

FLOW

DERIVATIVES INTELLIGENCE FOR THE RISK PROFESSIONAL

OTC clearing:
the road
ahead



plus
middle office
Latin America
reinsurance



Mapping out a future for Latin America



Activity within Latin American markets has been out of the spotlight in recent months, particularly as the growth across Asia is currently the focus of those interested in emerging markets. While the continued boom in China shows no sign of slowing down; new regulations, economies being rebuilt and rising exchange traded volumes mean Latin American derivatives are edging their way back on the radar screen.

"The interest that foreign investors have been showing in emerging markets has become particularly apparent recently," says Simon Derrick, head of currency research at Bank of New York. "There has been a huge general pick

up. Last year saw the highest inflow into emerging markets since 1997." This, he notes, is a result of the low yield environment across the major markets.

Export markets, particularly for commodities, are particularly strong in Brazil and Mexico and, as the demand from China increases, investors are beginning to see the lucrative potential within these markets. As Steve Auerbach, president of SunGard Futures Systems, puts it: "Markets are really beginning to open up and commodities are leading the charge."

Mexico

Although the 1998 launch of Mexico's derivatives exchange, Mercado Mexicano de Derivados (MexDer),

Recent investor interest in emerging markets is perhaps best exemplified by the current boom in Asia, but as **Helen Wray** finds out, interest in Latin America is also on the rise

The region as a whole is getting better at attracting capital flow, which is an improvement on ten years ago. We now have a strong presence of international banks and this goes some way in guaranteeing that old mistakes will not happen again

means it is a relatively new player, it has seen impressive volume growth over the past year. As Jorge Alegria, CEO of MexDer, explains, the Mexican peso/dollar contract is attracting more volume to the exchange than Chicago Merchantile Exchange receives. "January was a record month for this contract on MexDer. In one day, \$1 billion was traded," he points out. "It is traded in the same way as OTC markets trade, so it is a more accessible contract because participants are used to it."

Bond futures are also emerging as a useful hedging tool, according to Auerbach. "Volumes for the Mexican bonds have really exploded on the exchange as they are seen as a perfect

"Brazil has been doing a lot of bond swaps over the last year, basically swapping into rather than being exposed to dollar rates, which is obviously the problem they had during the Brazil crisis."



Simon Derrick, Bank of New York

hedge to their market space," he says. The volume explosion that the exchange has seen should continue as 2005 progresses, particularly as pension funds look set to enter the market.

"The Mexican financial authorities issued an authorisation last year for the Mexican pension funds to be able to trade derivatives," explains Mexico-based Gonzalo Zubillaga from Fimat USA. "So we have room to keep expanding our business in Mexico."

Furthermore, as Zubillaga explains, new taxation regulations may also impact the derivatives market. "There is a new tax regulation, which states that if you pay taxes in your own country, you don't pay taxes in Mexico," he says. "We have seen that foreign funds are participating in the Mexican derivatives market as a result of this, trading the index and the domestic interest rate contracts."

One of the main benefits of trading on MexDer is its clearinghouse, Asigna, according to Alegria. "International banks coming into Mexico are attracted to MexDer due to the clearinghouse within the exchange," he notes. In addition to this, the so-called "tequila crisis" in 1995 led to credit counterparty concerns, meaning that new international banks entering the market were unable to participate with local banks. "There has been disruption in the market, but with the clearinghouse in the exchange, a lot of these problems have been solved," states Alegria. "We have pieced together the reorganisation of the Mexican market through banks and new players and slowly, but consistently, these benefits are helping us to gain market share against the OTC market.

"The region as a whole is getting better at attracting capital flow, which is an improvement on ten years ago.

We now have a strong presence of international banks and this goes some way in guaranteeing that old mistakes will not happen again."

Brazil

"Whatever moves the market, Brazil is going to be in the middle of any changes," states Guillermo Matta, director of marketing at Fimat USA, citing the country's power in the commodity export industry as the reason for this.

Indeed, the success and growth of Brazil's derivatives market is largely due to its wealth of commodity exports, rather than a strong internal market. So, while its export markets have flourished, the internally established coffee, sugar and soybean markets "have not really gone anywhere", according to Mike McDougall, SVP at Fimat USA, due to Brazil's 45% share in the export market. This, he notes, is in contrast to developments in China.

"The focus of Brazil's attention is more external, whereas China has restrictions on the countries that can trade externally," he explains. "This has created an opportunity to build a stronger internal market in China."

This is, however, not to say that internal markets in Brazil are unsuccessful, says McDougall. "The internal futures market has been trading well for coffee," he observes. "Brazilian coffee exporters also trade more due to the fact that Brazilian coffee is not deliverable against Nybot's "C" contract. This could change down the road but for now it helps boost volume on the local market." He also points out that Brazil's success in the export of coffee and sugar began to flourish when the government relaxed controls on outside hedging, along with control on the physical export of those products. "Maybe there is a lesson for other countries there," he suggests.

Meanwhile, although financial derivatives in Brazil are currently displaying a "good turnover", according to McDougall, capital gains tax restrictions curb a strong participation. "There are still restrictions on hedge funds trading within the market, so participants will be taxed on money they bring in," he notes. "There's been talk that Brazil would further relax its restrictions to allow ease of access into