

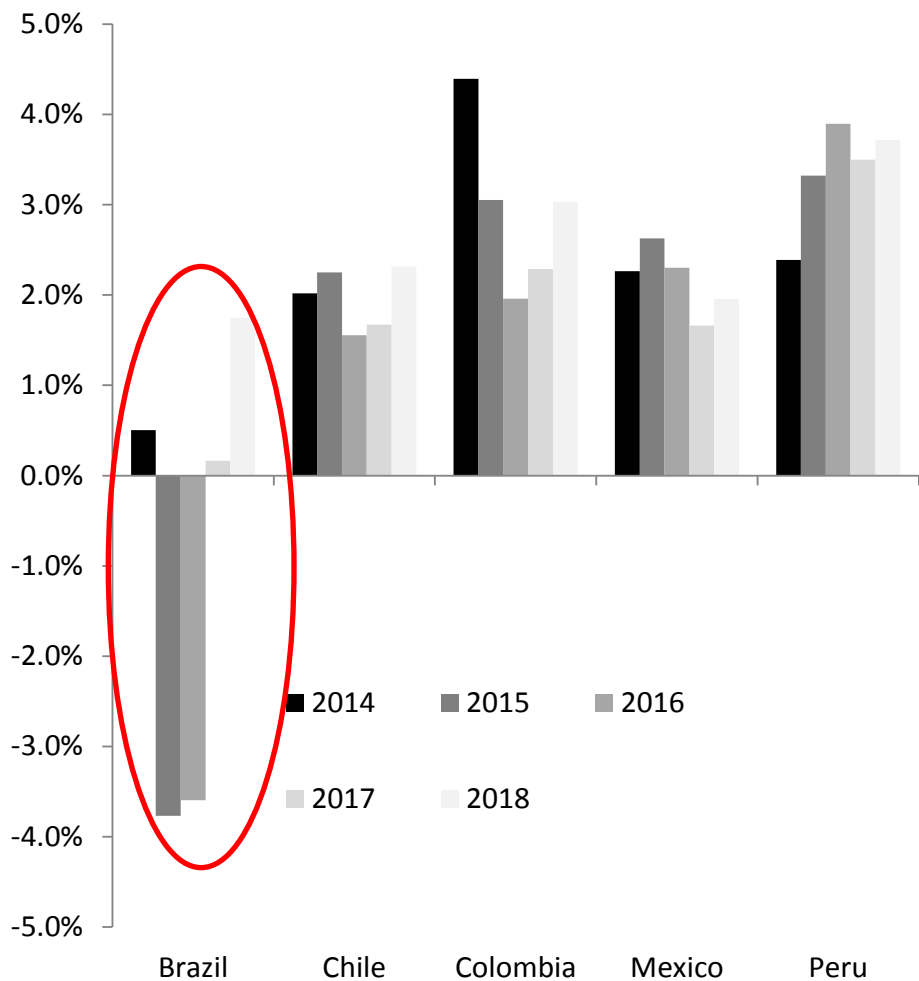
LATAM themes Q2 - 2017

Brazil's reforms... are they enough?

Brazil's growth collapse is a combination of confidence, Lava-Jato, and debt

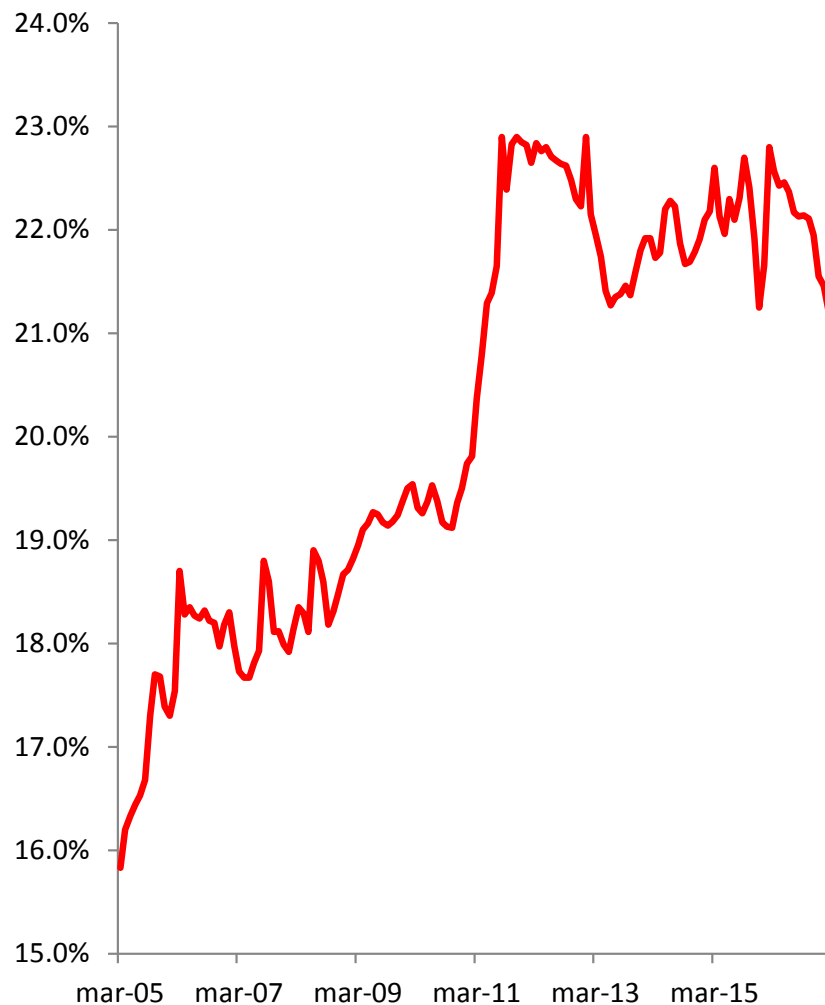
LATAM GDP growth (% y/y)

Source: IMF, ScotiaFIC Strategy.



Household debt service as % of disposable income

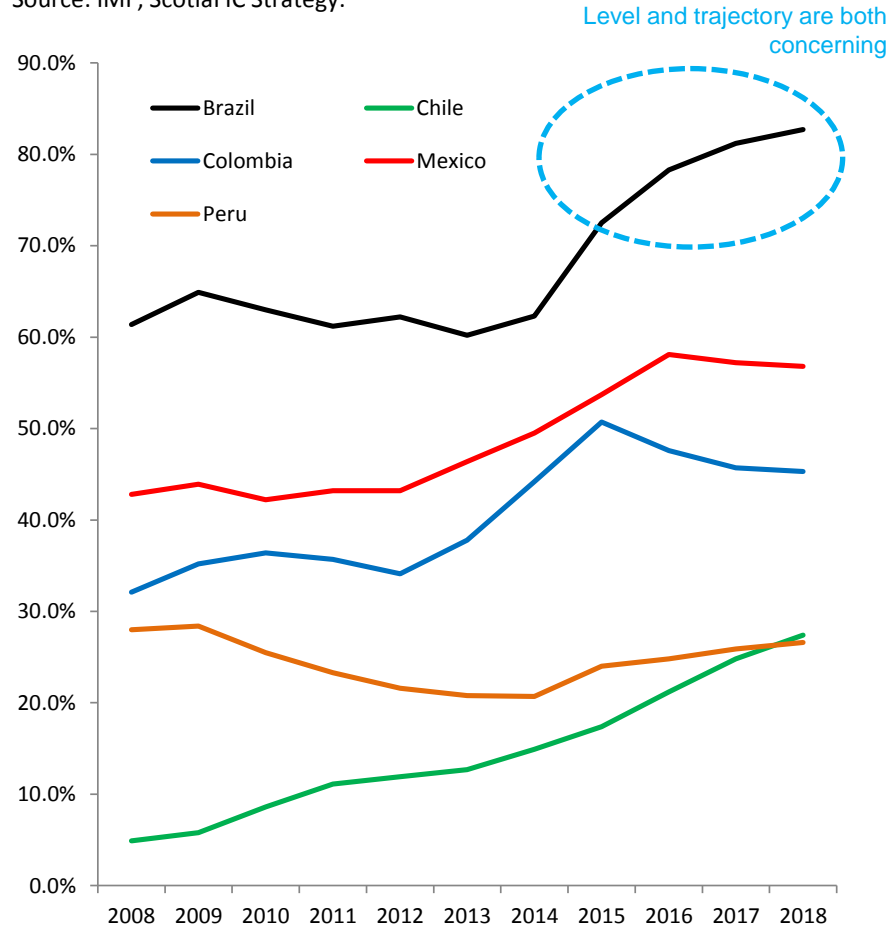
Source: BCB, ScotiaFIC Strategy.



Public finances face several challenges – reforms should help

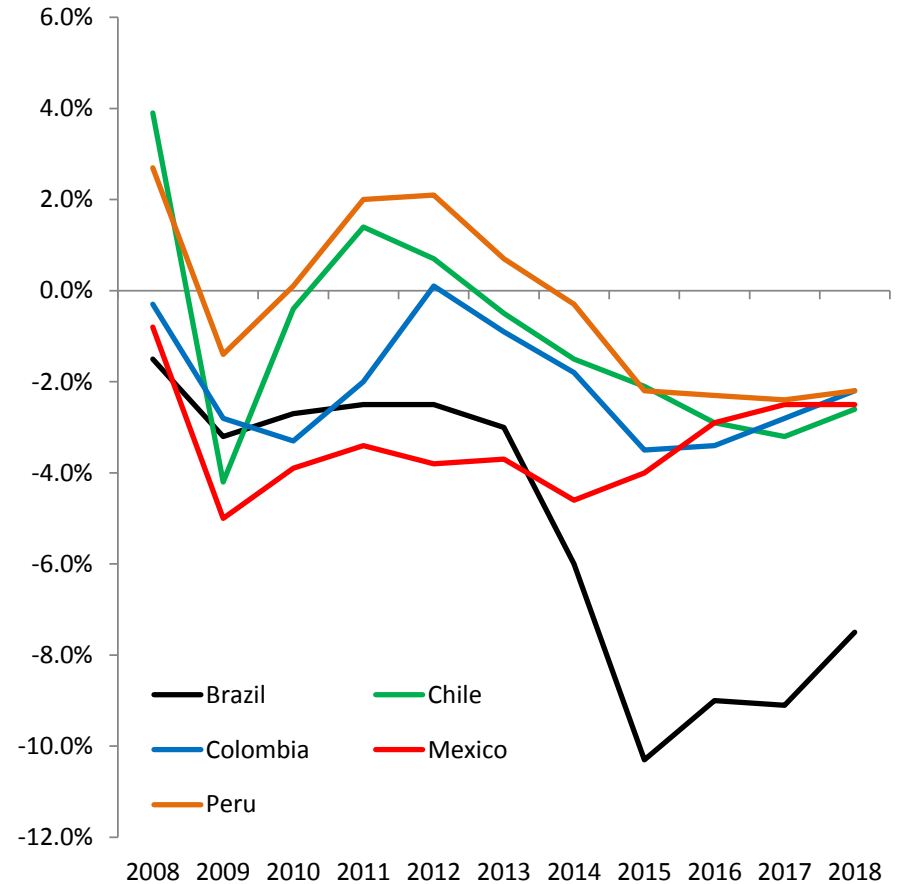
General Government Gross Debt (% of GDP)

Source: IMF, ScotiaFIC Strategy.



General Government Overall Balance (% of GDP)

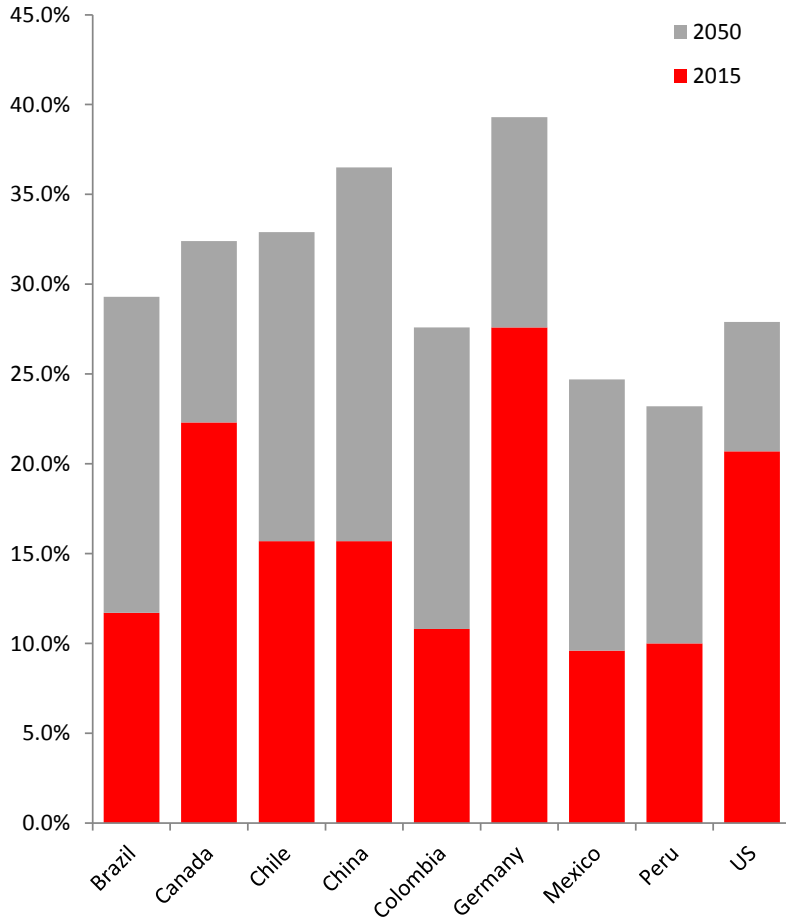
Source: IMF, ScotiaFIC Strategy.



