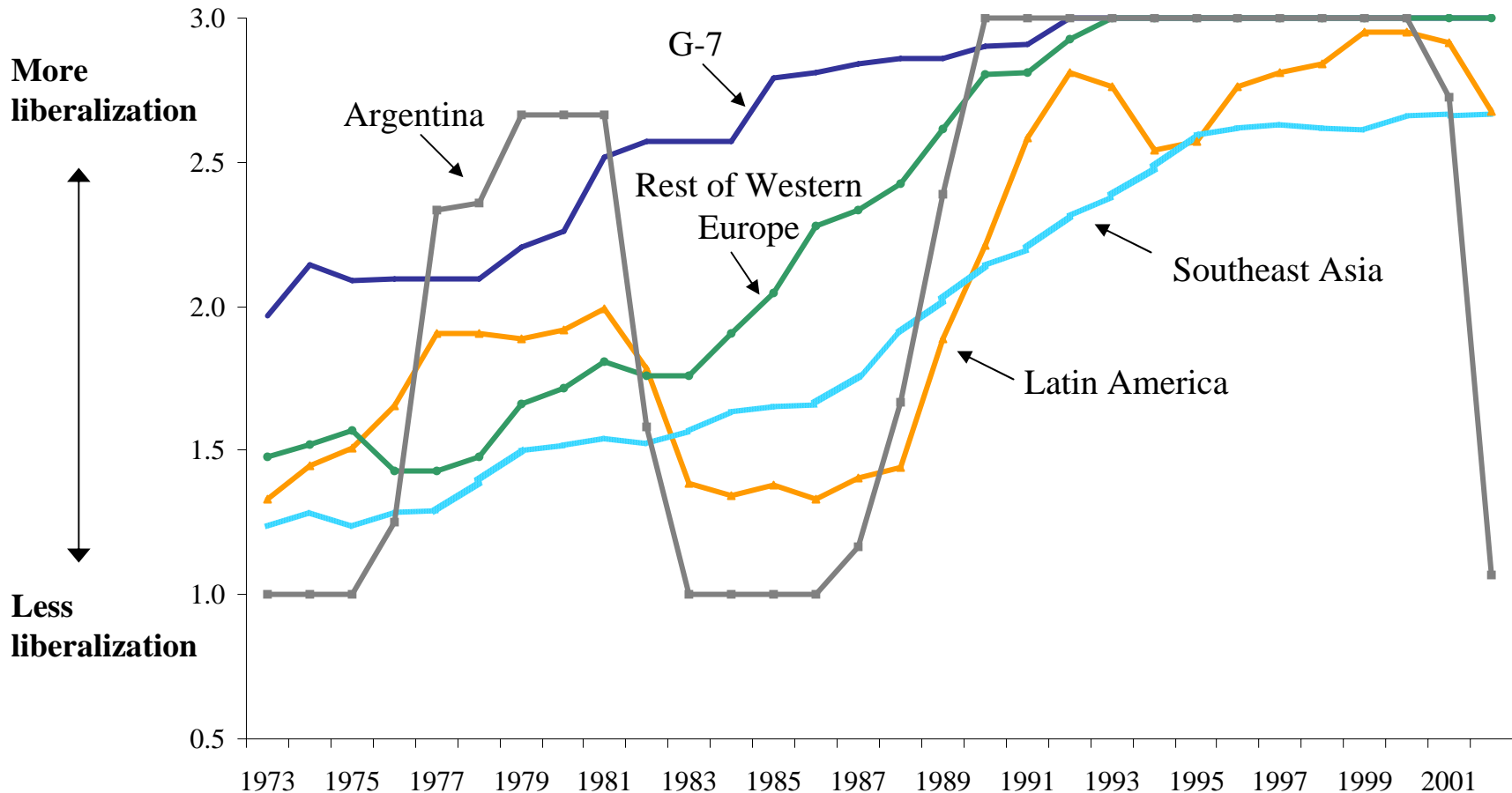
- Take stock
 - Stylized facts on reforms in Latin America
 - Stylized facts on performance in Latin America
- Econometric analysis
- Challenge existing views on market development
- Challenge current policy recommendations
- Do not provide policy prescription/recipe

No Shortage of Reforms: Financial Liberalization



The liberalization index is calculated as the simple average of three indices (liberalization of the capital account, domestic financial sector, and stock market) that range between 1 and 3, where 1 means no liberalization and 3 means full liberalization. These data are then aggregated as the simple average between countries of each region.

