Economic Watch
EAGLEs

Hong Kong, August 22, 2012
Economic Analysis

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New Pacific Alliance Bloc: Mexico and Andeans look towards Asia

Mexico, Colombia, Peru and Chile new strategy for the XXI Century

- **The Alliance is a new regional bloc aimed to foster economic cooperation and engage with Asian economies**

  Chile, Colombia, Mexico and Peru created this economic bloc with the aim of promoting cooperation and also as a strategy to get closer to Asian economies. Costa Rica and Panama are associate members. As a bloc, the Alliance is the ninth largest World economy, with more than 200 million consumers, and a GDP per capita above 10.000 US dollars.

- **The opportunities for increasing trade among its members are asymmetric. But there are other potential sectors where cooperation is expected to blossom**

  Although the total trade flows of the Alliance are the largest in the region, in 2011 they added more than 1 trillion US dollars; intraregional trade was less than 5%. Opportunities for increasing trade among its members are skewed towards Mexico, given the structure of this economy which exports high value-added manufactured goods, whereas its imports from commodities are small. However there are other sectors with high potential gains from cooperation like infrastructure and capital markets.

- **The Alliance creates an appealing economic bloc to foster ties with Asian economies, not only with China**

  Although China is the largest Asian trade partner of the Alliance, Japan and Korea are also important as they are big investors in the region, interested in other kinds of projects like automotive and electronics. On the other hand the Alliance creates an appealing economic block which may become part of the world value chain given its FTA with the US, EU and other developed economies.

Table 1
The Pacific Alliance

	2000	2011
GDP (trillion of US dollars)	0.9	1.9
Population (millions)	181	208
GDP per capita (US dollars)	4.989	9.186
Total exports in (billion of US dollars)	205	519
Total imports in (billion of US dollars)	232	548

Source: IMF and BBVA Research

What is the Pacific Alliance?

In an effort to create a new regional economic bloc, Mexico, Colombia, Peru and Chile signed in June 2012 an agreement with the purpose of promoting economic, energy and infrastructure integration and also strengthening ties with Asia[1]. Currently Costa Rica and Panama are associate members who are expected to gain a full membership as soon as they get a FTA with all the current members of the alliance[2]. All current members, but Colombia, are also part of the APEC; hence this new bloc already has a framework to promote economic cooperation with Asia.

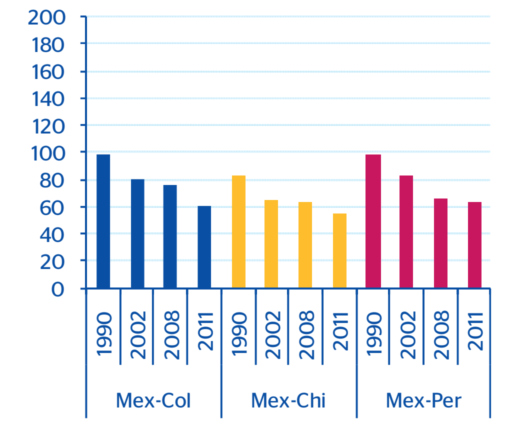
In 2011 the regional bloc had more than 200 million habitants, its aggregated GDP was slightly above 1.9 trillion US dollars in current prices, hence it was the ninth largest World economy, and its GDP per capita was almost 9200 US dollars in current prices. Its trade flows added up to 1.07 trillion dollars (519 and 548 US billions of exports and imports respectively), and its main partners were US and China (68% of total trade flows). Trade among the members of the bloc is very small representing only 4.2% of total flows.

Compared to MERCOSUR, in 2011 this bloc had a larger GDP (almost 3 trillion US dollars), population (almost 250 million people) and income (12.125 US dollars per capita). Trade among its members was also more intensive (16% of total flows), but the total trade flows were much lower, reaching less than 700 billion US dollars.