Pension reform is the “make or break”

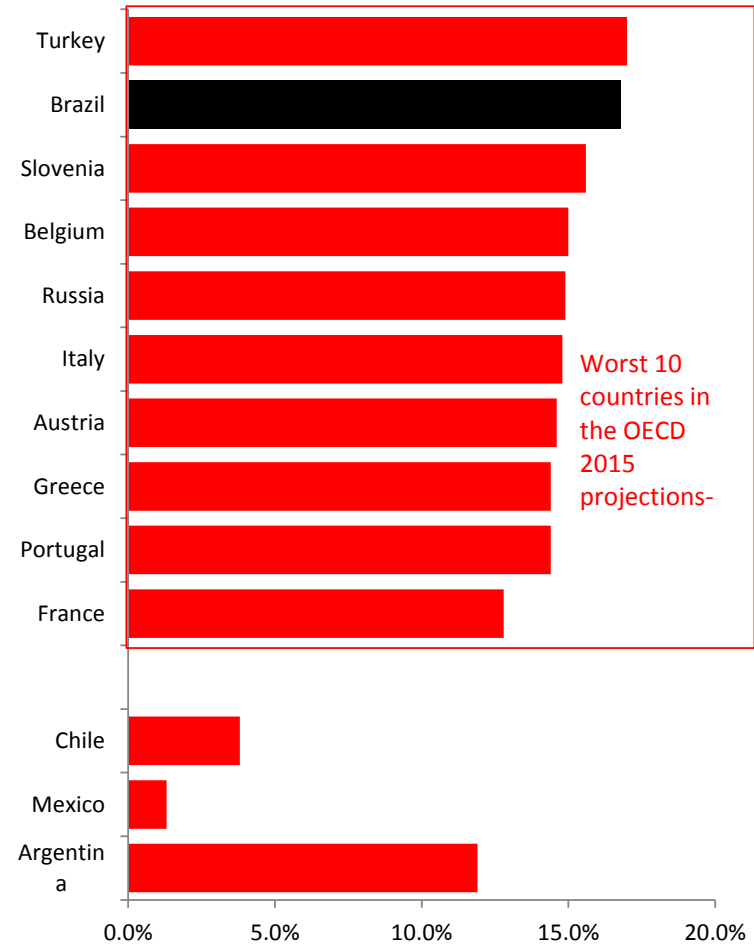
Share of the population over 60 years old: now and in 2050.

Source: UN, ScotiaFIC Strategy.



2050 projected public spending on pensions (% of GDP)

OECD projections



Where does the pension reform stand?

- The bill cleared the committee level with a vote of 23—14 (good news on the victory margin).
- The vote in the lower house (where it needs to secure 308 votes) has been delayed in order to secure the necessary votes.
- The effort to secure the necessary votes will be tough, with 71% of Brazilians opposing the bill, and President Temer's popularity already flirting with 10% approval rates.
- In order to improve the bill's odds of passage, about 25% of the initial planned savings have been watered down, reducing the expected savings by about US\$190bn over the next 10 years

The Pension reform should help, but subsequent reform is still necessary

Retirement age: currently, men can retire at 56, and women at 53 (there is no minimum number of years contributing to the system). In an ideal world, that age threshold would be linked to life expectancy, but for now, extending it to 65 would be solid progress (the current proposal looks to increase the retirement age to 65 for men and 62 for women).

Excessive generosity: In the average OECD country, a pension can retire at age 65.5, receiving 53% of pre-retirement earnings. In Brazil today, a man can retire at 55, receiving 70% of pre-retirement earnings. Under the current proposal, a man could retire at age 65—but receiving 96% of pre-retirement earnings!!

Benefit indexation: The Brazilian Constitution mandates that every person's pension must at least equal the minimum wage, essentially meaning pensions are indexed. The political pressure to increase minimum wages essentially means that when political pressure succeeds, pension spending does to—which has led to the minimum pension almost doubling in the last 10-years.

Short contribution period: Under the current system, a worker is entitled to a full minimum pension after only 15 years of contributing into the system—much less than the OECD average of 26 years of contributions.

Lava Jato – top Brazilian export of 2017?

What is the Lava-Jato?

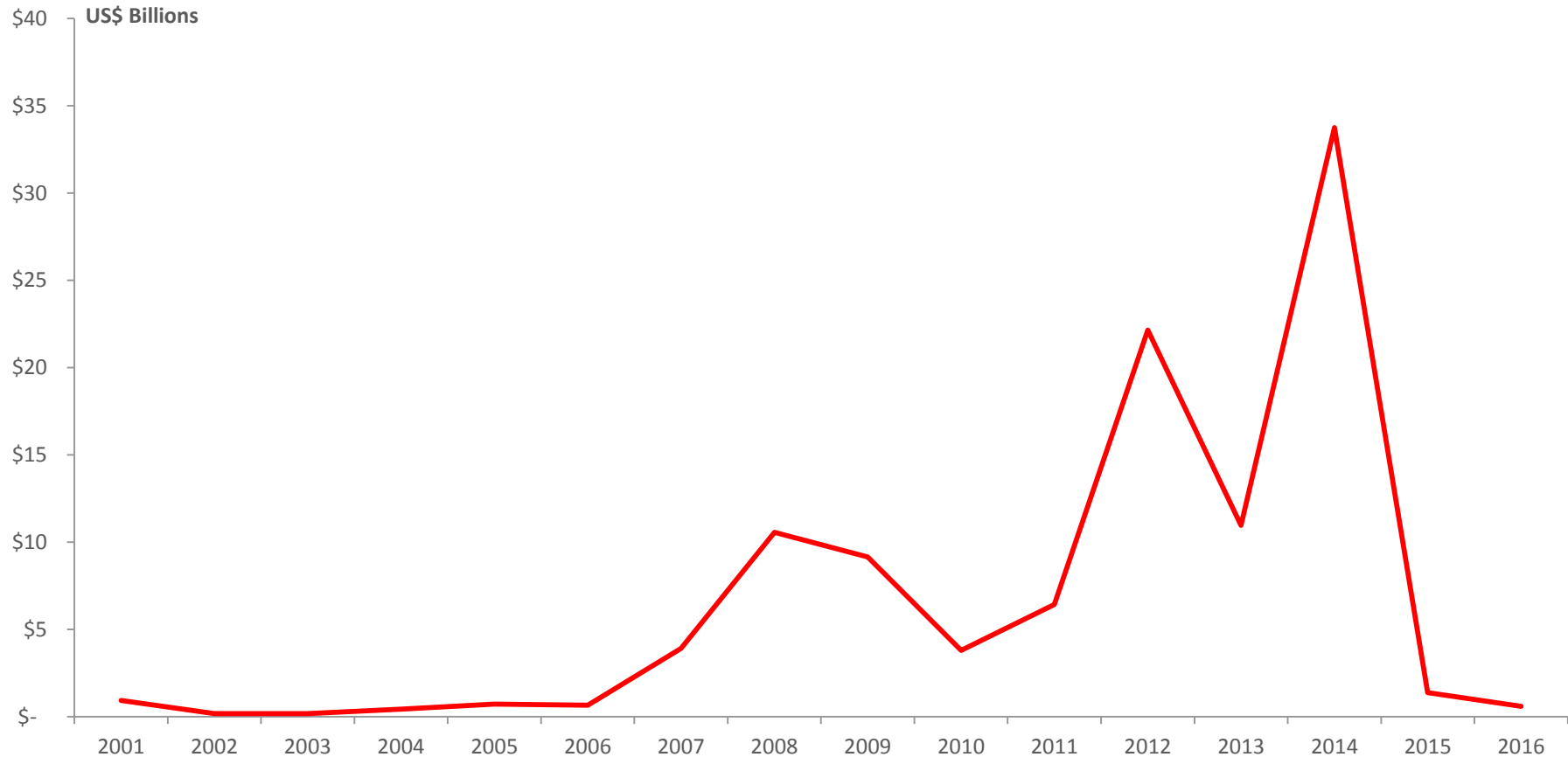
- An investigation into corruption in Brazilian politics and business that kicked off in March-2014.
- The Lava Jato contributed to the impeachment of President Dilma Rousseff (PT party).
- The key figure in the investigations has been Sergio Moro – an independent prosecutor (Federal Judge).
- 160 people have been arrested so far...
- 93 people have been convicted.
- 16 companies in Brazil have been implicated so far – the scandal continues to spread internationally – Odebrecht is acting as a “contagion vehicle”.
- **The investigations have contributed to the country’s macro-stagnation.... Among other reasons by paralyzing investment....**

Brazil continues to struggle with the fallout of corruption investigations

- Lava Jato has contributed to a collapse in infrastructure investment in Brazil

Brazil: Investment in transport with private participation (current US\$)

Source: World Bank.



There is fairly widespread distrust of public institutions across LATAM

- Outside of the army (and in Chile's case civil servants), major economies in LATAM suffer from deep distrust of public institutions.
- Does this mean that, like elsewhere, LATAM is rife for “anti-system” candidates?
 - We would argue this is the case, but its a nuanced issue – in much of the region, an anti-system candidate can mean someone like PPK (a very market friendly candidate).
 - In Brazil, its tough to predict how it will all play out, but I would argue we are still “early in the process”.

Perception of Corruption in Government Institutions

	Mexico	Brazil	Chile	Denmark	Spain	USA	India
Political parties	91%	81%	76%	30%	83%	76%	86%
Legislative branch	83%	72%	68%	18%	67%	61%	65%
Army	42%	30%	36%	17%	19%	30%	20%
Police	90%	70%	53%	9%	37%	42%	75%
Judicial system	80%	50%	67%	5%	51%	42%	45%
Civil Servants	87%	46%	58%	11%	42%	55%	65%

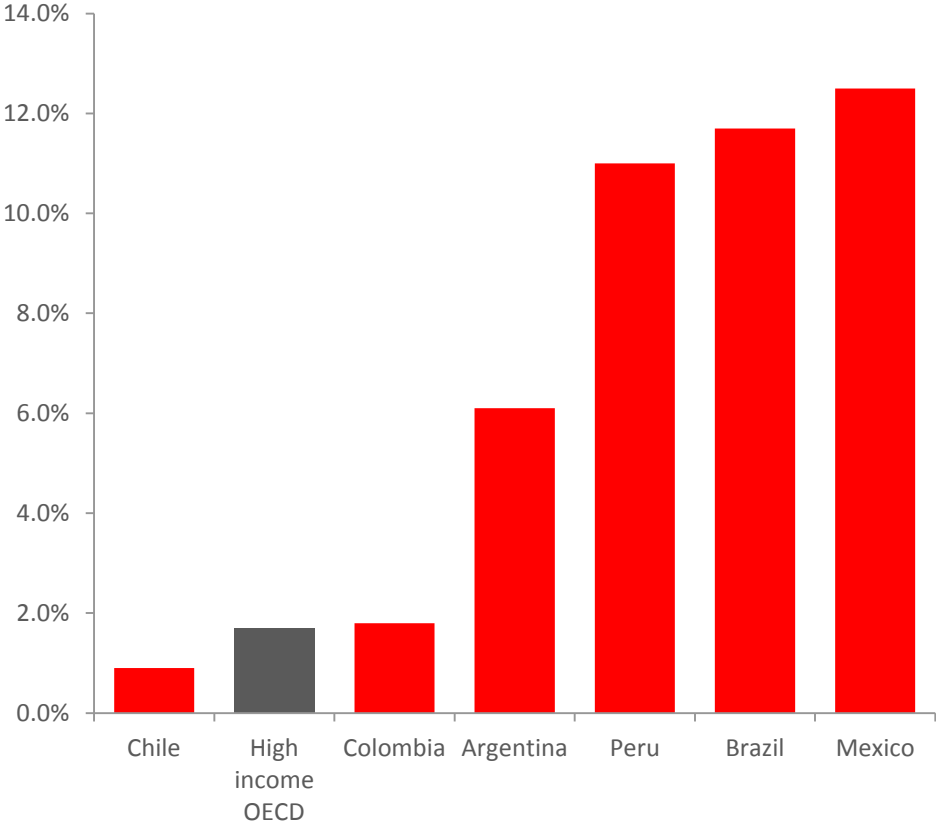
Source: IMCO, from "Corruption Barometer", Transparency International.

