REPORT

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Investing in Infrastructure for Latin America's Economic Growth

This report provides a summary of the key issues raised by multilateral institutions, investors, and concessionaires at Latam GRI Infra & Energy 2023, held on May 11-12, in New York.

GRI Club
INFRASTRUCTURE

INTRODUCTION

Investing in infrastructure and energy in Latin America is crucial for economic growth in the region. There are several areas of infrastructure that need investment, including renewable energy, water, social infrastructure, and transportation systems. By investing in sustainable infrastructure, the region can reduce its volatility and create a stable economy.

It is important to focus on infrastructure that maximizes interconnectedness in the region, making Latin America's markets more competitive and attractive to foreign investment.

CLOSING THE GAP

In Latin America, the current investment in GDP is 2%, which is far below the required investment of 5% to close the gap with other countries. While financing is essential, it's important to work with guarantees such as co-financing and other instruments that improve the quality of projects and attract investors. Improving the quality of infrastructure is essential not only to drive sustainable development but also to promote safety and economic growth.

Given that the region is highly urbanized, investments in sustainable transport, energy-efficient buildings, and green spaces could help in closing the infrastructure gap.

Some of the best opportunities for new investments in Latin America infrastructure are in the sectors below.

DIGITAL INFRASTRUCTURE

Access to broadband is still limited to only 13% of the population in Latin America, which hampers intra-trade, inclusion of rural areas, and productivity. Digital infrastructure development can be an enabler for all these aspects. The World Bank Group is working to move this agenda forward and identifying new ways to enhance access.

RENEWABLE ENERGY

Globally, the World Bank Group has already invested $35 million in renewable energy, but there is much more that needs to be done in Latin America. The region has opportunities to become a leader in green hydrogen, lithium mining, battery storage, and electromobility, but this would require the creation of conducive conditions, the participation of the regulators, and the public sector.

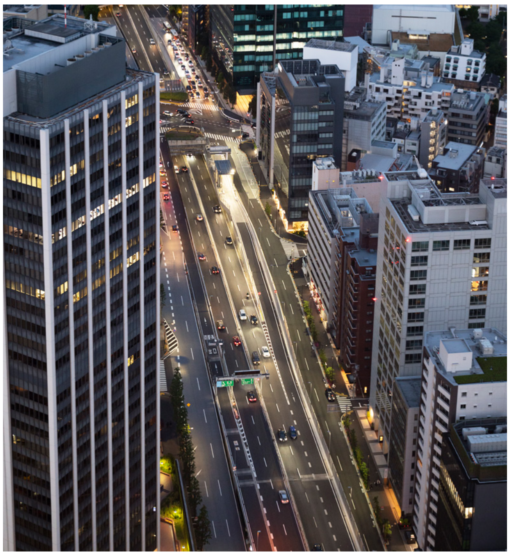
SOCIAL INFRASTRUCTURE

Investing in infrastructure is a no-brainer for Latin America because of the externalities it generates in the economy. One of the main bottlenecks is political instability in the region. There is a need for policy makers and regulators to be aligned with the infrastructure agenda, which is a medium-to-long term one. Having a strong GDP framework can be a game-changer that helps reduce political instability and provides security for planning and execution. Financing social infrastructure, such as education, is important to help promote inclusion.

TRANSPORT AND MOBILITY

Transport and mobility infrastructure needs to be a priority when it comes to sustainable development in Latin America. Road building, in particular, has played a significant role in the growth and inclusion of many countries in the region. However, there is still a lot of work that needs to be done. Investing in sustainable transport can help in reducing greenhouse gas emissions and traffic congestion while promoting economic growth and social inclusion.

CITIES AND MUNICIPALITIES



Cities and municipalities also play a significant role when it comes to sustainable development in Latin America. With 80% of the population living in cities, there is a need to address issues such as water sanitation, energy efficiency, and green spaces. Collaboration between stakeholders is essential to drive progress in these areas. With the threat of climate change looming, it's imperative to work towards sustainability and mitigate its impact on urban populations. Therefore, developing infrastructure that supports the well-being of the urban population should be a priority.

IMPORTANCE OF POLITICAL STABILITY IN ATTRACTING INTERNATIONAL INVESTMENT

Amidst the doubts and many factors that could have affected the investment markets in Latin America, some companies have increased the time of investment in the region. As players in the international investment market, they believe that they play an important role in countering this political instability. When they scale up and do business in the region, it provides a good signal to other global investors, thereby encouraging them to invest in the region as well.

The maturity of the political system in the region is a good signal to the investors. In some countries, a significant number of ministers and presidents have come and gone in the last couple of years, yet the macro fundamentals are stable. This brings confidence to the investors, knowing that irrespective of the political instability, the macroeconomic fundamentals are still solid.