Asymmetric opportunities for increasing trade among the bloc members

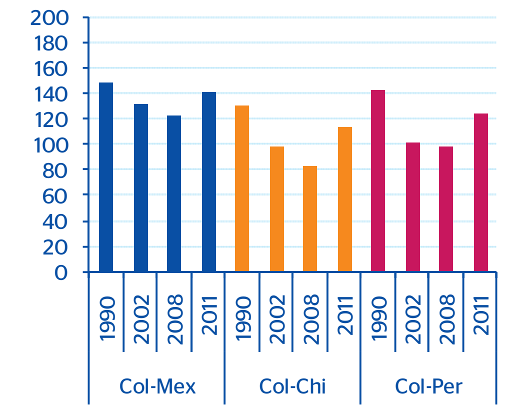
The analysis of the trade structure of these four economies shows there are opportunities for increasing trade among its members, but there are biases in favour of Mexico[3]. For instance Mexican economy exports most of the goods (high value-added manufactured products) the Andeans import, but not the other way, especially in the cases of Chile and Peru. In other words, Mexico is not an intensive natural resources importer, in particular of cooper and its ores which are the main Chilean and Peruvian exports. In the case of Colombia, there has been an intensive change in its exports composition in recent years that has diminished the complementarities with the other members of the bloc. Nevertheless, the data suggests Chile and Peru may have the potential to substitute Venezuelan market after the collapse of trade flows in 2009 (for more information see the Economic Watch "Colombia: new export markets, but for the same products").

Chart 1
Mexico: Potential of exports in partner country (Index: 0 = very high - 200 = nonexistent)



Source: COMTRADE and BBVA Research

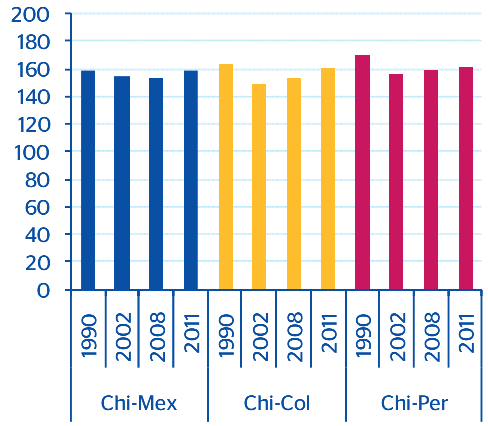
Chart 2
Colombia: Potential of exports in partner country (Index: 0 = very high - 200 = nonexistent)



Source: COMTRADE and BBVA Research

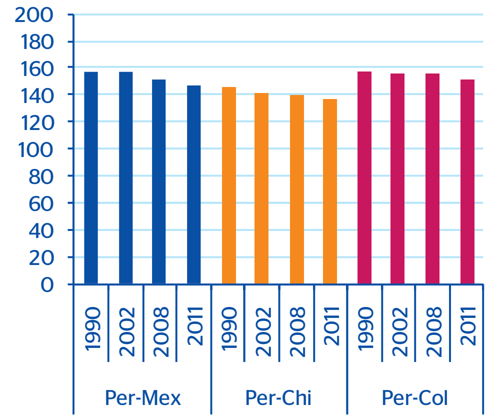
1 http://www.reuters.com/article/2012/06/01/us-latam-summit-chile-pact-idUSBRE8501FY20120601
2 http://es.wikipedia.org/wiki/Alianza_del_Pac%C3%ADfico
3 For this analysis we built an index which compares the export and import composition of the economies using COMTRADE data since 1990 up to 2011 according to SITC rev 1 classification at two digits disaggregation level. We compute pair wise the absolute value of the difference between exports and imports for each category. If the economies are "absolutely" complementary the value of the index should be zero, where as if their interest for trade is null the value of the index will be 200.

Chart 3
Chile: Potential of exports in partner country (Index: 0 = very high - 200 = nonexistent)