LATAM corruption levels are high, but not in all countries

- In some ways, Brazil was one of the countries “ready” for corruption to become a scandal... but not the only one.**

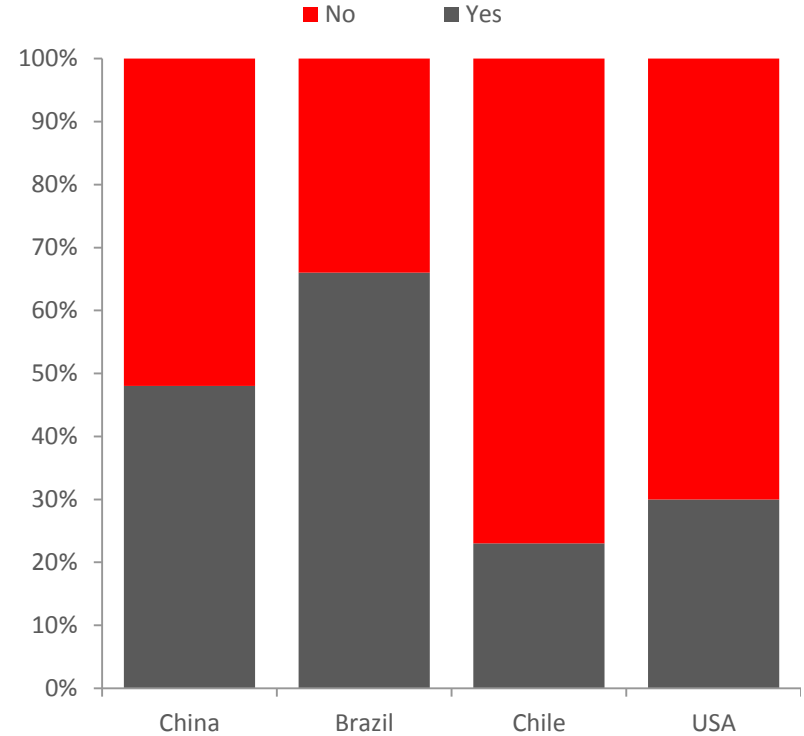
Bribery Incidence

Source: World Bank Enterprise Survey.



In the past 12 months, do you think your company did not get a contract due to a bribe by a competitor?

Source: IMCO "La Corrupcion en Mexico", data from Transparency International, "Putting Corruption out of Business".



The Lava Jato has blown open investigations across the region

- **Lava Jato continues to spread across Brazil**
 - The fall-out from the Lava Jato already contributed to the collapse of one government in Brazil. It now has nearly 1/3 of the current government's cabinet under investigation, as well as over 100 politicians.
- **Lava Jato's is now being exported across the region:**
 - Peru's FinMin suggested the Lava Jato investigation could shave 1 percentage point off the country's GDP growth as it paralyzes infrastructure investment.
 - A judge ordered the arrest of Peru's former President Toledo, following accusations of involvement in the Odebrecht corruption scandal.
 - In Colombia, the fallout from the Lava Jato scandal has already paralyzed at least US\$1.7bn worth of infrastructure projects (Ruta del Sol II). The delays could stretch 5 years.
- **Where does it hit next?**
 - Accusations of bribery requests have already surfaced in Mexico, with Pemex's former CEO being the target of a recent accusation for soliciting a US\$5mn bribe (its only an accusation in Brazilian courts so far – rejected by the accused). Which suggests the scandal could also spill over into Mexico.

How does the anti-corruption drive impact markets?

- **Corruption as a major election driver likely here to stay. Don't be surprised to see it having a major impact in regional elections:**
 - **Chile** holding Presidential elections in November 2017.
 - **Brazil** (October), **Colombia** (May) and **Mexico** (July) having Presidential elections in 2018.
 - Anti-establishment candidates on the rise? Not yet clear, but stage could be ripe for Trump-like outsiders in some countries.
 - What does an outsider look like in LATAM?
- **Potential headwinds to growth – region needs to clean up its act.**
- **Positive spin on the corruption story – is the region finally building institutions?**

Mexican example of civil society showing a maturing democracy

- Civil Society is driving important institutional improvement:
 - *Tres-de-tres* (IMCO led): following a number of scandals over government official conflict of interest / illicit enrichment allegations civil society has organized behind a proposal requiring public officials to disclose their 3-declarations: 1) Conflict of Interest, 2) Tax Returns, 3) declaration of assets.
 - *Mexicanos Primero*: this movement, is arguably one of the main reasons why we believe the education reform was made possible.
 - *Mexico Unido Contra la Delincuencia*: another interesting example of how civil society has come together with a common cause is security. Civil society has gotten together to push for justice system reform, for increasing accountability of the justice system, as well as for helping citizens track crime, and push for crime resolution. **New law was a big step.**
- The rise of the citizen reporter: We think “camera phones” and social media are also behind some of the positive changes in accountability.
- [June 5th, 2016 elections](#) saw governors perceived to be abusive or corrupt kicked out by popular vote. Only [4 of the 12 governors up for election saw the incumbent party re-elected, and the states where corruption or government inefficacy was perceived to exist were quite consistently the “transition states”](#).

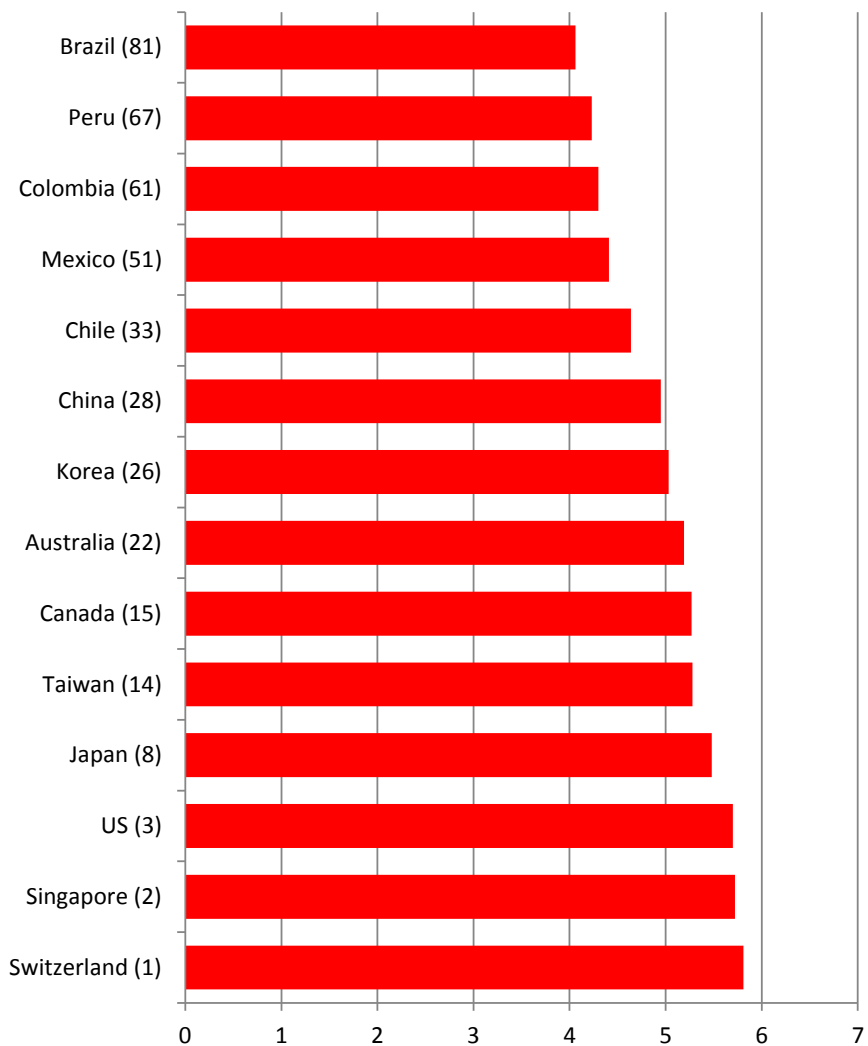
LATAM: one region – very different business environments

How competitive is LATAM?

Global Competitiveness Index 2016 - 2017

(Numbers in brackets: global rank)

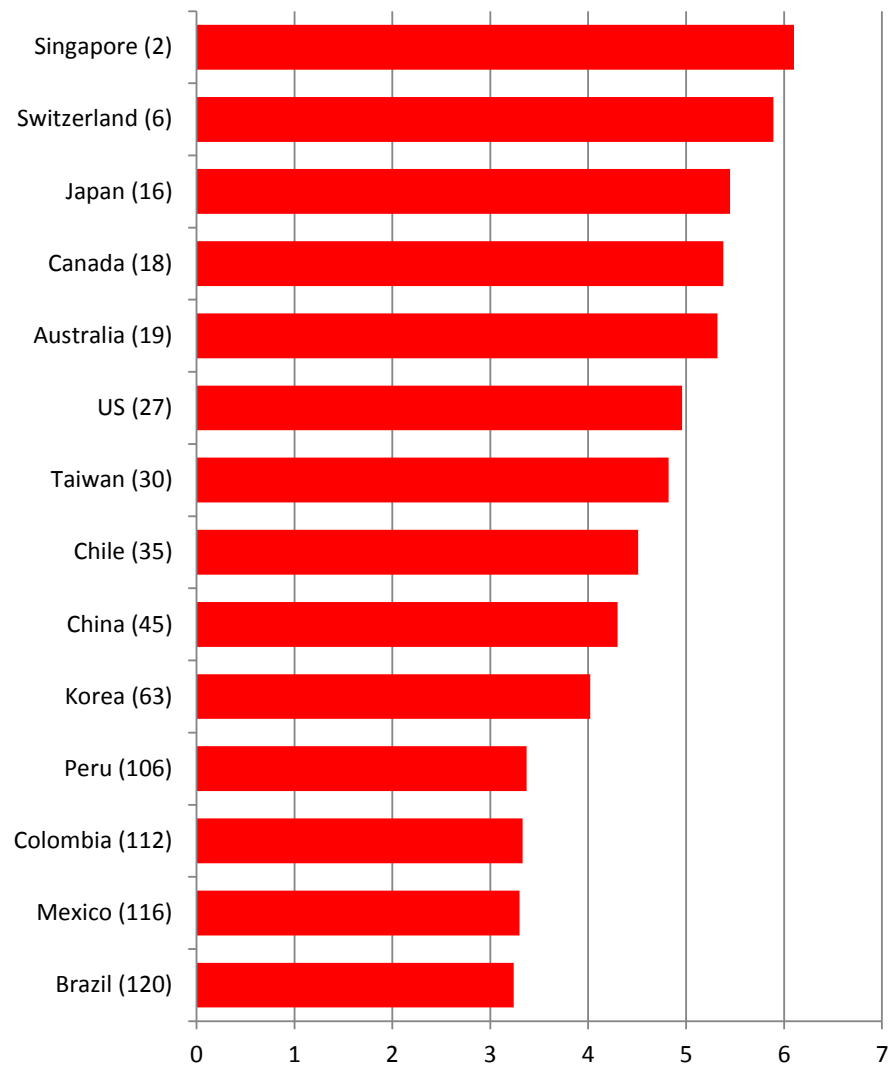
Source: WEF, ScotiaFIC Strategy.



Institutions Competitiveness Index 2016 - 2017

(Numbers in brackets: global rank)

Source: WEF, ScotiaFIC Strategy.