“We tend to follow a lot of work by the book, to review and notate the potential areas for developing, which can be very helpful to investors considering alternatives or doing something else. Ultimately, we have reasons to be optimistic regarding the future of the region, especially when we combine it with the increasing demand for the things that Latin America can produce”, says an investor.

IMPACT OF INTEREST RATE INCREASES ON EQUITY AND DEBT

Different investors hold differing views on how interest rate increases impact the equity and debt market. While some investors take a more long-term view and continue to invest in good projects and companies, others tend to have a more fundamental view on risk and rate of spreads of debt. Furthermore, on the strategic side, some investors still have a lot of cash and liquidity, and they need to continue investing. Due to this, they take a lower-luxury view while looking at the projections of the curve. It’s not as simplistic as the curve increasing 300 dibs, and the fiscal rate increasing by a fair bit. Thus, while some investors factor in the increase in the cost of debt, others don’t raise their expectations.

THE WORLD BANK'S CULTURE PARTNERSHIP FRAMEWORK: WHAT IT IS AND HOW IT WORKS

The World Bank Group has a five-year strategy called the Culture Partnership Framework that defines the priorities for each country where it operates. This framework focuses on non-financial aspects of development, such as policy and regulatory issues, with the goal of mobilizing private capital. Along with the World Bank, the IFC has a team dedicated to working on pre-investment projects, helping to package them so that they are ready for investment officers to come in and make them a reality. This partnership between the World Bank and IFC allows for more efficient and effective development projects.

Developing countries are facing a fiscal crisis, which makes it difficult to establish long-term projects. However, there is an urgency for development in all areas, including social infrastructure, digital, green energy, and roads. The private sector is ready to participate in these projects, and many governments are looking to attract foreign investors.

While some developers may be hesitant to approach multilaterals like IFC and CAF, there are options available that are worth pursuing. Asset managers are developing funds with a regional focus to help bring knowledge, experience, and capabilities to the table for effective and efficient development projects. Despite the challenges, there are opportunities to move forward with the support of multilaterals and the private sector.

MANAGING CURRENCY RISK IN INVESTMENT PROJECTS

For long-term investors, worrying only about the entry window can make managing currency risk a little more straightforward. Private equity funds that are exposed to both entry and exit, however, can get all kinds of exposure to short-term volatility. Projects that generate only US dollars and ones that generate in local currency can pose different levels of exposure. The energy sector in Colombia, Chile, and Mexico is different, as it generates in the global currency, avoiding exposure to currency risk. Projects in logistics, airports, and others that generate US dollars make it more or less the same.

When it comes to financing infrastructure projects in foreign currencies, there are ways to mitigate the financial risk involved. One approach that some banks and institutional investors have taken is to use structured hedges to finance projects in US dollars while mitigating the risk of foreign exchange fluctuations.

While some projects can be financed by matching cash flow in dollars and pesos, toll road projects present a greater challenge. Sponsors in these projects have been known to refinance by exchanging FX risk for foreign currency debt with strict terms. This approach effectively swaps one risk for another, leaving uncertainty when it comes to project cash flow in the long term.

Despite the challenges presented by turbulent market conditions, strong fundamentals are expected to drive growth in infrastructure financing. Investors who manage to mitigate market risk are likely to fare better than those who cannot. Political factors must also be taken into consideration, as populist movements can affect infrastructure financing in the region. However, recent developments suggest that these movements are beginning to cool down, at least in some parts of the world.

THE IMPORTANCE OF ESG IN FUNDABILITY

The past few years have seen a shift in the market's focus on ESG, or environmental, social, and governance factors. While at first there were talks of green instruments and premiums for ESG-backed projects, we've instead seen a decline in fundability for non-ESG projects. This trend is especially pressing for the energy sector, where non-ESG modes of power are no longer considered acceptable. This shift has raised questions about how the trend will continue to evolve in the next few years.

INDUSTRIALIZING AGRICULTURE, MINING, AND GREEN ENERGY

Latin America must capitalize on its competitive advantage in agriculture, mining, and green energy to promote sustainable economic growth. Latin America already has a dominant position in global demand for food, minerals, and green energy.

Investing in infrastructure that capitalizes on comparative advantages in these areas can promote economic growth and job creation while meeting the needs of the global market. This means developing infrastructure that improves access to renewable energy sources and improves efficiency and environment-friendliness in the production of food and minerals.

Industrializing agriculture and mining presents a challenge, but a value chain approach, coupled with innovation and technology, can transform these sectors for the better. Additionally, while producing more raw materials and commodities is a viable option, a shift towards value addition can enable the region to compete globally while also promoting sustainable development.

The digital economy is rapidly transforming the business and economic landscape of the world. Latin America has also significant untapped potential in the digital economy. As such, investing in infrastructure that enhances the region's digital connectivity, skills training, and integration into global digital networks will create jobs, promote innovation, and create new opportunities for Latin America to export their digital products and services.

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