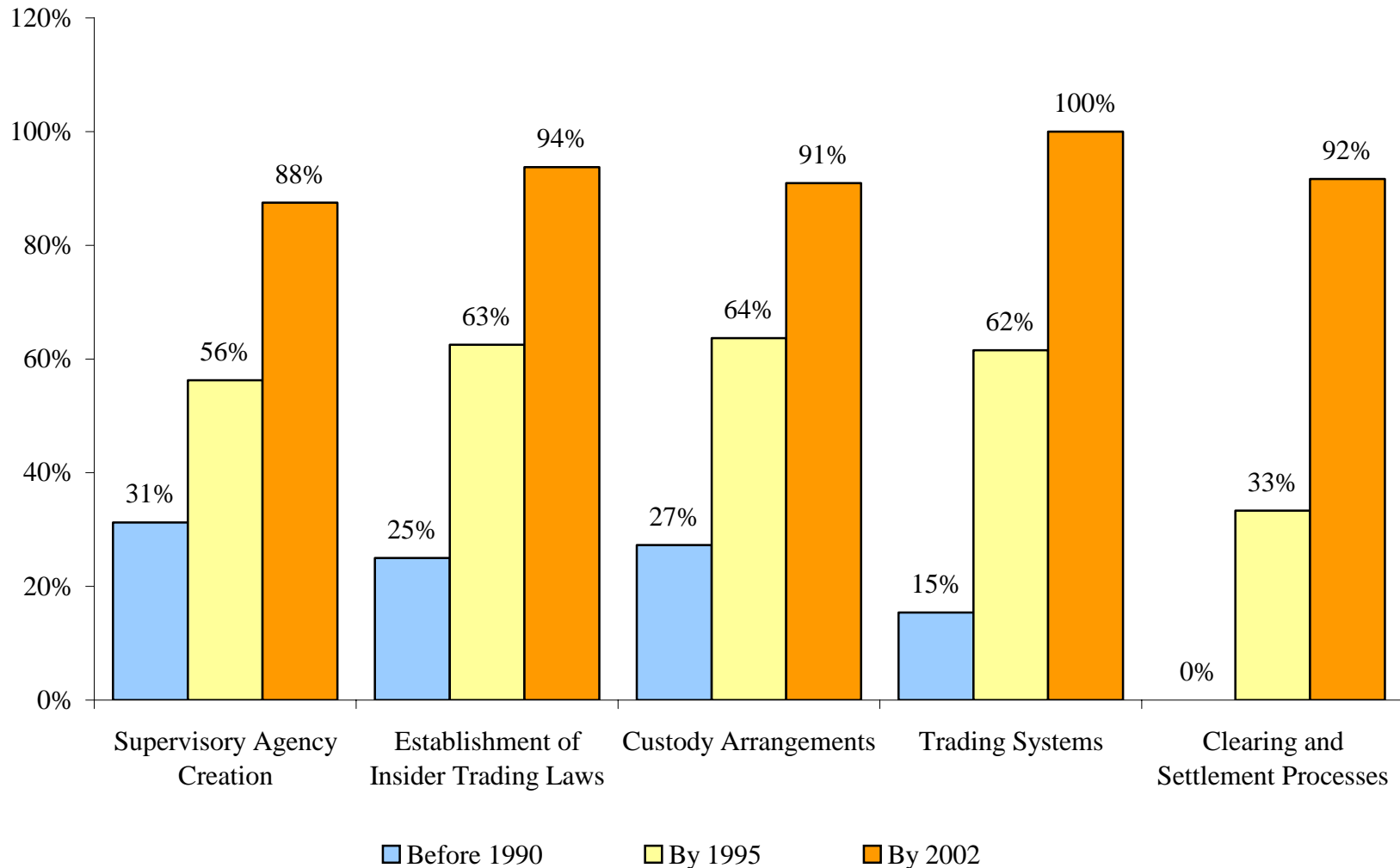
No Shortage of Reforms: Financial Liberalization



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No Shortage of Reforms: Capital Markets Laws, Regulation, and Infrastructure

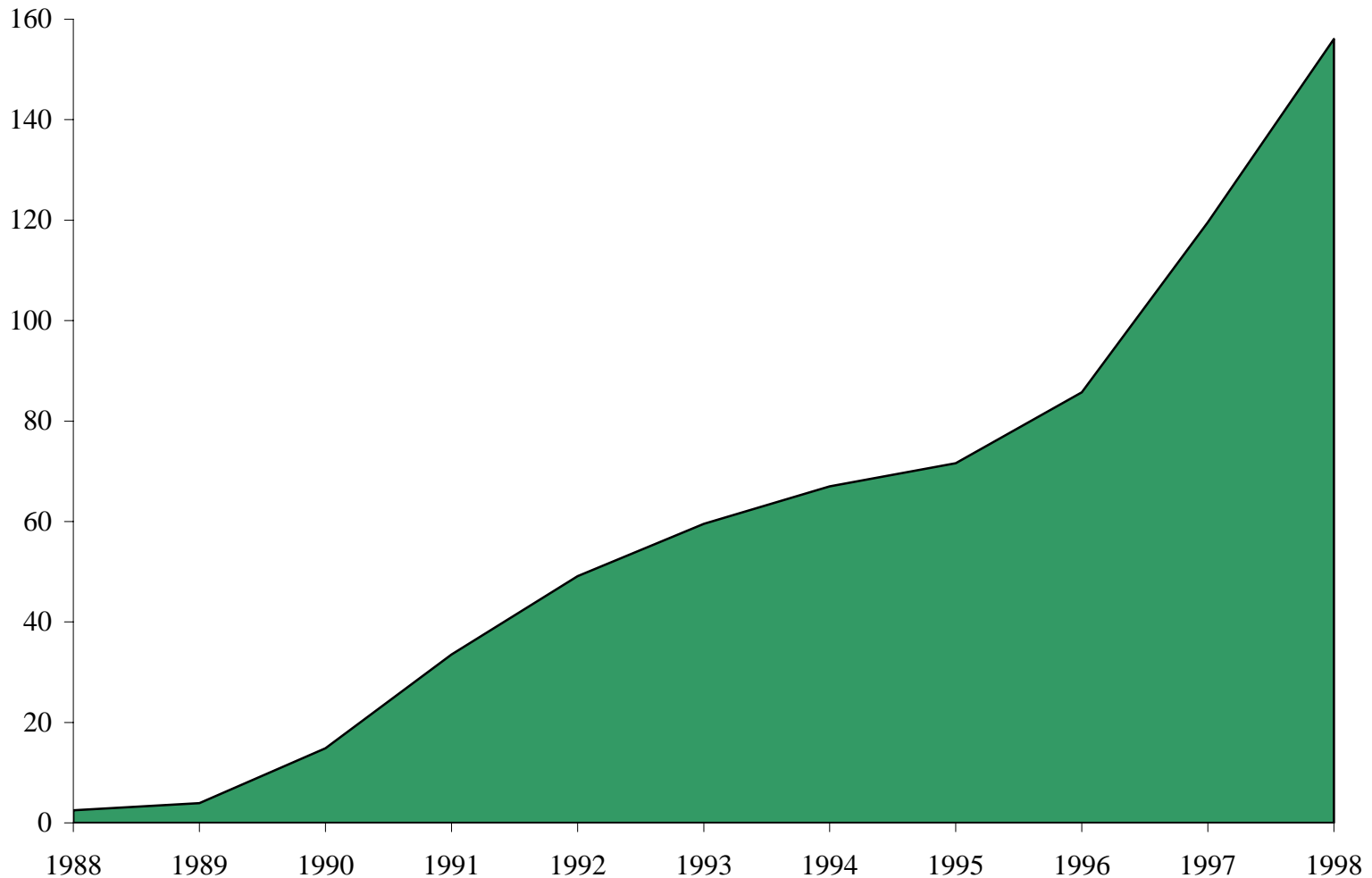
Percentage of Latin American Countries Having Implemented Reforms