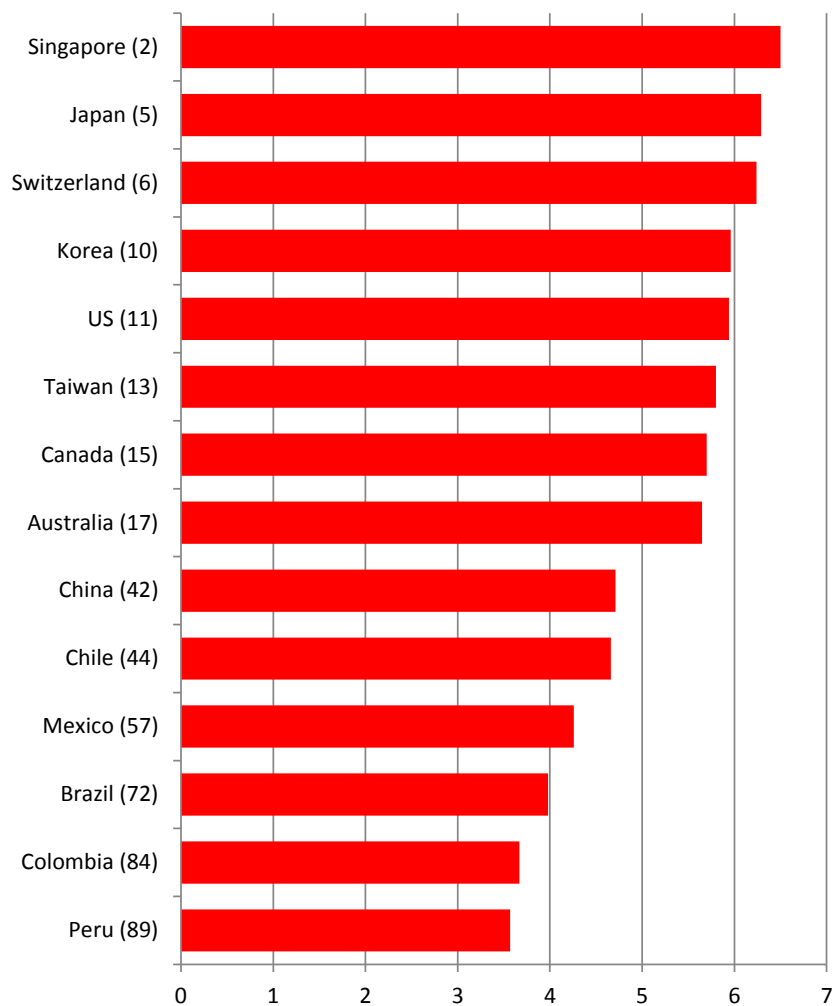


Infrastructure in Latin America

Infrastructure Competitiveness Index 2016 - 2017

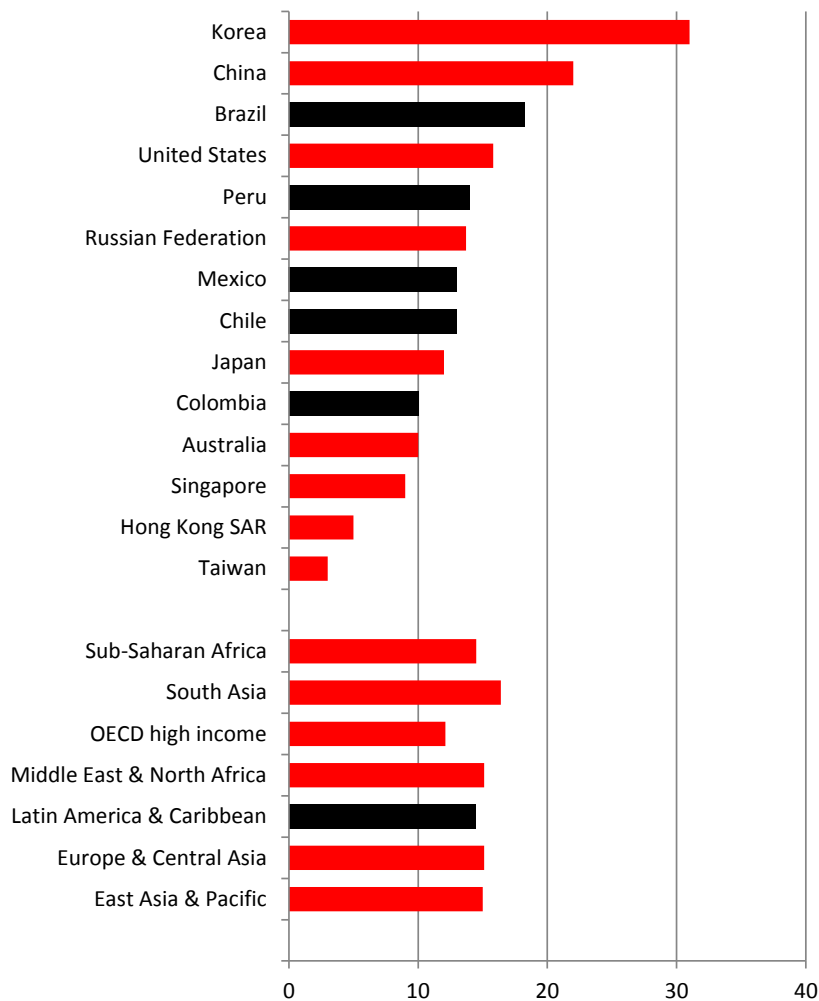
(Numbers in brackets: global rank)

Source: WEF, ScotiaFIC Strategy.



Procedures to obtain a permit (number)

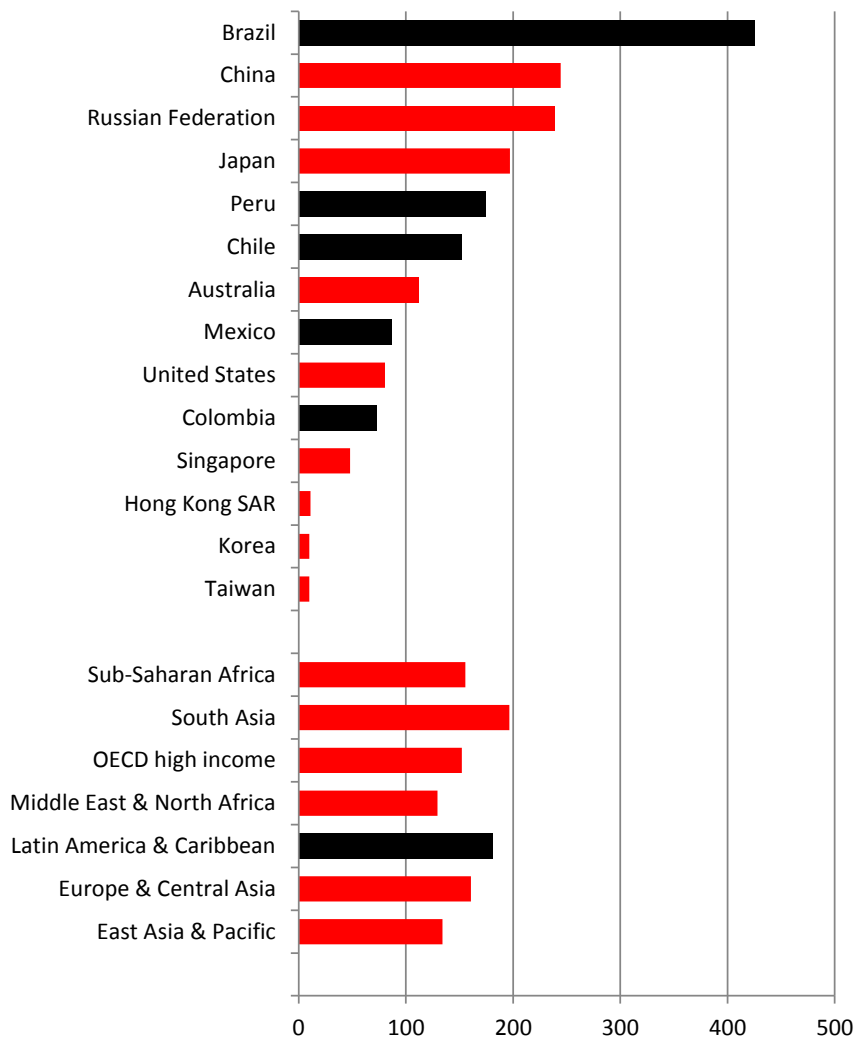
Source: World Bank, ScotiaFIC Strategy.



Infrastructure in Latin America

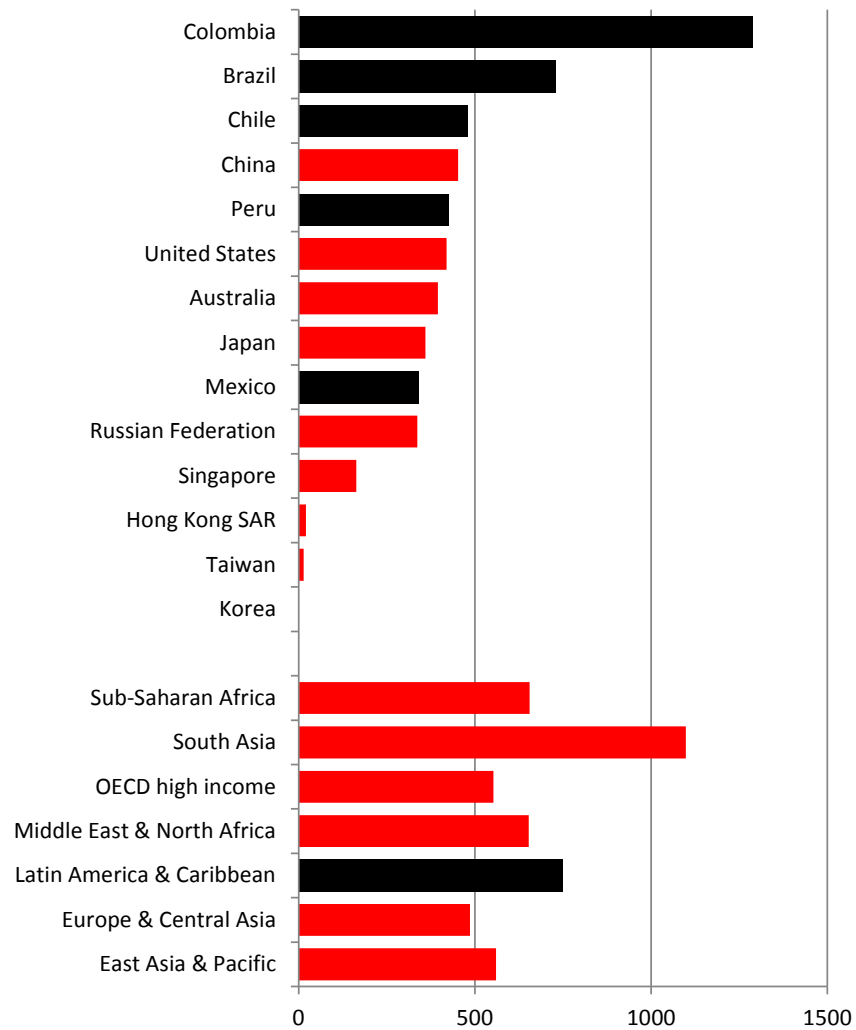
Time to obtain a permit (days)

Source: World Bank, ScotiaFIC Strategy.



Time to enforce a contract (days)

Source: World Bank, ScotiaFIC Strategy.



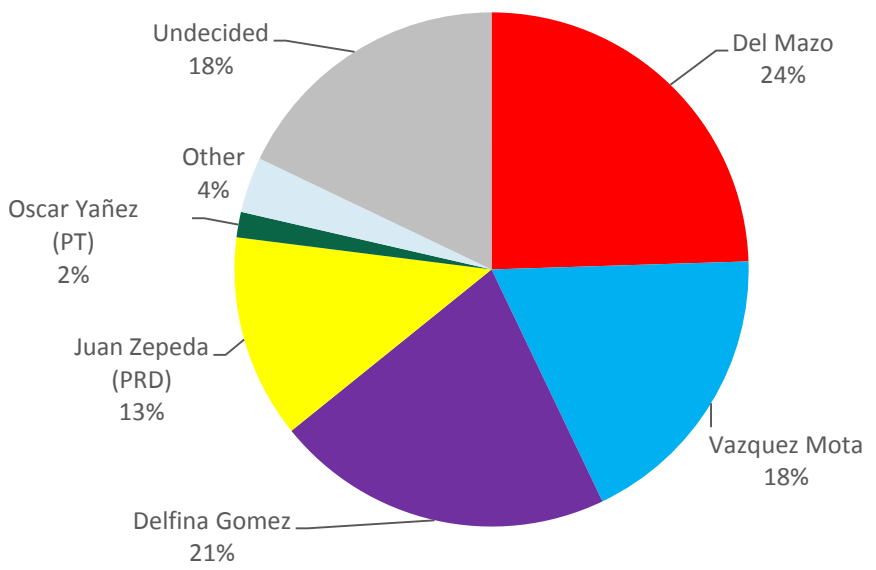
Mexican 2018 presidential elections come to focus

Election year for 2018 should kick-off this summer – with EdoMex election

- Largest state in Mexico by population (16mn), one of the three largest in the country by GDP (normally #2).
- Many political analysts see it as a bell-weather for the presidential election: state has large share cosmopolitan Mexico City, rural population, strong industrial sector, etc....
- PAN running with former Presidential hopeful Vazquez Mota, PRI with EPN's cousin (del Mazo – son of a former Governor), and Morena with a relatively unknown Delfina Gomez.

