Danske Bank

Latin America

The Continent of Opportunities, once again. But this time it is a bit different!

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But first:
Let us revisit Sub Saharan Key take-aways from last year…

We continue to see high growth in Sub-Saharan Africa (SSA). Financial and trade integration, better macro-management and ample global liquidity also contributes positively.
So, this story is much more than commodities and China

SSA will be among the World's fastest growing regions in 2016–20, especially non-oil SSA countries

Africa is not a country! African countries are much more diverse than European countries

Current headwinds from commodities and China does create opportunities

There are a number of regions and Intra-African trade is growing

The private sector is a less risky option in the Commodity/Oil countries

SSA is expected to grow at a high pace

Danske bank will support clients in their efforts in SSA!

The global financial environment

Still abundant amount of global liquidity despite tentative signs of more hawkish central banks in advanced economies

Solid global economic momentum across regions

Weaker USD and lower US yields

Rebound in commodity prices

Adjustment and relatively prudent policy making in many EMs

It will probably take a significant uptick in inflation in the US for example or a geopolitical event to really shake market's EM sentiment

LatAm — Recovery across the region in the year to come

The external environment remains benign and is now more clearly fuelling activity in LatAm

Still, there is slack in the economy that is unlikely to disappear soon, so there is no imminent demand-side inflationary pressure, while currency appreciation is helping to bring tradable-price inflation down. Accordingly, the central banks of Brazil, Colombia and Peru will likely engage in further monetary easing in the near term. Conversely, we do not expect further rate cuts in Chile, and the central banks of Argentina and Mexico will likely wait before engaging in further easing

What are the biggest challenges facing Latin America going forward?

Corruption

Education and Skills Development

Increasing inequality

Weak rule of law

The need for structural and institutional reform

Low productivity and low levels of education

Complex and regulated economies in some countries

Continuous fiscal reform and fiscal efficiency ("more bang for the buck")

Why corruption is becoming a main item on the political agenda in many Latam countries

"Corruption is a tax paid by the poor"

Corruption distorts the signals in the economy

Corruption increases uncertainty

Corruption increases risk

Corruption reduces foreign investments

But, there is a game changer – Internet and social media has made corruption much more visible by many more people. People that do vote in elections...