No Shortage of Reforms: Privatizations

Cumulative Amount Raised by Privatizations in Latin America

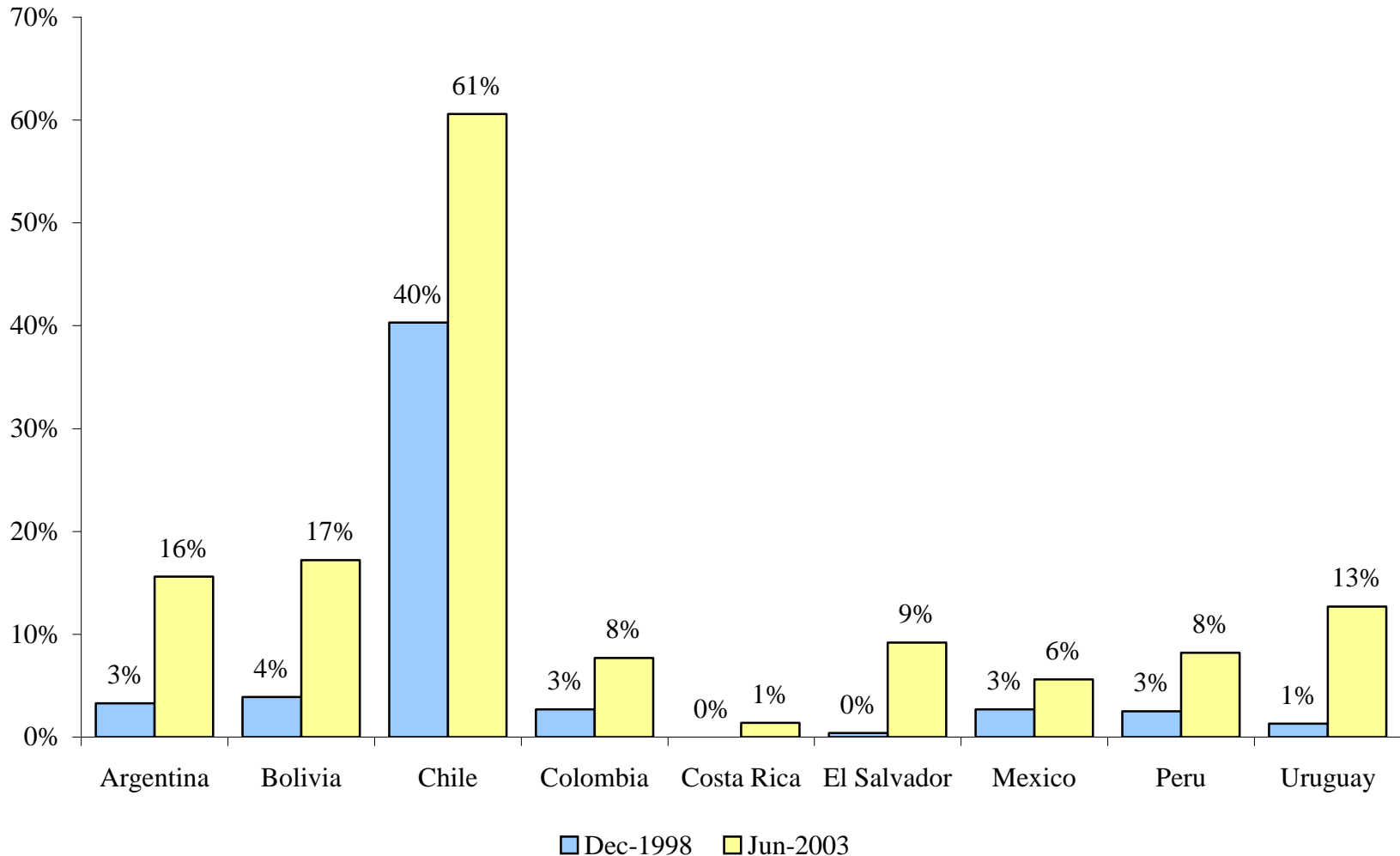
Billion U.S. dollars



No Shortage of Reforms: Pension System Reform

Assets Held by Mandatory Pension Funds in Latin America