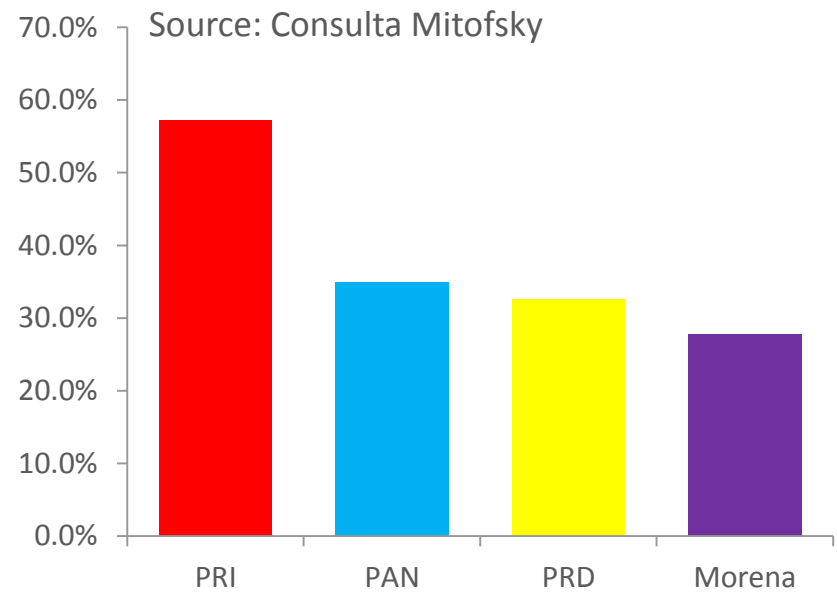
Electoral preference (EdoMex, %)

Source: Consulta Mitofsky



Rejection Rate (EdoMex, %)

Source: Consulta Mitofsky



Who are the candidates? ... still too soon to tell in some cases

AMLO has by far the strongest brand – which is both a plus and a minus

Other party's candidates are still “up in the air”

Candidate	Party	% recognition
AMLO	Morena	95.2%
Osorio Chong	PRI	76.9%
Margarita Zavala	PAN	75.4%
Miguel Mancera	PRD	64.3%
Luis Videgaray	PRI	59.2%
Ricardo Anaya	PAN	49.6%
Manlio Fabio Beltrones	PRI	49.5%
Eruviel Avila	PRI	48.1%
Jaime Rodriguez (Bronco)	Independent	47.6%
Moreno Valle	PAN	42.3%

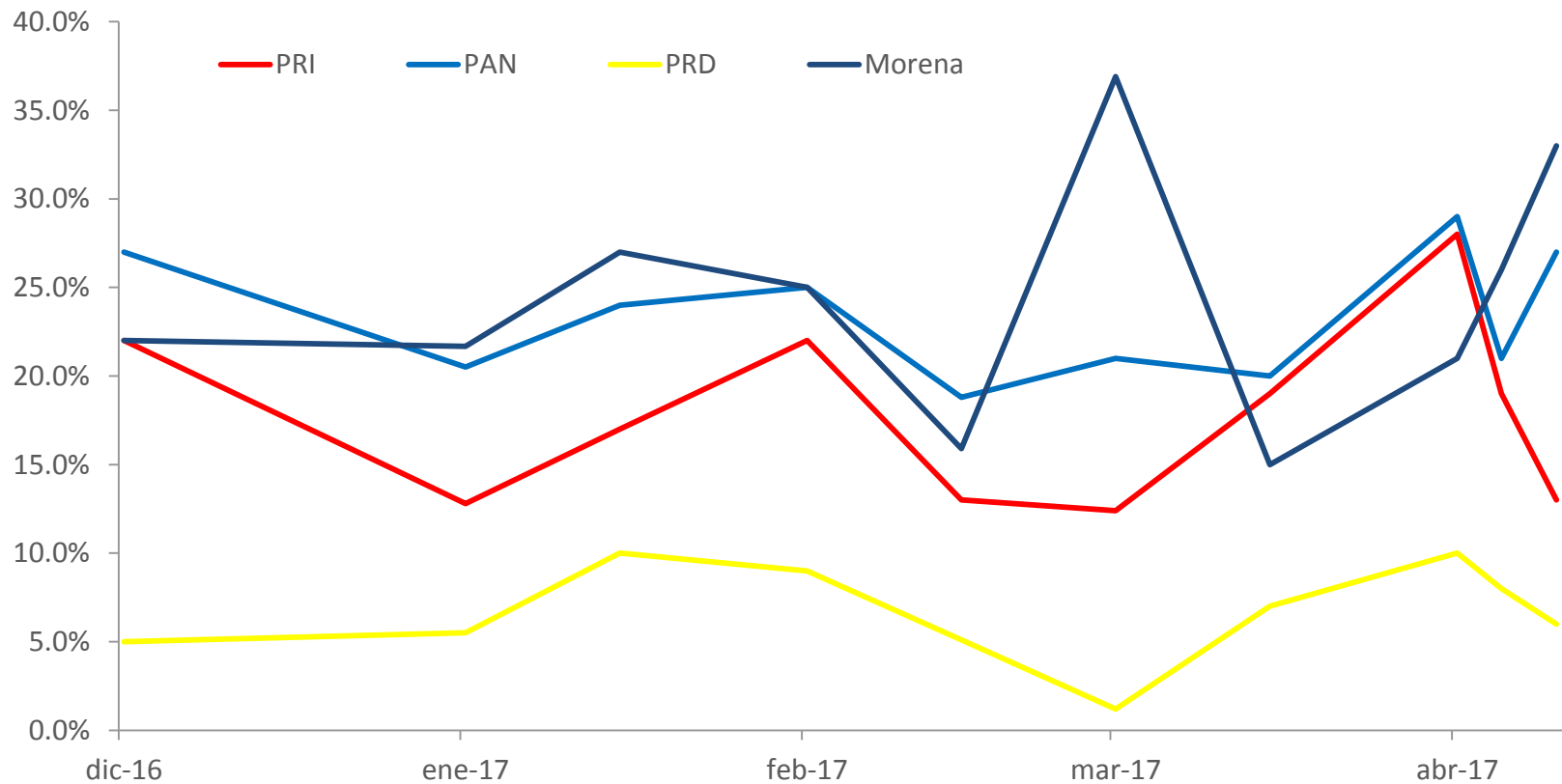
AMLO is the only “sure bet” to lead his party

Who will win 2018's presidential elections? Who knows, but AMLO is strong

The PRI has had a very strong collapse in early 2017.... Is now a distant third place.

Evolution of recent electoral polls

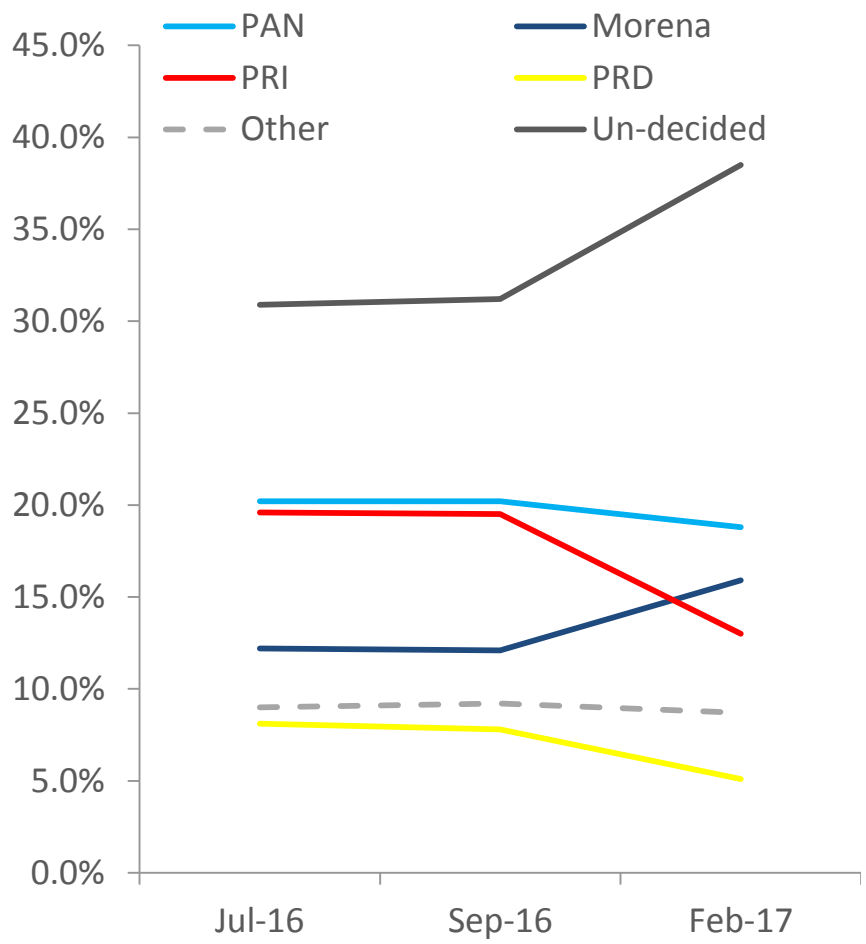
(note, this includes: Reforma, Massive Caller, El Financiero, Mitofsky, Mexico Elige, GEA-ISA, Excelsior, and El Universal - hence polls that are not methodologically consistent)



Its not only important to look at who people like.... But also who they dislike

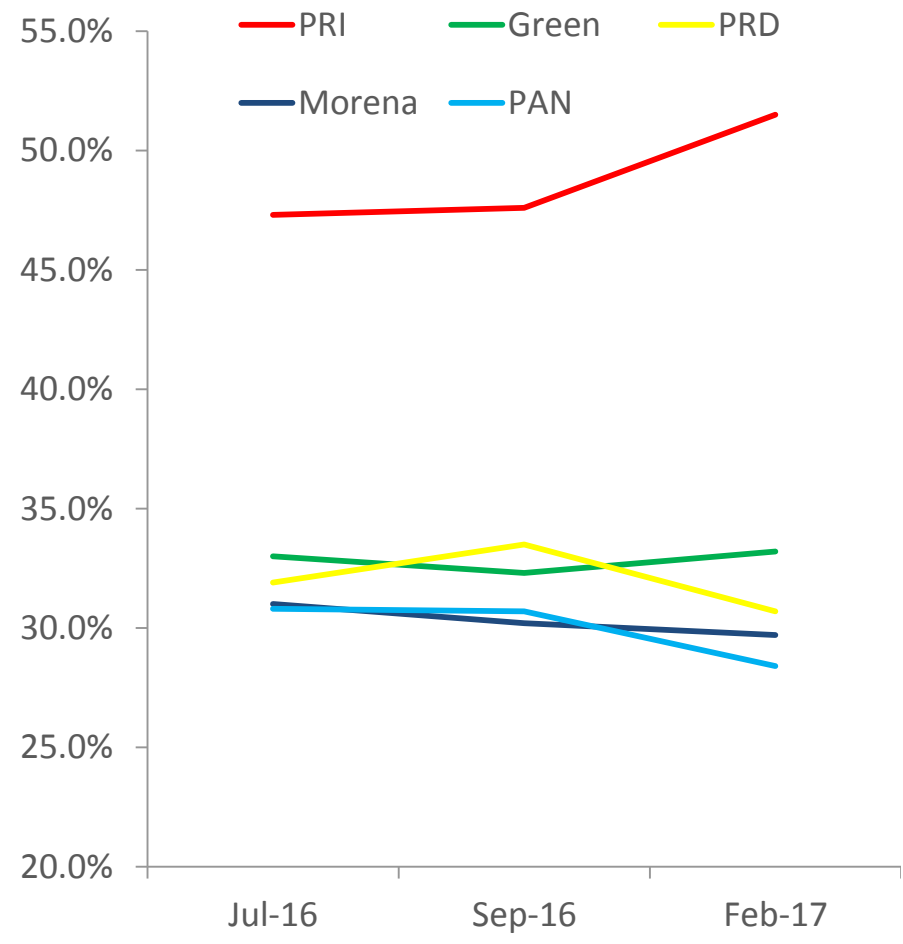
2018 electoral preferences - by political party
(% of voter intentions)

Source: Consulta Mitofsky.



Rejection of political parties
(% of voters)

Source: Consulta Mitofsky.



How do parties do at the regional level?

- The PRI has gone from the only “nationally strong” party, to “nationally weak”.
- The PAN is arguably today’s “national party”.
- Morena is super strong in the Center / South, but is very weak in the North.
- Huge number of “undecided voters” – particularly in the Center (i.e. Mexico City), and the North-West – a PAN bastion.

	Northwest	Northeast	West	Center	Southeast
PAN	20.0%	23.7%	28.1%	14.2%	12.3%
Morena	7.4%	12.4%	11.7%	20.5%	20.3%
PRI	6.4%	25.1%	10.5%	12.2%	13.6%
PRD	5.0%	2.0%	4.8%	4.7%	8.9%
Other	8.4%	6.5%	15.0%	4.3%	12.0%
Un-decided	52.8%	30.3%	29.9%	44.1%	32.9%

Source: Consulta Mitofsky, ScotiaFIC Strategy.

How bad can it be under AMLOve?

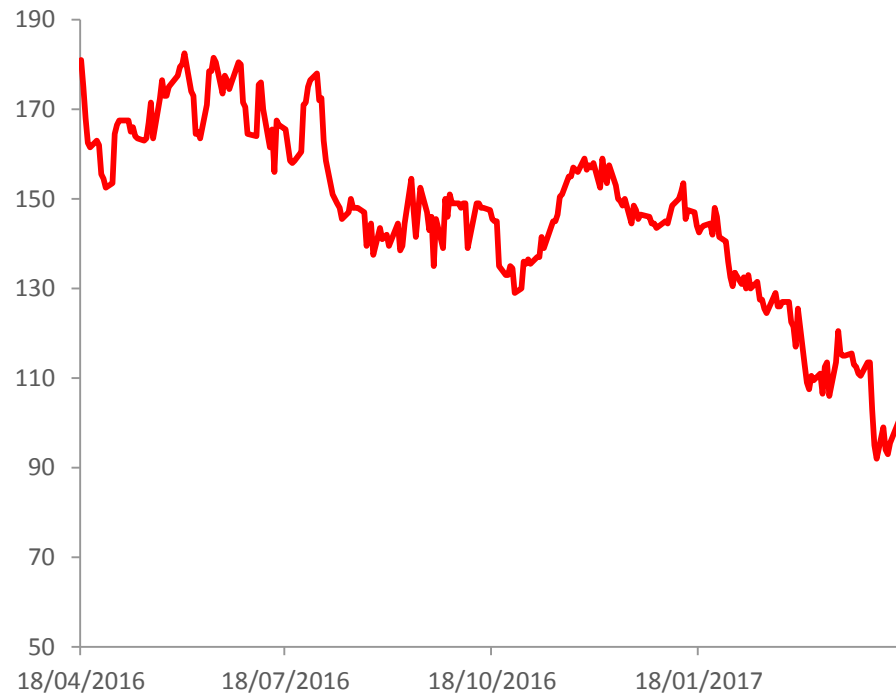
- **Hard to see a scenario where he controls Congress**
 - Regionally concentrated Morena, may struggle to attract undecided voters outside of its sphere of influence (it does not crack 13% in: 3 of the 5 regions of the country)
- **Referendum on energy reform may not be legal**
 - Article 40 of the Constitution, electoral matters, issues related to public income and spending, national security and issues related to the armed forces cannot be subject to referendum.
- **Don't forget NAFTA**
 - Energy chapter
 - Ratchet clause
- **He is somewhat of a known quantity**
 - He already governed Mexico City – was not horrendous.
 - Not good for nascent civil society
- **Damage is limited in an economy that is no longer natural resource based**

Pemex.... What to make of it?