Still, rule of law and investments into the legal system/ppl is needed

We are at a historic junction for Latin America

The Chinese driven commodity cycle is drawing to a close

Interest rates are at historic low levels

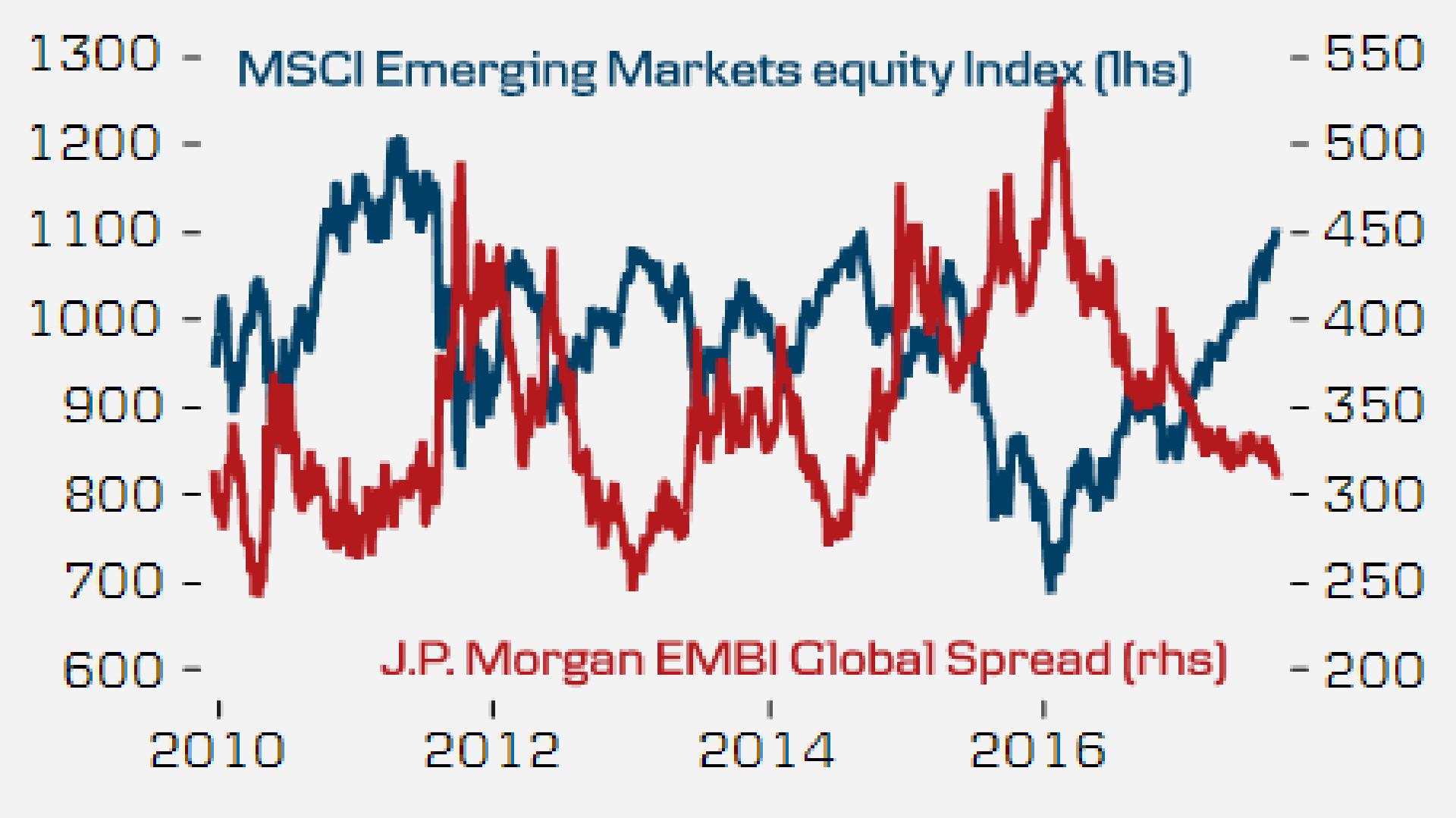
Patterns of trade are changing — Protection in LatAm receding and potentially increasing in the US and Europe

Lava Jato — a water shedding anti corruption drive in Brazil, spreading around the country

Latin American economies are adapting their monetary and fiscal strategies in the face of slower growth and budget cuts

Major elections in the region during 2017-18, Chile, Brazil, Mexico, (hopefully in Venezuela), Colombia and Argentina. And potentially even Raul Castro will step down in Cuba

So, the benign external environment and internal initiatives are fuelling activity in LatAm more clearly


MSCI Emerging Markets equity Index (lhs)
J.P. Morgan EMBI Global Spread (rhs)
1300
1200
1100
1000
900
800
700
600
550
500
450
400
350
300
250
200
2010
2012
2014
2016

LatAm — a region of very different countries, so difficult to analyse the region as a whole

2016 was a miserable year for the whole region with — 5% reduction of exports from the region to the outside in 2016 and even worse figures for intra regional trade (China part of the cause), much to the slowdown in Brazil and the depreciation of the Real

2017 is indeed a better year with modest growth of 2.5–2.7% and industrial production Policies uncertainties of the US Government is a concern

Realization that governments in the region need to do what they can to strengthen their economies to foster growth in the long term

Intra-regional trade would be a boost to growth but is this realistic? History tells us differently

Relatively curbed inflation of 8.3% (excluding Venezuela)

Increasing International reserves and lower sovereign risk with several countries back into the international capital markets

Public spending has increased

However, 11 consecutive quarters of falling investments

Great uncertainties relating to trade with several of the trade agreements not working as well as intended

Reduced fiscal space in most countries

LatAm — Public finances and what governments can do

Assess fiscal space and pursue Fiscal reform in two ways — tax reform (= raising taxes) and ensure more efficient spending:

Tax reforms — More than 14 countries in the region have undergone tax reforms, including Mexico and Chile

Higher tax burden need to be spent more appropriately, e.g., through public tender processes

Fight tax evasion, which is estimated at 6.7% of GDP in 2016 for the region in evasion of income tax and VAT, excluding Illicit business and flows

More structural reforms are needed strengthening Institutions and Rule of law

Ensure trade agreements encouraging intra-regional trade

LATIN AMERICA

Growth to pick up in 2018 but risks to outlook are high

Mexico 2.3 %
Earthquakes and slower private consumption growth to weaken economic growth