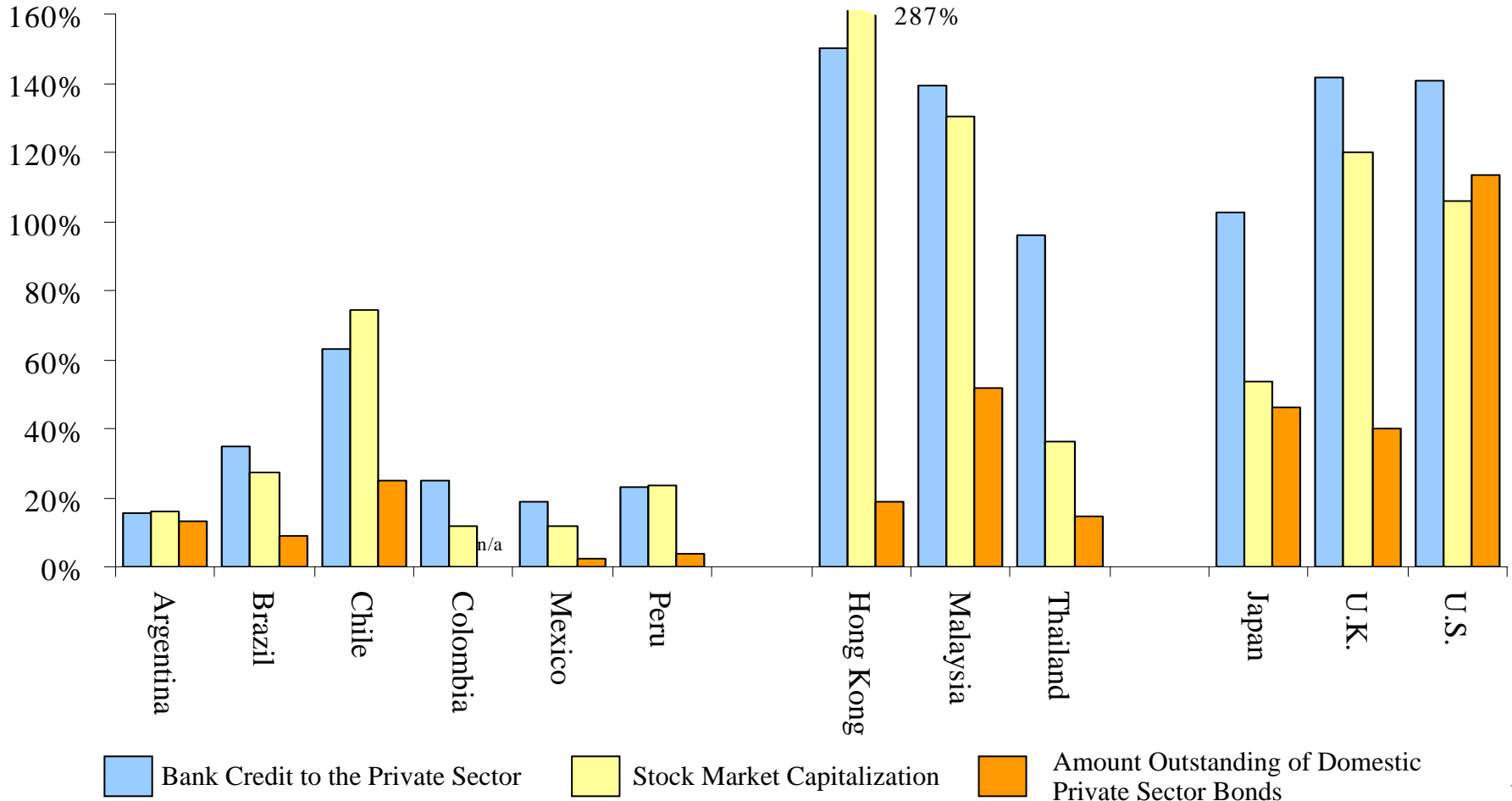
Percentage of GDP



Domestic Financial Markets in LAC are Underdeveloped

Financial Sector Size Across Countries

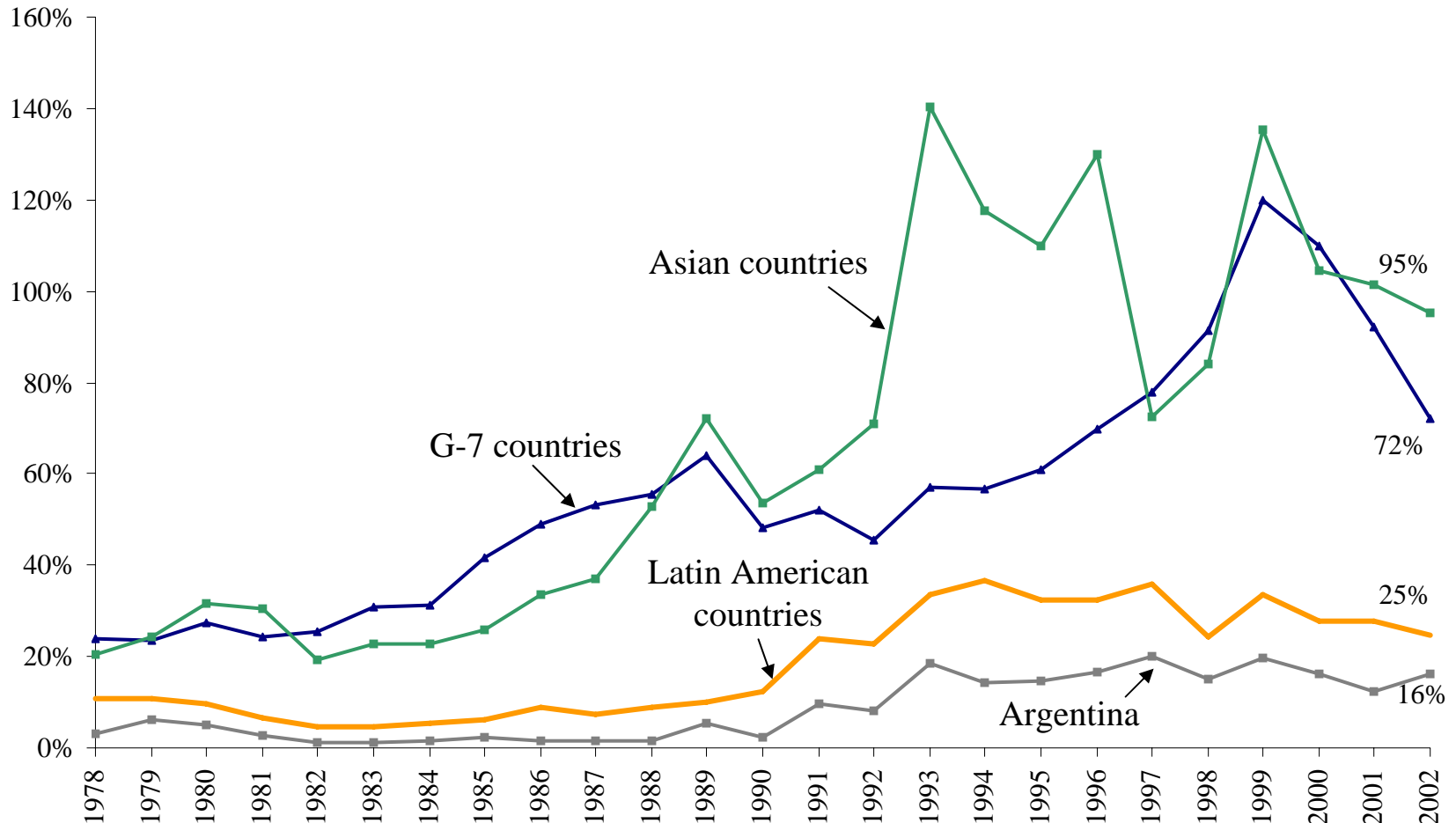
Percentage of GDP,
2002



Stock Market Capitalization in LAC has Lagged Compared to Other Regions...