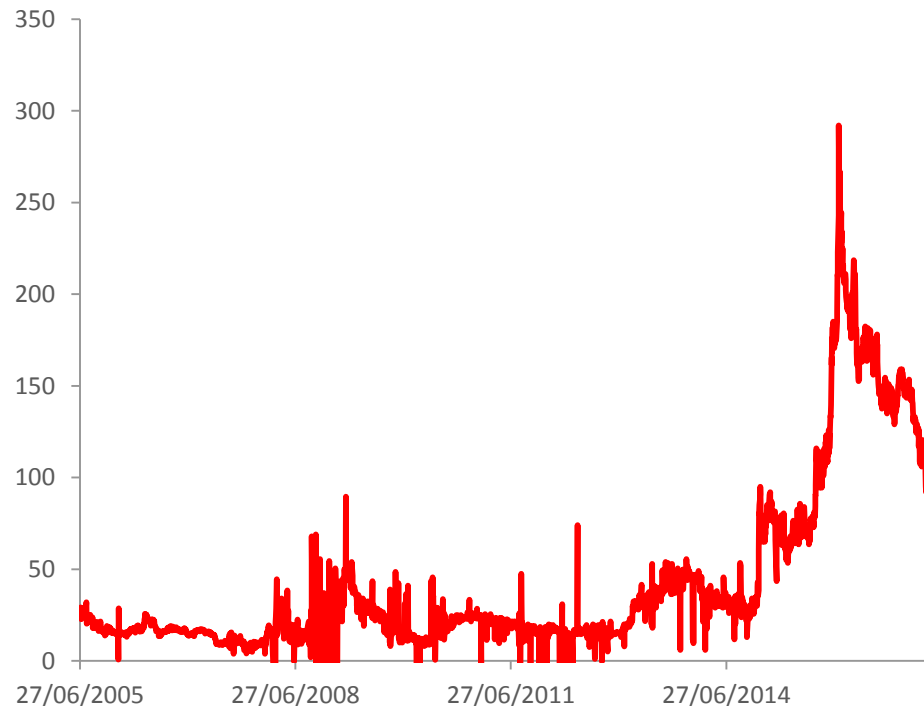
What is the “fair spread” between UMS and Pemex?

- Pemex – Mexico spreads have tightened quite a bit recently, but it all depends on your starting point.
- What is the Pemex – UMS end-game?

5yr Pemex CDS - 5yr Mexico CDS



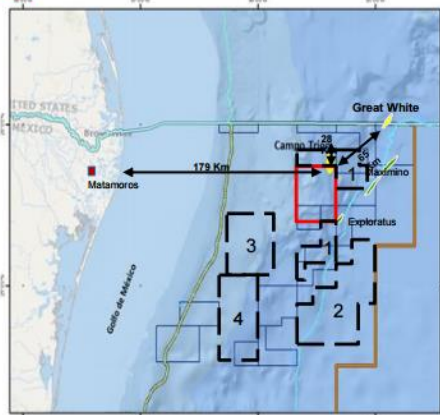
5yr Pemex CDS - 5yr Mexico CDS (bps)



Company completed its first JV... what does it mean?

E&P: Recent Developments (Trión & Block 3)

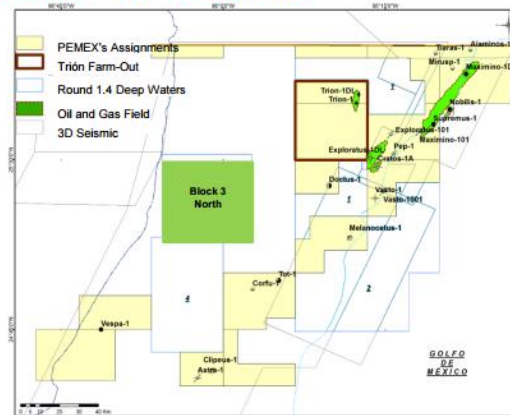
Trión



□ Trión □ Blocks awarded in Round 1.4

- BHP Billiton will invest up to USD 1.9 billion before PEMEX makes additional contributions
- Joint operating agreement was signed on March 3, 2017
- PEMEX expects to invest USD 600 million by the time initial production is achieved

Perdido Fold Belt – Block 3



- Joint Venture with Chevron and Inpex
- The contract considers 3,374 work units, equivalent to USD 3.4 million
- No wells were committed for this contract
- Contract was signed on February 28, 2017

Slide from Pemex' March 2017 Investor Presentation

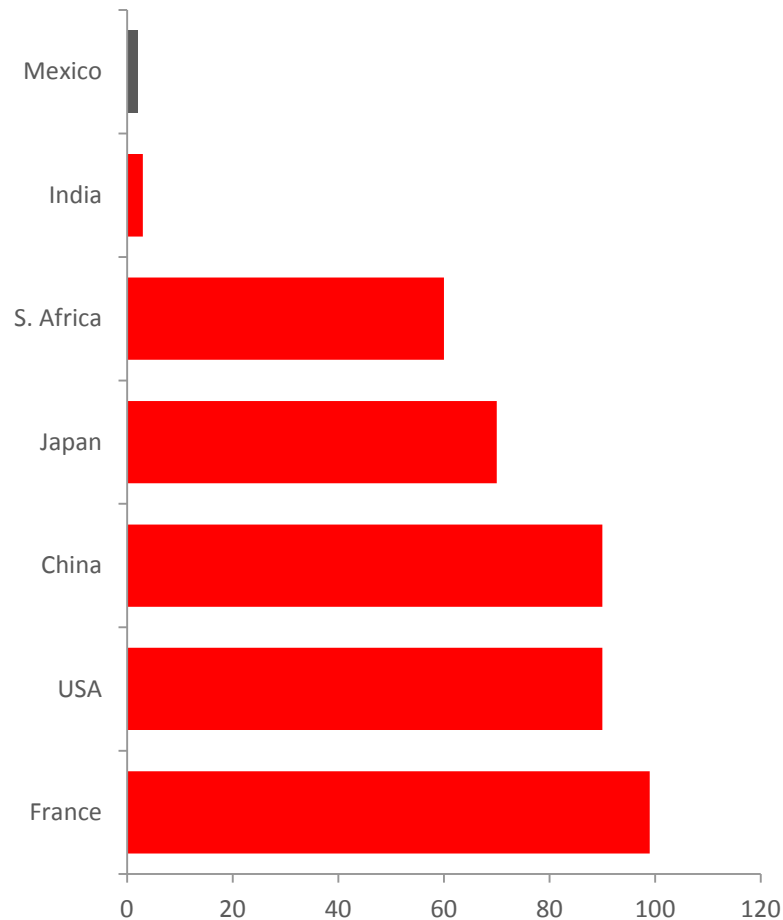
• Why was Trión the first JV chosen by Pemex?

- Deep water was a tough hurdle for the “first partnership”.
- Was it because being a “new project”, dealing with the Pemex Union would not be such a big challenge?

Opening up Mexico's gasoline market

Gasoline storage days by country

Source: Pemex.

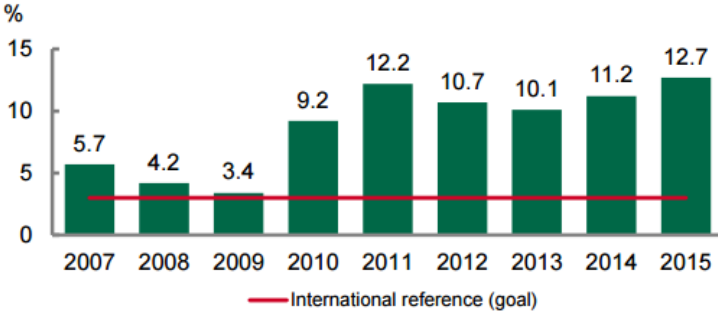


- Mexico's gasoline market could arguably be classified as dis-functional (a net importer with virtually no inventories)
- Starting this year, private players can import gasoline. This could become an important source of investment – as distribution / storage facilities are build.
- However, some hurdles remain:
 - Issues on what the definition of gasoline is need to be ironed out (i.e. additives).
 - A consolidation of the gasoline industry is taking place....
- Key dates:
 - Zone 1 price liberalization March 2017.
 - Zone 2 price liberalization: June 2017.
 - Zone 3 price liberalization: October 2017.
 - Zone 4 price liberalization: November 2017.
 - Zone 5 price liberalization: November 2017.

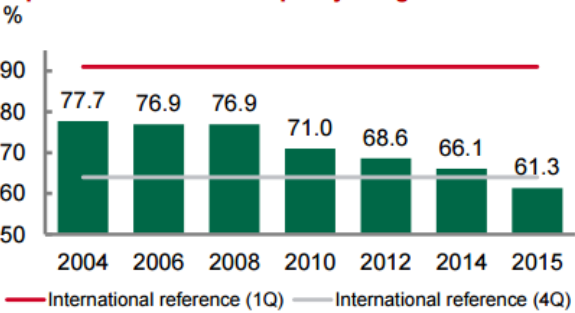
Downstream: Current Status and Challenges

- The challenge is to reverse the economic and operational losses of close to MXN 100 billion

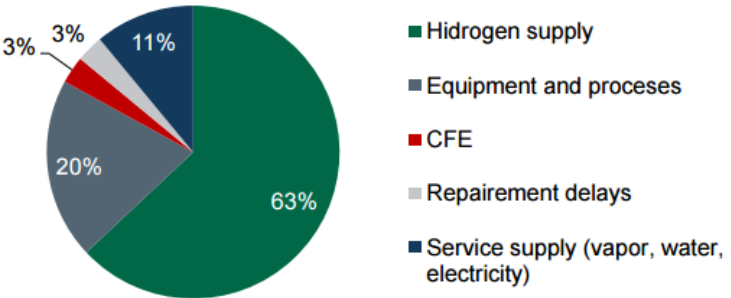
Non-Scheduled Shutdowns Index



Equivalent Distillation Capacity Usage



Main Causes for Non-Scheduled Shutdowns 2016¹



¹ From January to August 2016

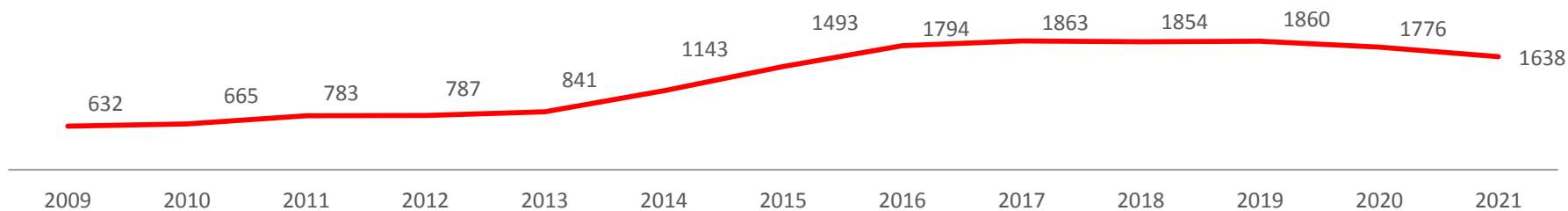
Slide from Pemex' March 2017 Investor Presentation

- Unions will likely be a challenge for sector overhaul....
- If Union challenge can be overcome, there should be important opportunities.

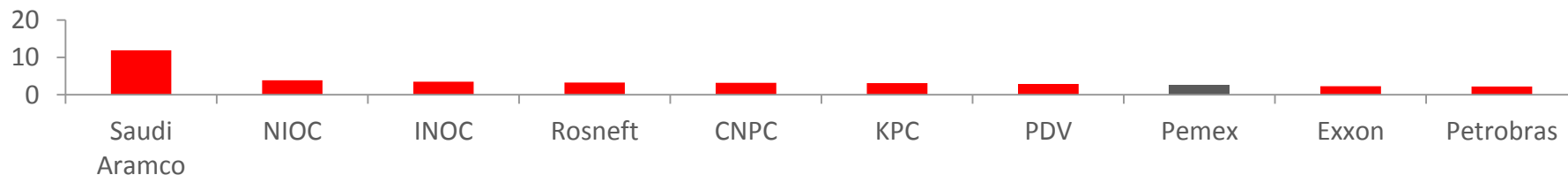
Some good news...