Colombia 2.7%
Pre-election spending to lift growth

Peru 3.9 %
A strengthening mining sector and growing infrastructure investment to sustain growth

Chile 2.8 %
The economy to remain vulnerable to fluctuations in global commodity prices

Venezuela - 3.2 %
As oil prices continue to ascend, crippling political uncertainty persists

Brazil 2.3 %
Political noise is holding back economy's strength

Argentina 3.0 %
Buoyed by business-friendly reforms adopted by the Macri administration, the economy is expected to rebound

2018 GDP Growth Forecasts for select countries (Annual Variation in %)

FOCUSECONOMICS
FocusEconomics Consensus Forecast for Latin America, October 2017

Brazil

The largest economy in LatAm is back in positive growth, 5th largest economy in the world…

"Lava Jato" is NOW considered encouraging and long term positive for the country, although short term it has stalled investments and activity

Real has depreciated (around 30%) from very high levels making Brazilian exports more competitive

External Vulnerability is much lower than in previous crisis: External debt is fairly low (17.6% of GDP) and External reserves are substantial (20.6% of GDP)

Contraction of the economy had seriously negative effects on imports from the rest of LatAm

Falling inflation (2.54% in Sep 2017) paves the way for looser monetary policy with lower interest rates which should support revival of the economy

Falling unemployment and falling Non-performing loans in banks and Agricultural Harvest is up 30% (50bp of GDP growth)

Business and consumer confidence index improving and Manufacturing, Retail and Services indices are up

Lots of political "noise" but still Government has managed to make progress on its reform agenda

GDP growth expected at 0.7% for 2017 and 2.7% for 2018

Brazil cont'd

The Temer government may be disputed, however, there important actions are taken

- Introduced a cap on central government total spending and same for the regional spending
- Introduced a tax reform
- Indexed the pension system
- Reforming social security

Mexico

The economy has been struggling for some time with low growth and 2017 will not be a good year for Mexico

Corruption is rampant and the government has de facto lost control over some of the regions in the country

The US administration "turning its back on Mexico" is a great concern both politically and economically

The manufacturing and export sector is part of an integrated supply chain with the US being the dominating trade partner

The potential re-negotiation of the NAFTA agreement is a dark cloud and slows down economic activity and investments

Inflation is increasing and the highest in years, especially the PPI number

Public debt and External debt levels are increasing and are now at 50.2% and 30% respectively

Argentina

The present government inherited an economy with enormous problems

Over regulated

Exchange controls

High Fiscal deficit

De facto in a default situation and isolated from the world

Rampant corruption and populist policies

But the country had one single advantage..

Relatively low public debt

However, present government is a minority government with limited control (5 of 25 Governors, 90 of 270 MPs) so we should expect gradual change

Argentina going forward

The economy is growing

- Solid growth in fixed investments and private consumption
- Q2 economic growth at 2.7% and expected growth at 3% in 2018
- Narrowing fiscal deficit and Decline in unemployment and falling poverty
- Government pushing agenda of business friendly reforms including reduction of red tape and subsidies
- Overvalued currency? And still very high inflation (41% for 2016)

The question remains – What is the business proposition of Argentina to the world?

Colombia

Relief thanks to higher commodities prices with expected growth of 1.8% 2017 and 2.7 in 2018

Fiscal reform in 2016 resulting in higher income taxes and VAT

Investment spending of USD 10.4 billion in 2017 for the 4G road infrastructure program is boosting economic growth

Substantial slump in Exports from USD 55bn pa 2012-14 to USD 31.4bn in 2016

We now see slow and steady recovery in the external sector

Weaker Peso has improved Export competitiveness

Inflation is under control (5.5% 2016 and External reserves at record levels (USD 47bn)

Coca harvest/production at record levels

Transition of FARC to a political party might change the political landscape

2018 is an election year in Colombia … And this will increase pre-election spending

Ecuador

Sour fiscal situation and continued austerity measures reduce growth to 1.1% in 2017 and 1.0% in 2018

Public debt has increased from 21% of GDP in 2012 to 38% in 2016

Rapid credit growth boosted Private consumption

Steep decline in Investments (-8.9% in 2016) and industrial production growth is flat

Country is highly dependent on oil exports with exports down from USD 25bn to USD 18bn

External debt is up from 18.2% of GDP to 33.8% of GDP (including some very expensive Chinese loans)