Stock Market Capitalization

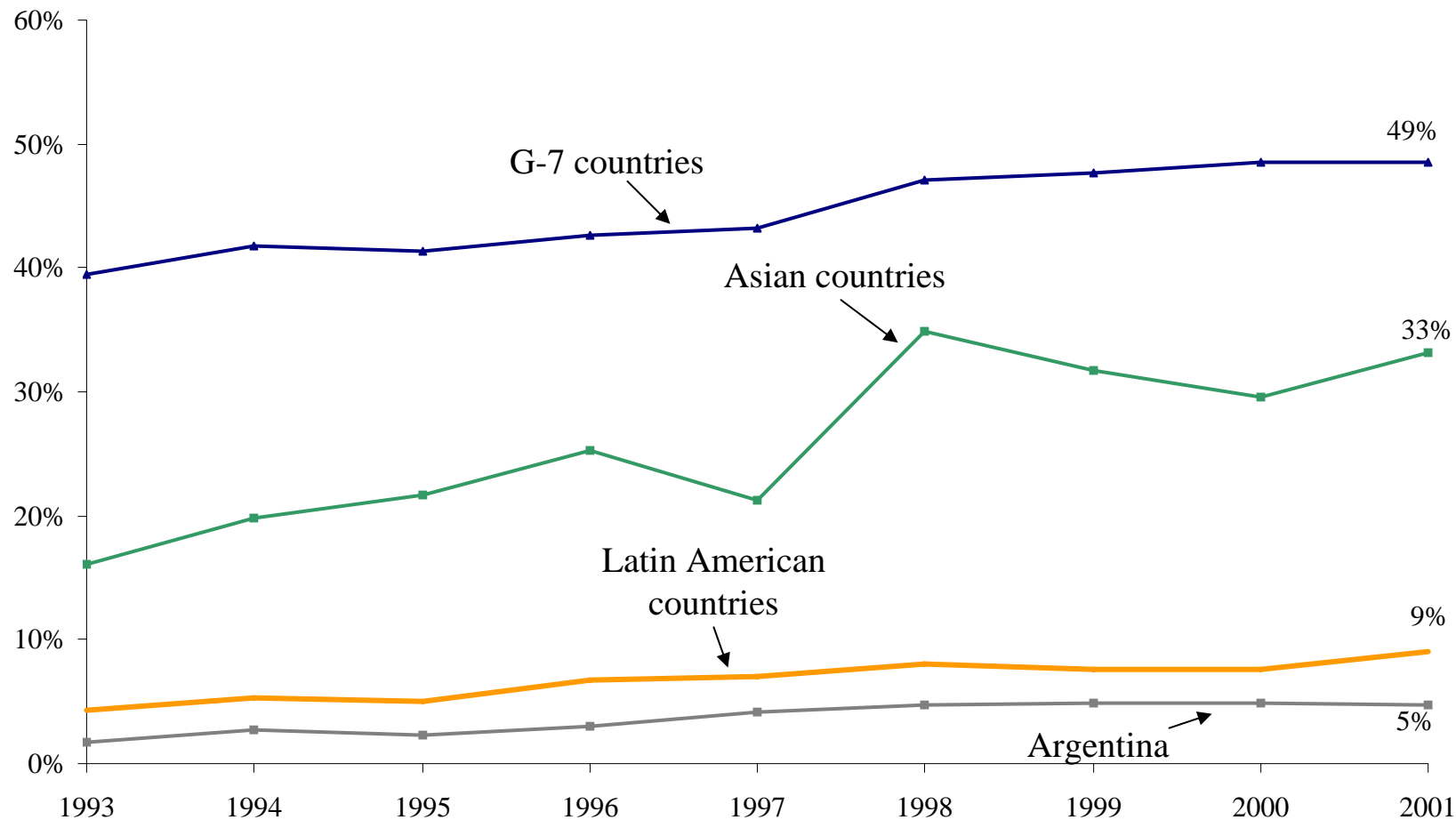
Percent of GDP



...and so have Domestic Private Sector Bond Markets

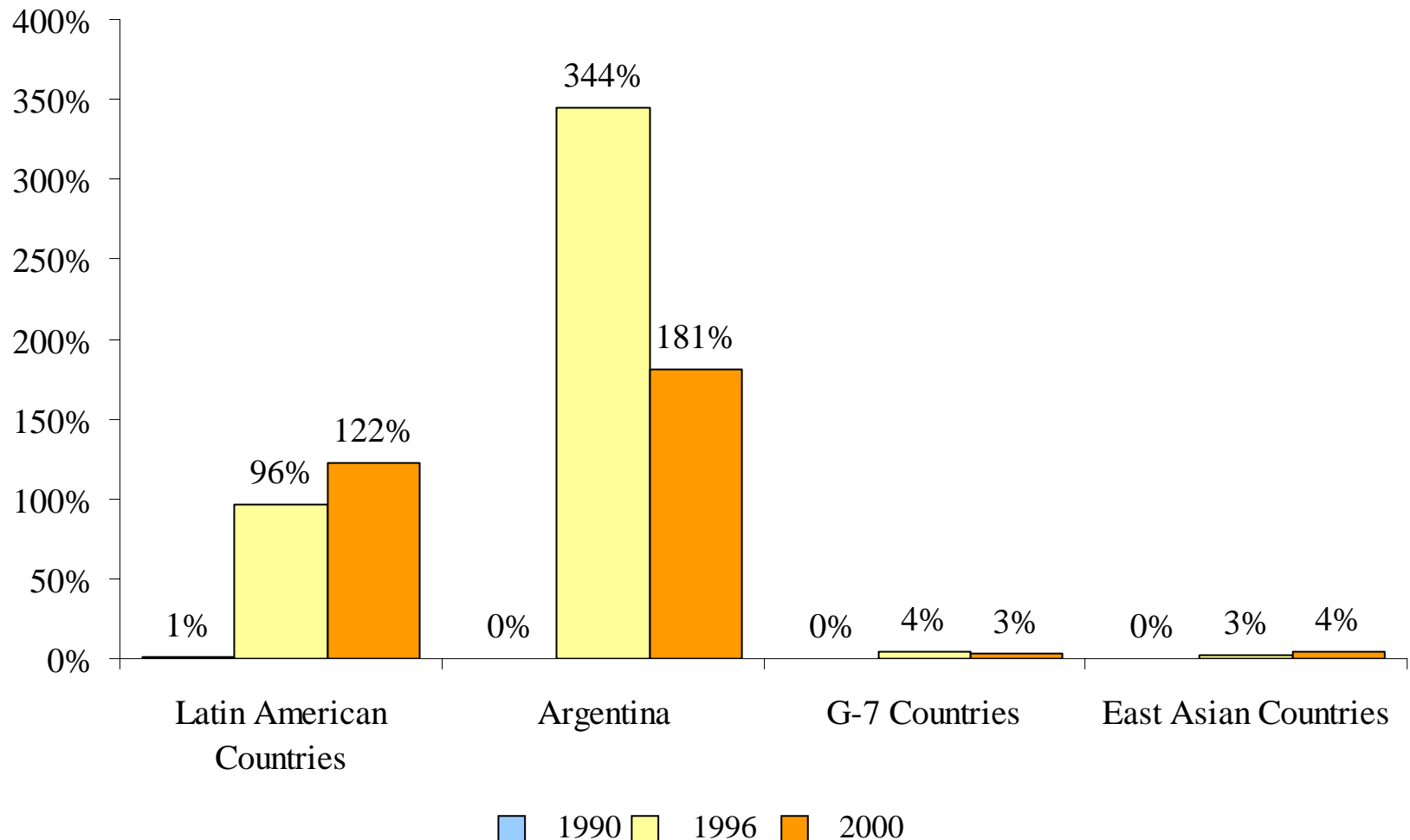
Domestic Private Sector Bonds Outstanding

Percent of GDP



But International Trading of LAC Stocks has Exceeded that of Other Regions

Ratio of Value Traded Abroad to Value Traded Domestically



1. Motivation

- ✚ Still many questions
 - Why apparent shortage in outcomes relative to reform expectations?
 - Was reform effort insufficient or badly sequenced?
 - Is there a need to recast the reform agenda? How?
 - What is the future of domestic capital markets under globalization?

1. Motivation

✦ In what follows

- Issues on stock market development and internationalization
- Issues on bond market development and internationalization

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2. Stock Market Development

Main Characteristics of Equity Contracts

- ✦ No default risk
 - Variable income: payments depend on the issuer's performance
- ✦ Internationalization does not generate vulnerabilities in the balance sheet of issuers
 - Firm performance might be affected by exchange rate fluctuations, but effects are passed on to investors via dividends
- ✦ Attention concentrated on links between corporate governance and market development/internationalization

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3. Bond Market Development

Main Characteristics of Bond Contracts

- ✦ Commitment to payments, independent of performance
- ✦ Contract features: currency, duration/maturity, jurisdiction
 - Contract features used to cope with idiosyncratic and systemic risks
- ✦ Risks inherent to bond contracts
 - Apart from corporate governance problems
 - Interest rate risk, default risk induced by interest and currency fluctuations, post-default litigation risk, dilution risk, confiscation risk
- ✦ Attention concentrated on contract features

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4. Open Questions in Capital Markets

- a. Regional Differences
- b. Future of Reforms
- c. Future of Latin American Capital Markets