- The company is starting to reduce its net indebtedness, is planning to stop its rising debt trajectory over the next couple of years...
- The company met its crude oil production target for the first time in 5-years (2016 production target was 2,130 mbd, and it achieved 2,154 mbd).
- The company managed to cut operating expenses 26% in 2016.
- Supplier payment backlog issue is now solved.

Consolidated debt plan (MXNbn)



Crude oil production (mmbd)



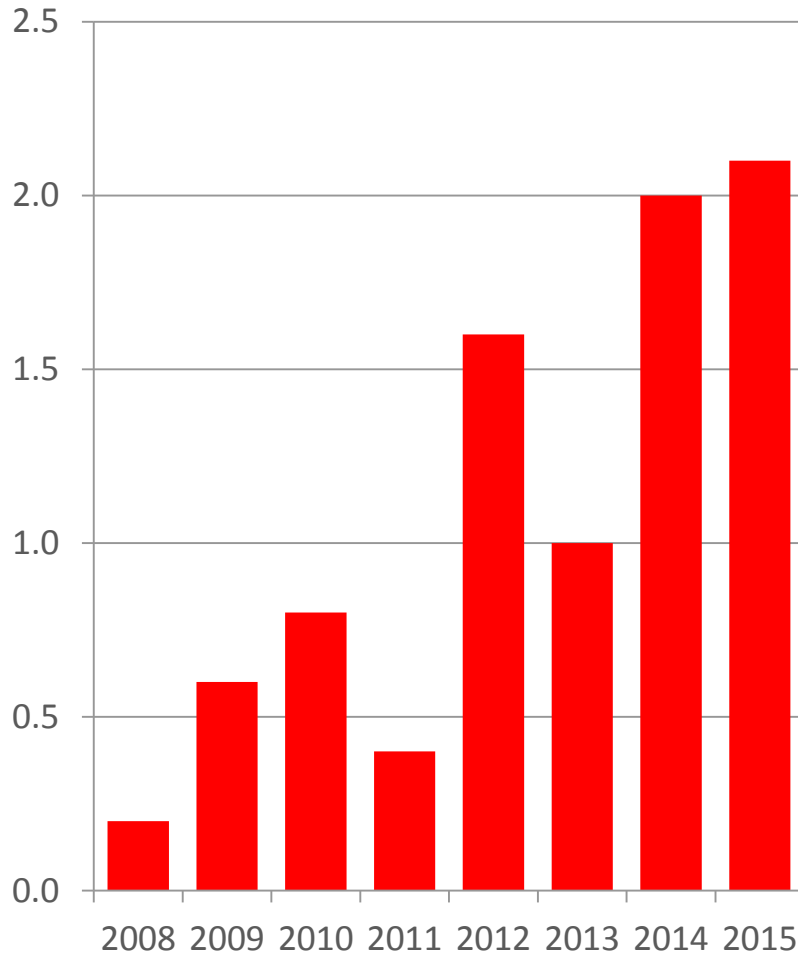
Reforms bringing private equity in Mexico to life

Competition – driving surge in entrepreneurship

Beer is a prime example.... We went from 2 brands, to “surging micros” (i.e. visit beerhouse.mx)

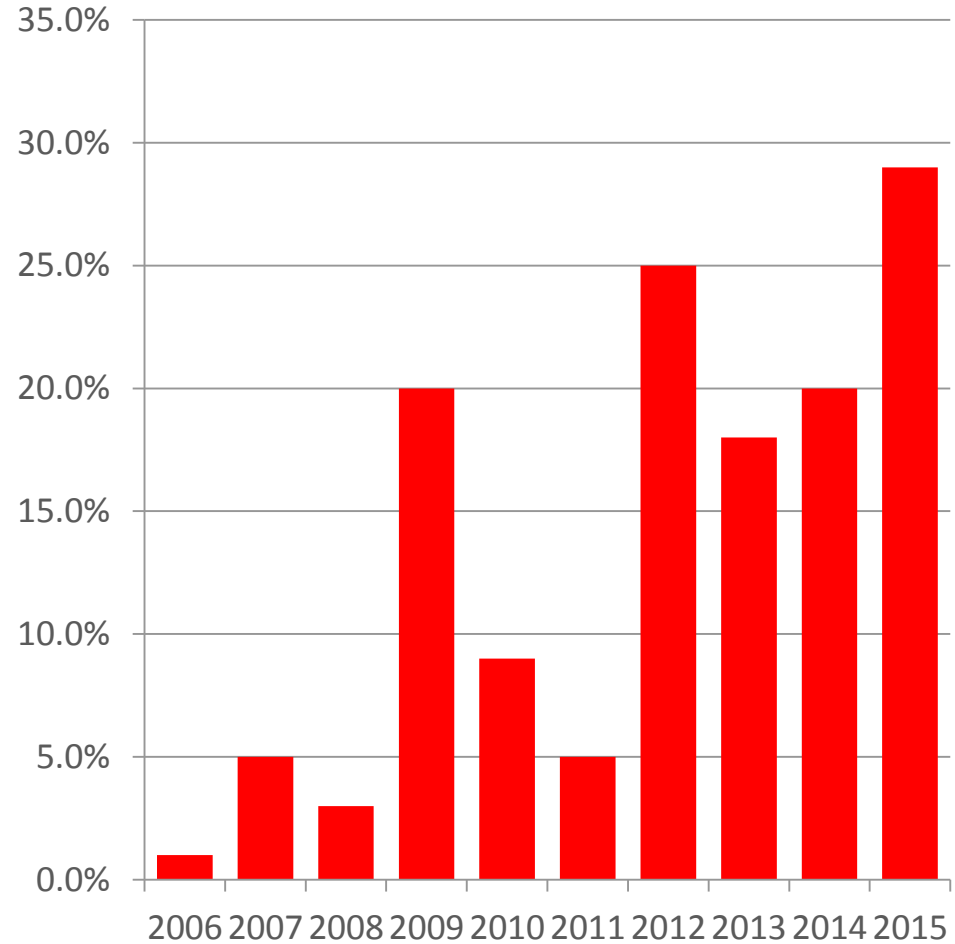
Mexico private capital fundraising (US\$bn)

Source: EMPEA.



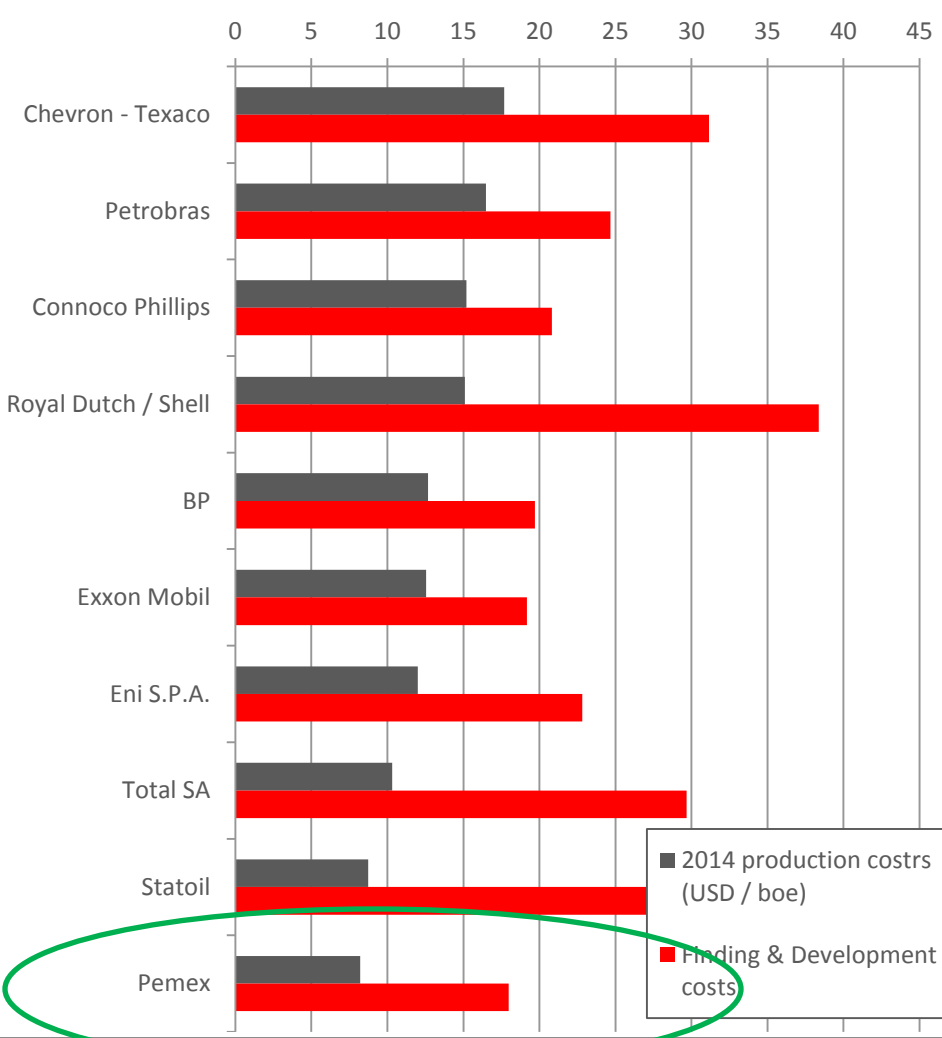
Mexico private capital fundraising (% LATAM)

Source: EMPEA.



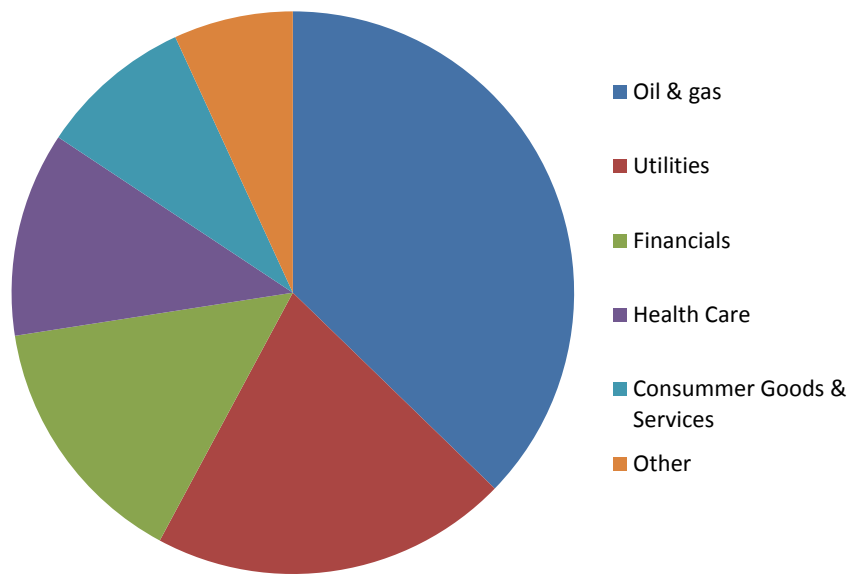
Energy: reform should move forwards, with or without Pemex

Our take is Mexico's energy issues are more "Pemex efficiency related", than driven by geology



Investor interest in energy is important – but not the only sector

Private Equity Investment: % by Sector
Source: EMPEA.



How concerned should Mexico be about its northern neighbor?