Source: COMTRADE and BBVA Research

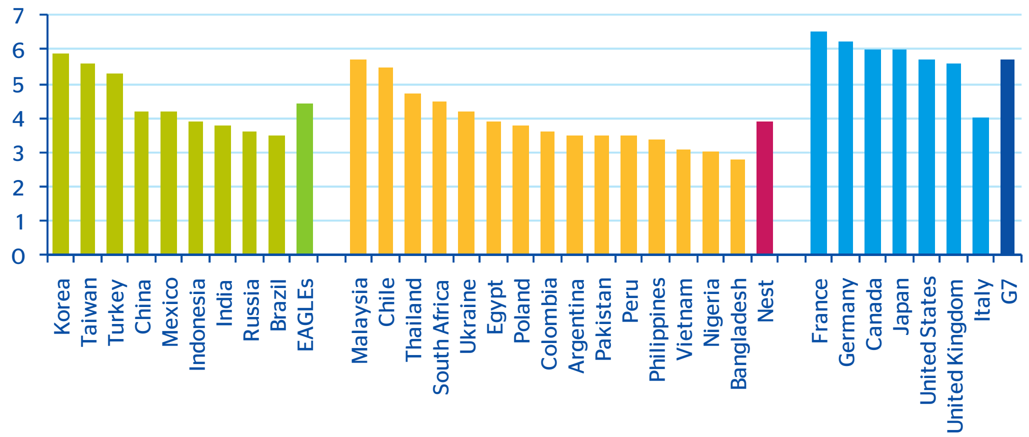
Chart 4
Peru: Potential of exports in partner country (Index: 0 = very high - 200 = nonexistent)



Source: COMTRADE and BBVA Research

However, economic cooperation among the bloc members can go beyond trade flows. For instance, Chile has developed one of the best infrastructure grids in the region with a quality similar to the average of the G7, or almost as good as the one available in the US, the UK, and much better than the one available in Italy[4]. When only considering Emerging Economies, the quality of Chilean infrastructure ranks in the top 4, among the EAGLEs and the Nest countries. On the other hand, the quality infrastructure available in Mexico, Colombia and Peru has a lower score and also has a significant gap compared to its peers. Hence, Chile can provide its *know how* and experience of structuring these kind of projects. There are several other areas where cooperation may be effective, like capital markets with a possible *joint venture* between MILA[5] and the Mexican Stock Exchange, creating the largest equity market in the region, and also in retail, energy and manufacture of high value-added goods.

Chart 5
Quality of infrastructure index in 2012 (scale 1 – 7)



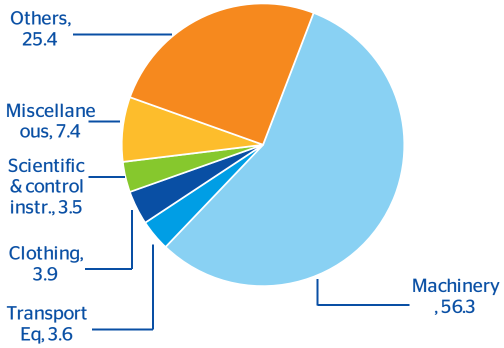
Source: World Bank and BBVA Research

4 Source: The World Bank Global Competitiveness Report 2012
5 Mercado Integrado Latinoamericano (MILA) is the integration of equity markets in Chile, Colombia and Peru. Currently has the largest number of issuers in the region. For further references check http://mercadointegrado.com/

The Pacific Alliance is a good strategy to engage with Asian economies, not only China

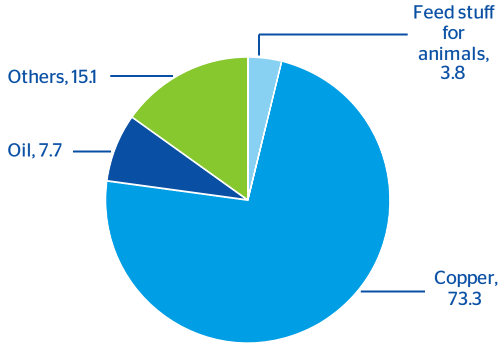
Trade flows between Asia 3[6] and the "new Bloc" reached 176 billion US dollars in 2011. China accounted for 64%, Japan for 21% and Korea 15% of the total flows. Clearly the main contributor is the Sino economy, but the others have also a sensitive contribution. As expected commodities, in particular copper, are the main exports from the Pacific Alliance, whereas machinery and transport equipment are the most important exports from Asia 3. However when considering the case of Mexico, trade flows are more intensive in capital goods; almost two thirds of Mexican exports towards Asia 3 are machinery or transport equipment, highlighting the opportunities for the two blocs to create a world value chain for the US and Latin American markets. Moreover after the official announcement of this new economic bloc, Premier Wen Jiabao said "Beijing was ready to trade with the newly formed trade bloc"[7]. It is also important to bear in mind the important network of FTA the members of the Alliance have with other markets like the US, the European Union and other Asian economies. Also for Asia 3 this is an attractive bloc since most of its population is still young and the middle class is rising fast, hence it's a dynamic region with an increasing household expenditure in consumption goods; while other regions like the European Union are facing an economic crisis and also an aging population process.