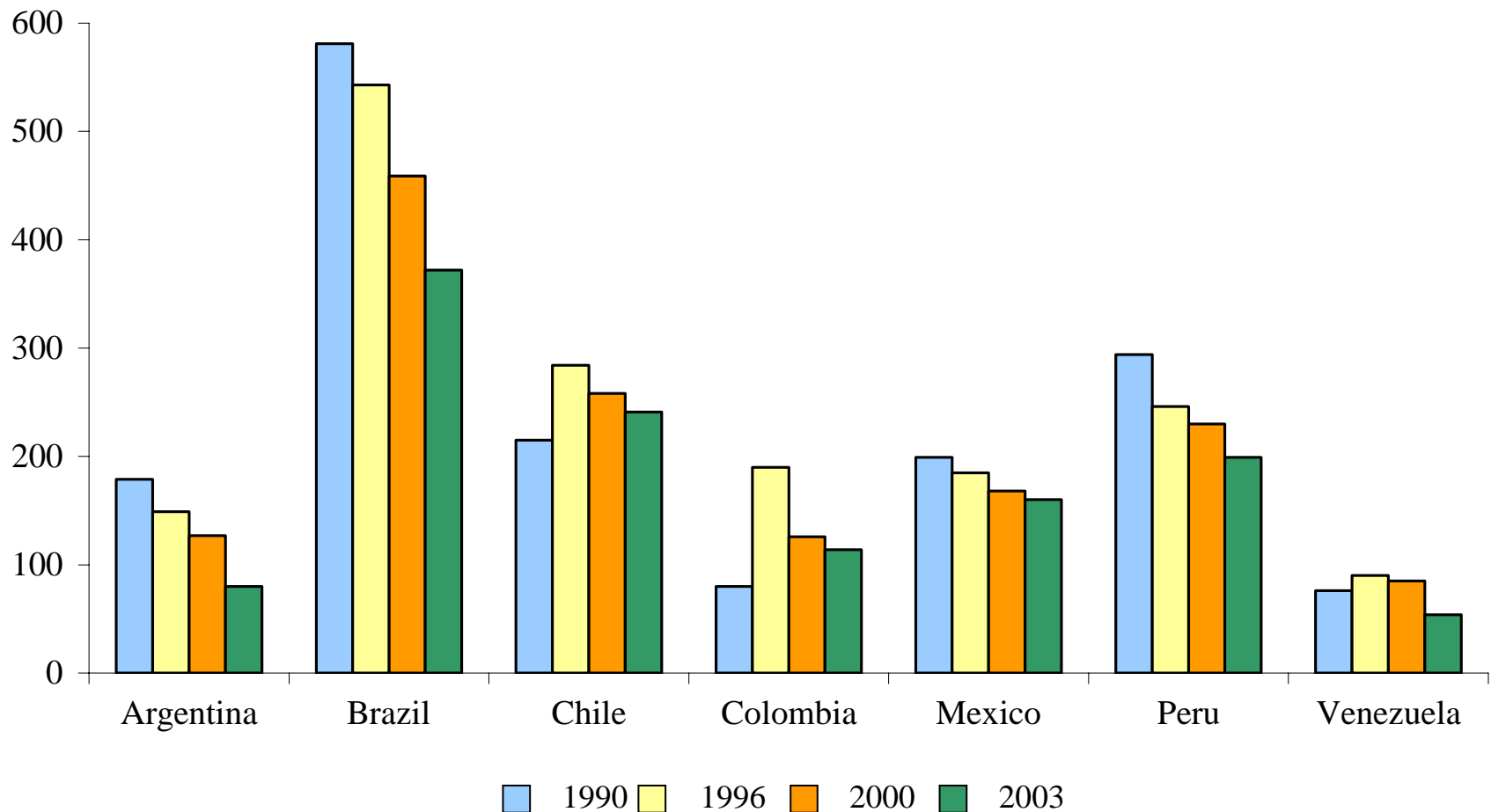
4.a. Open Questions in Capital Markets

Regional Differences

- ✚ Latin America is different – a robust econometric result
 - Domestic stock markets are less developed than predicted by fundamentals and less responsive to reforms
 - Internationalization of stock trading and issuance is higher than predicted by fundamentals and more responsive to reforms
 - Domestic currency bond markets are less developed, controlling for fundamentals and size
- ✚ Latin America is an extreme, but it is not alone...
 - Witness Eastern Europe and even Western Europe
- ✚ ...and Asia is at the other extreme
 - Is Asia the future or the past?

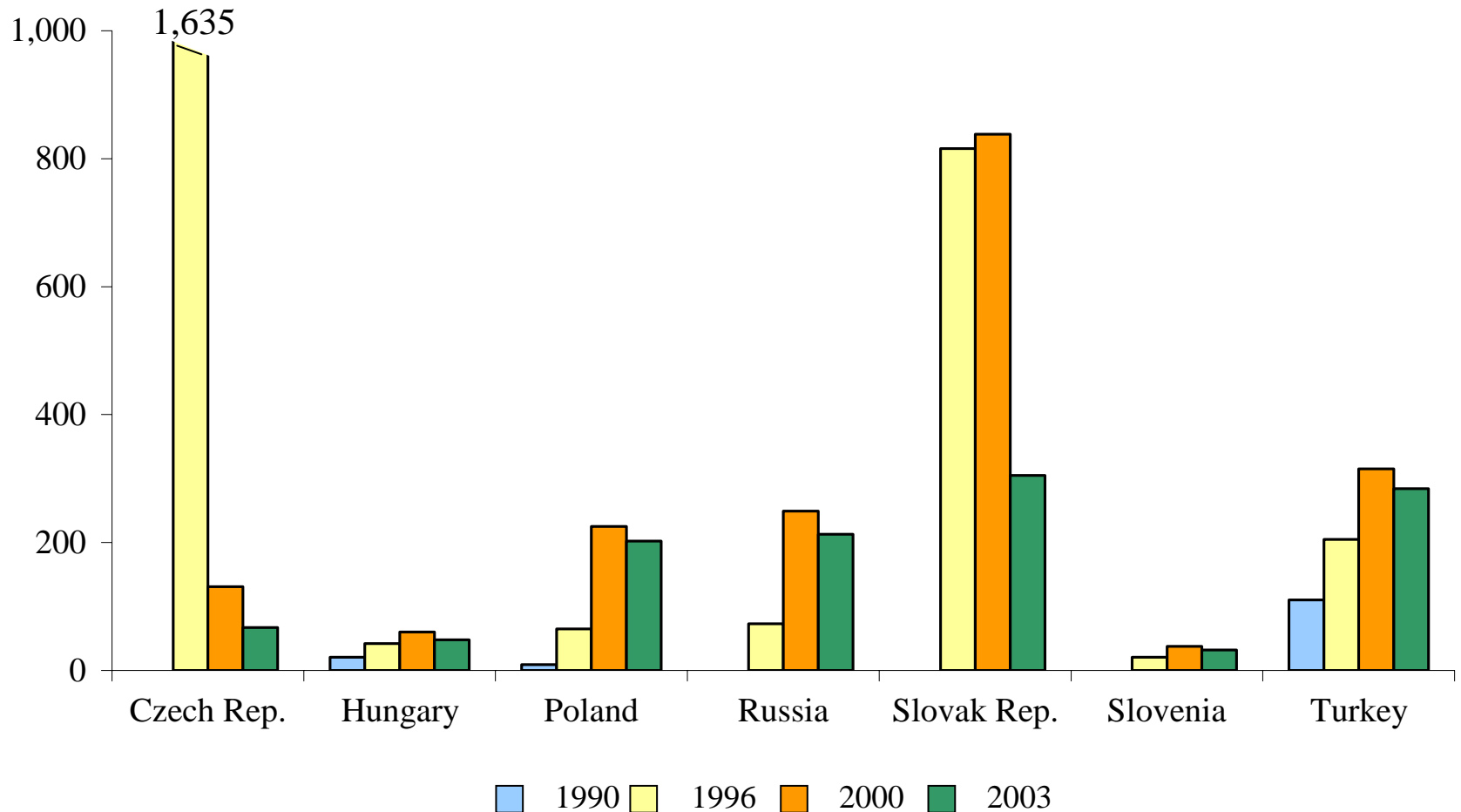
4.a. De-Listings in Latin Stocks Markets...