The good news is that inflation is down at 1.1% and expected to stay low

Dollarized economy reduces potential of independent Monetary policy

2018 might see a referendum pushed by President Lenin Moreno on election terms and block former president Rafael Correa from being re-elected but some turbulence is expected…

Paraguay

Paraguay was less affected by the commodity price downturn with average GDP growth of 4% for 2014-16

This year has seen economic activity recovering with solid performance in the construction, trade and transport sector

Private sector consumption and investments are expected to propel growth also during 2018 (3.8%)

Brazil is key trading partner so recovery in Brazil will be positive for Paraguay

Energy export revenues might be affected by the upcoming renewal of the Itaipu Dam treaty

Public debt is at very reasonable levels of 21.5% although external debt is close to 60%

Inflation increased in 2015 but has since been reduced and is around 4% but we have seen unemployment rates increasing somewhat (to 7.4%)

Chile

Chile is a highly developed economy by comparison but also touching the "Middle Income Trap" with USD GDP per capita shrinking over the last five years

Four consecutive years (incl 2017) of low growth below 2% on average and substantial currency depreciation since 2012 (479 v 670) and substantial reduction in export value

Growth for 2018 is expected to pick up at 2.8% thanks to greater mining investments, expansive monetary policy and stronger private consumption growth

In early October President Bachelet announced a 3.9% spending increase in the 2018 budget (Much focussed on education and healthcare)

Presidential elections in the coming months are expected to result in a change to former (conservative) president and business owner, Sebastian Pinera

As always, the economy is vulnerable to fluctuations in global commodity prices (Coppar)

Public debt at 21% of GDP, Inflation lower at 2.7%

External debt among the highest in LatAm 66% of GDP, while external reserves remain stable at around USD 40bn

Peru

Economic performance has been quite robust with less negative effects from the lower commodity prices than what we see elsewhere in the region. This reflect a more diversified economy

Strengthening mining sector coupled with growing infrastructure investments should sustain growth

Expansionary fiscal and monetary policy expected to continue during 2018 and will support growth

Business confidence is up and unemployment is down at 6.5% (partly effects of the el Nino rebuilding efforts)

GDP growth recovered to more normal levels already in 2016 (3.9%) with a somewhat lower figure for this year 2.7%

Political turmoil expected to continue with president Kuczynski´s government having a troublesome relationship with Congress (minority govt)

As always, the economy is vulnerable to fluctuations in global commodity prices (Coppar)

Public debt at 24% of GDP, Inflation at 3.6%, trade balance show a small positive number!

External debt at a moderate 38% of GDP , while external reserves are one of the highest in the region in relation to months of imports at USD 39bn

LatAm opportunities for Nordic Corporates and Investors

Investing in Mid sized companies as we are at the bottom of the economic cycle in most countries (including weak currencies)

Potential for High Yield bond market to develop outside Brazil

Export contracts for Nordic Corporates supplying equipment related to Energy (green), Infrastructure, Telecom and IT, Healthcare

Large government projects in Infrastructure and Energy plus all kinds of Industrial goods

The Complexity of markets also act as protection from competition

Medium and Long term financing of exports is generally available

Banking sector is consolidated and the larger banks are professional

LatAm Challenges that affects a Nordic Corporate or Investor

Need for Institutional and Fiscal reforms

The "Families"

Very low level of Productivity

Low level of education and lack of specialist competencies

Corruption and Tax evasion

What you see is not always what you get — lack of Transparency

China and US dependency

LatAm countries are in many cases competitors and not supplementary so Intra-regional trade opportunities are limited

So, how to get a "Piece of the pie"?

1. *Do not just make a desk top analysis. You have to go there!*
2. *There is a big difference between Brazil and the rest. Do not expect to use your office in Brazil as a hub for LatAm*
3. *Its big. Perhaps use Panama as your hub for central and northern Latam and Santiago de Chile as your hub for the southern part*
4. *Tax and "red tape" is a big issue so do your homework. Panama is an exception…*
5. *Do you need a local partner? Family and connections are important — even more so in LatAm*
6. *Finding local staff with the right skills may be a challenge*
7. *Consider how you will compete with the Chinese and the Americans (Brazil an exception)*
8. *You need a good bank. And not all local banks are good. Liase with us!*
9. *Be patient, be consistent and do mix business and pleasure! That is expected*
10. *You have to travel there, often*

Q&A