Chart 6
Pacific Alliance: Trade flows with China. Imports, %



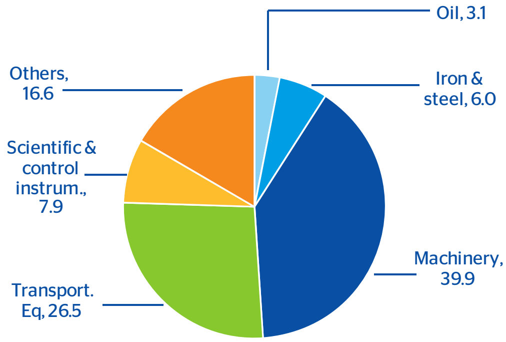
Source: COMTRADE and BBVA Research

Chart 7
Pacific Alliance: Trade flows with China. Exports, %



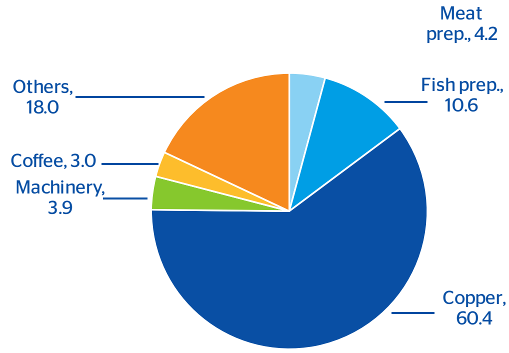
Source: COMTRADE and BBVA Research

Chart 8
Pacific Alliance: Trade flows with Japan. Imports, %



Source: COMTRADE and BBVA Research

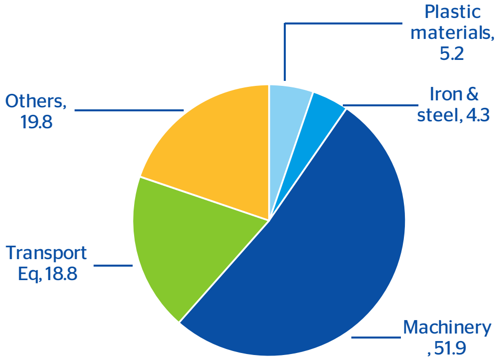
Chart 9
Pacific Alliance: Trade flows with Japan. Exports, %



Source: COMTRADE and BBVA Research

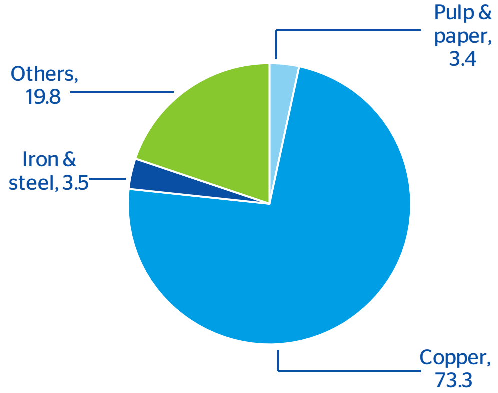
6 Asia 3 = China, Japan and Korea
7 http://www.china-invests.net/20120628/29378.aspx

Chart 10
Pacific Alliance: Trade flows with Korea. Imports, %



Source: COMTRADE and BBVA Research

Chart 11
Pacific Alliance: Trade flows with Korea. Exports, %



Source: COMTRADE and BBVA Research

FDI flows are also another mechanism to strengthen economic relationships. The flows from Asia to the Alliance are larger than the ones in the opposite direction. While Japan and Korea flows are mainly directed to manufacturing projects (in particular automotive and electronics), China has focused its efforts in mining and natural resources projects. When considering the figures for 2011, the members of the Alliance where the destination of almost 45% of the total FDI inflows into Latin American and the Caribbean[8]. However it is important to highlight that most of the investment from China in the region is made through tax heavens (Bermuda, Cayman Islands and British Virgin Islands) and their final destination is not easy to track.

8 According to the ADB and the IDB

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