Number of Firms Listed in Domestic Stock Exchanges in Latin America



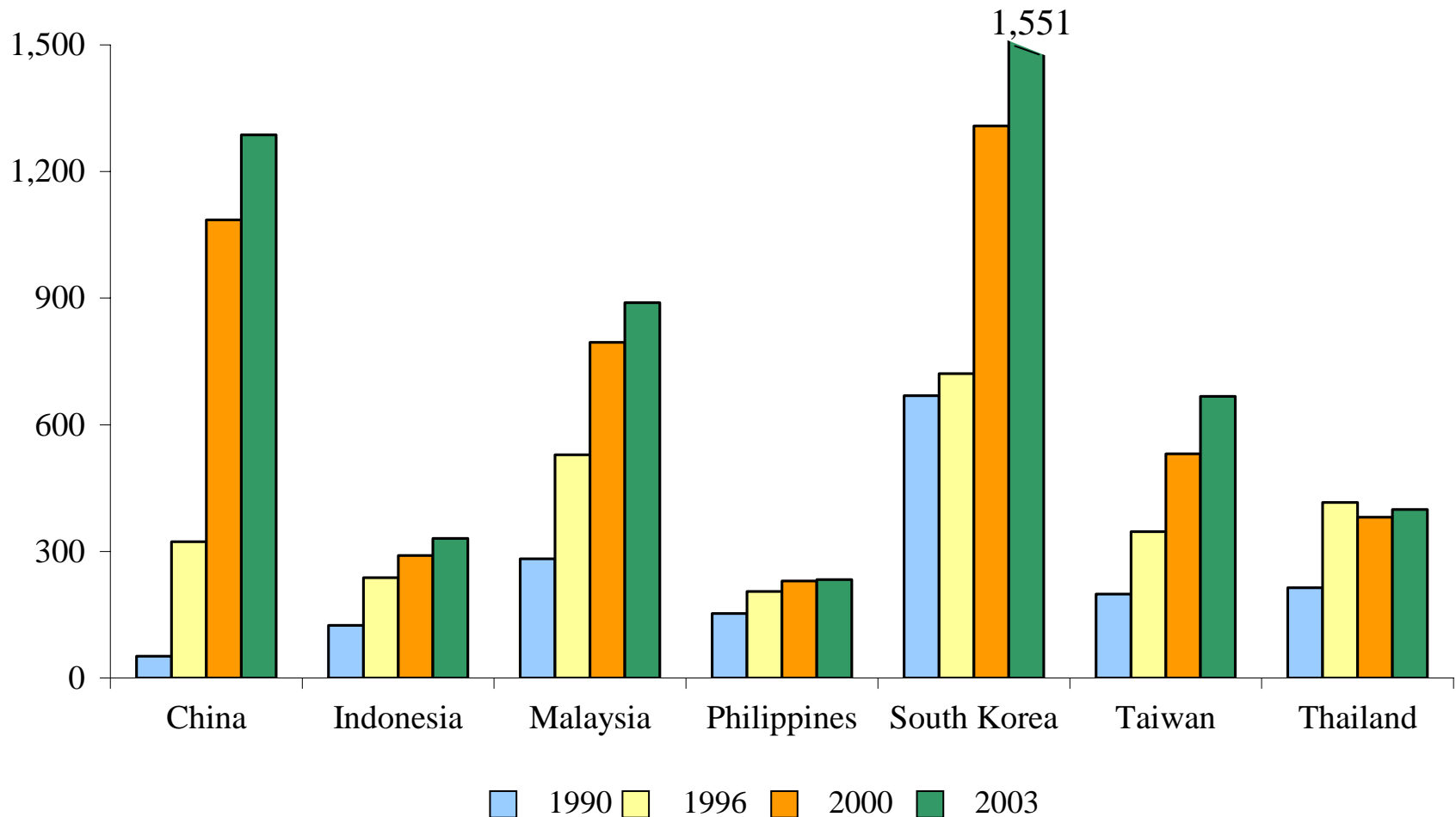
4.a. ...and in markets in Eastern Europe

Number of Firms Listed in Domestic Stock Exchanges in Eastern Europe



4.a. Listings in East Asian Stock Markets

Number of Firms Listed in Domestic Stock Exchanges in South East Asia



4.b. Open Questions in Capital Markets

Future of Reforms

- ✦ What went wrong and what to do next?
 - The same evidence examined from different angles can lead to different diagnoses and policy recommendations
 - But new evidence has to be taken into account seriously
- ✦ Three possible views – complementary in many respects
 - Be patient and redouble the effort
 - Get the sequence right
 - Revisit basic issues and revise expectations

4.b. Open Questions in Capital Markets

Views on the Reform Agenda

- ✦ Revisit basis issues and reshape expectations
 - Diagnosis: shortcomings of previous views
 - Reforms spur both domestic securities markets development and internationalization, and the latter relatively more
 - Resistance to reform might not yield without outside competition
 - Implicit premise that developed capital markets are the adequate benchmark for developing countries
 - Policy recommendation: step back, revisit basic issues and adjust expectations, before reformulating reform agenda in detail
 - Basic issues: globalization, liquidity, risk diversification
 - Cross-cutting themes: size; segmentation of access

4.c. Open Questions in Capital Markets

Future of Latin American Capital Markets

- ✚ New model for capital markets?
 - Abandon hope of creating mini-Wall Streets in every Latin country
 - Difference between int'l financial centers and peripheral markets
 - Local markets should be complementary rather than replicative
 - Reassess role of regional integration vis-à-vis global integration
 - Emphasize links between capital markets and the rest of financial service providers and the real sector
 - Financial structures and hybrid products joining multiple stakeholders
 - Unrealistic to expect that firms of all sizes will have *direct* access to formal bond and stock markets
 - What matters is access, regardless of where or by whom provided

END