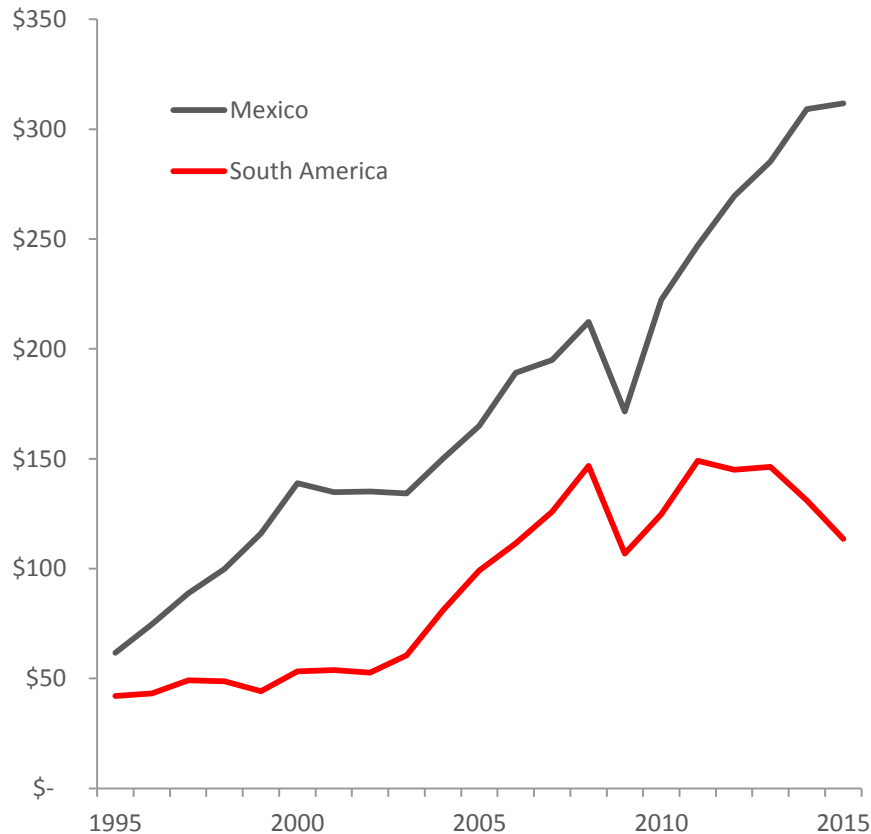
NAFTA has helped turn Mexico into a diversified economy

Most Mexican imports are “intermediate goods” – which limits FX – inflation pass-through

Mexico’s export diversification should also be seen as a sort of buffer

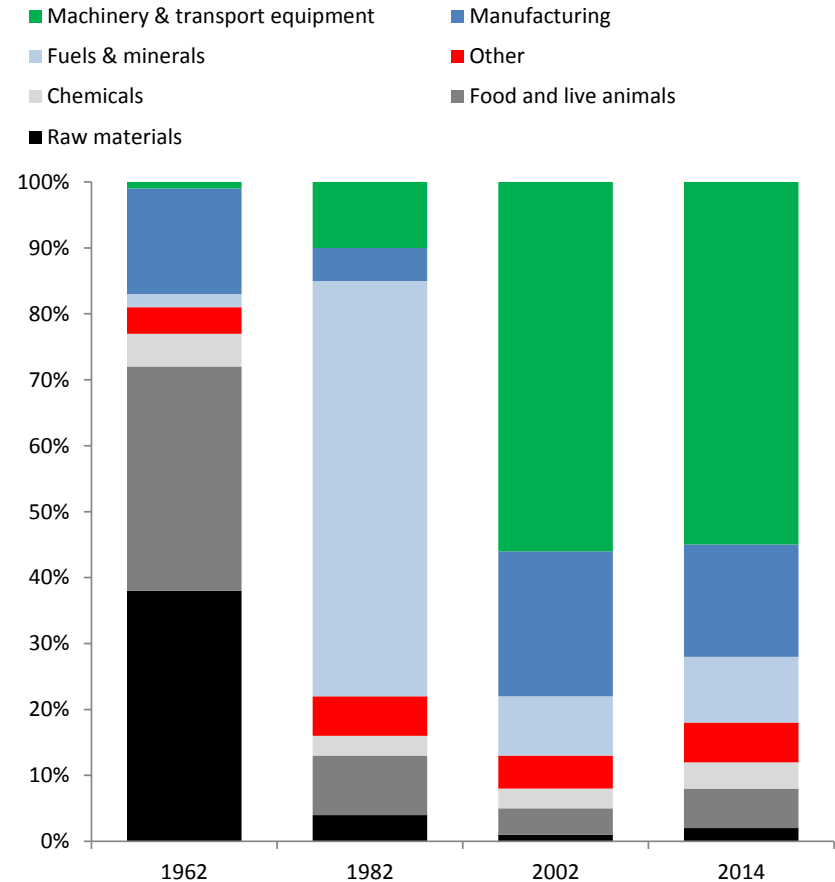
Exports of manufactured goods (US\$bn)

Source: UnctadStat.



Composition of Mexican exports (% of total)

Source: IMCO, from Atlas of Economic Complexity



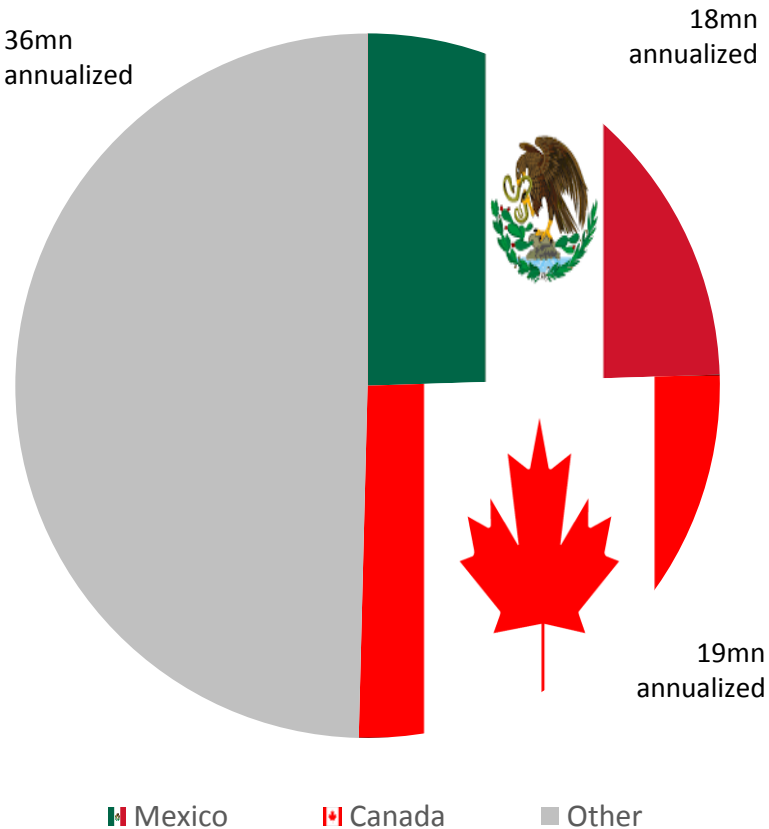
- **Build the wall – and pay for it:**
 - Way to pay has morphed constantly:
 - Tariff – what about NAFTA & WTO?
 - Border adjustment tax.
 - Remittances tax
- **What's next for NAFTA?**
 - Update: add-ons to existing treaty.
 - MOU renegotiation: limits risks – can lead to update for the whole block.
 - Open Pandora's Box: breakup
 - Time is on Mexico's side
- **Mass-deportations.**
 - Mexico cannot absorb that many.
 - Insecurity.
 - Who will take those jobs?

Mexico is not only a country that sells a lot into the US

- Mexico is the second top source of tourists visiting the US, and the second top importer of US goods – by a wide margin

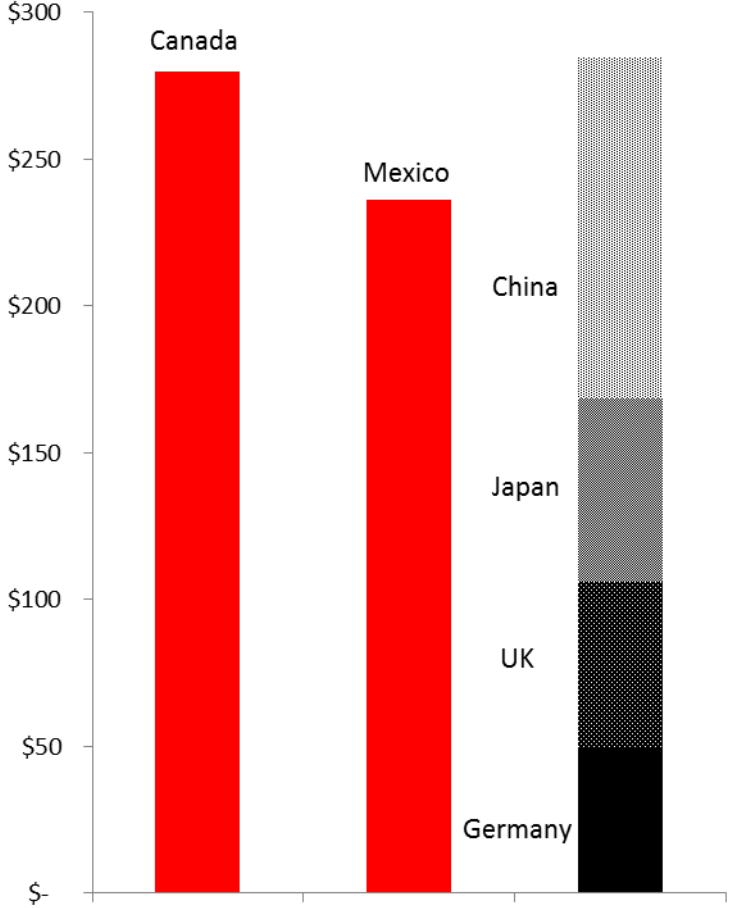
International tourist arrivals into the US (% of total)

Source: US Trade, Scotia FIC Strategy.



US exports to its top 6 export markets (US\$bn)

Source: UNCTAD, ScotiaFIC Strategy.

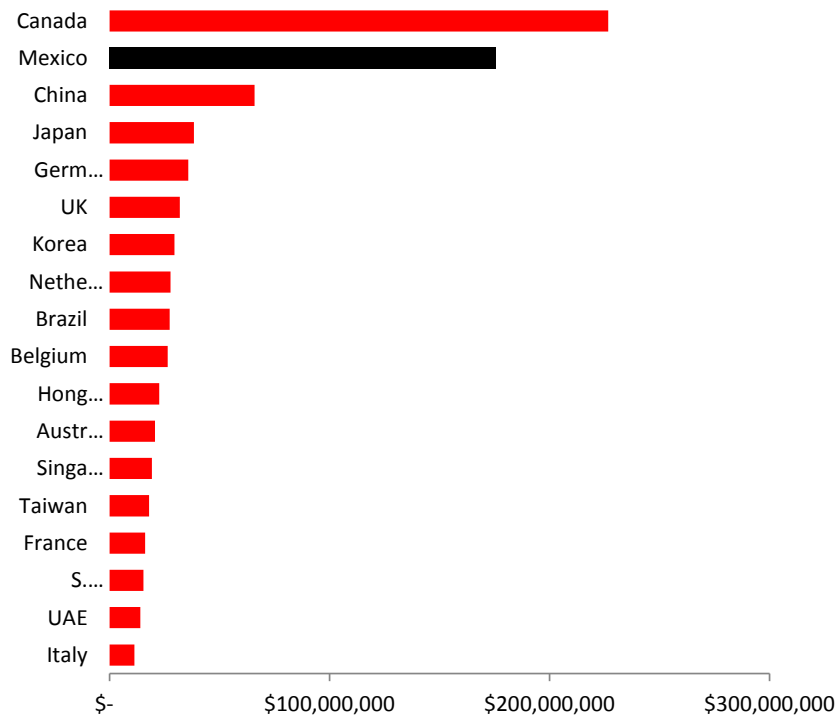


Mexico: arguably the most integrated manufacturing sector w/ US

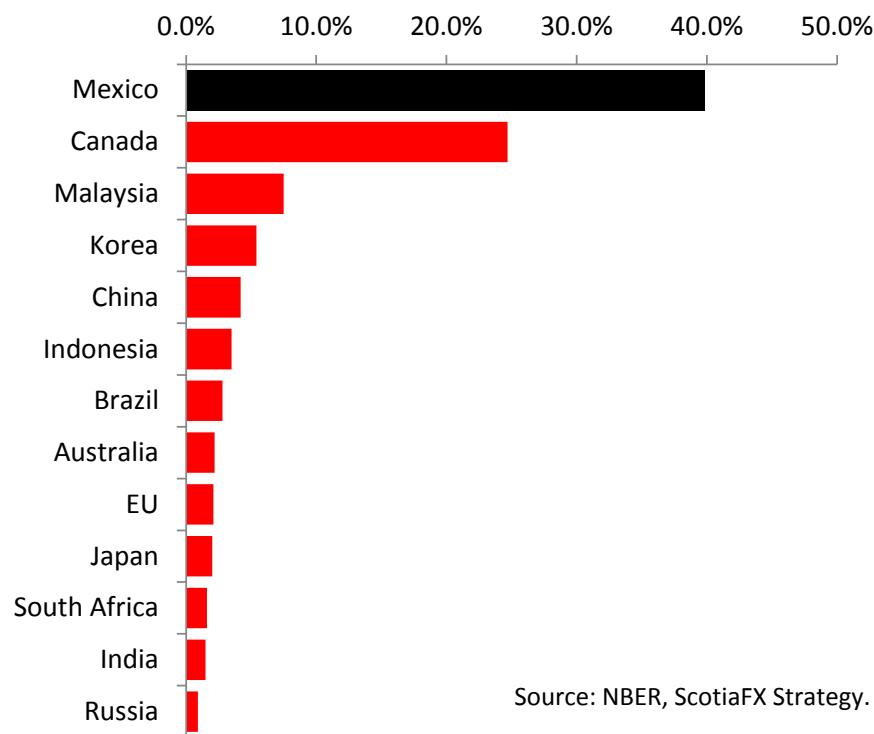
- Its tough to see US manufacturing not pushing back vs disruptions to US-Canada-Mexico manufacturing hub (cross value added is huge).
- There is arguably no two manufacturing industries globally more integrated than US-Mexico. Differences in wage costs suggest they are complementary to each other, rather than competitors.

Major destinations for US manuf. exports (US\$thds)

Source: UNCTAD Stat, ScotiaFIC Strategy.



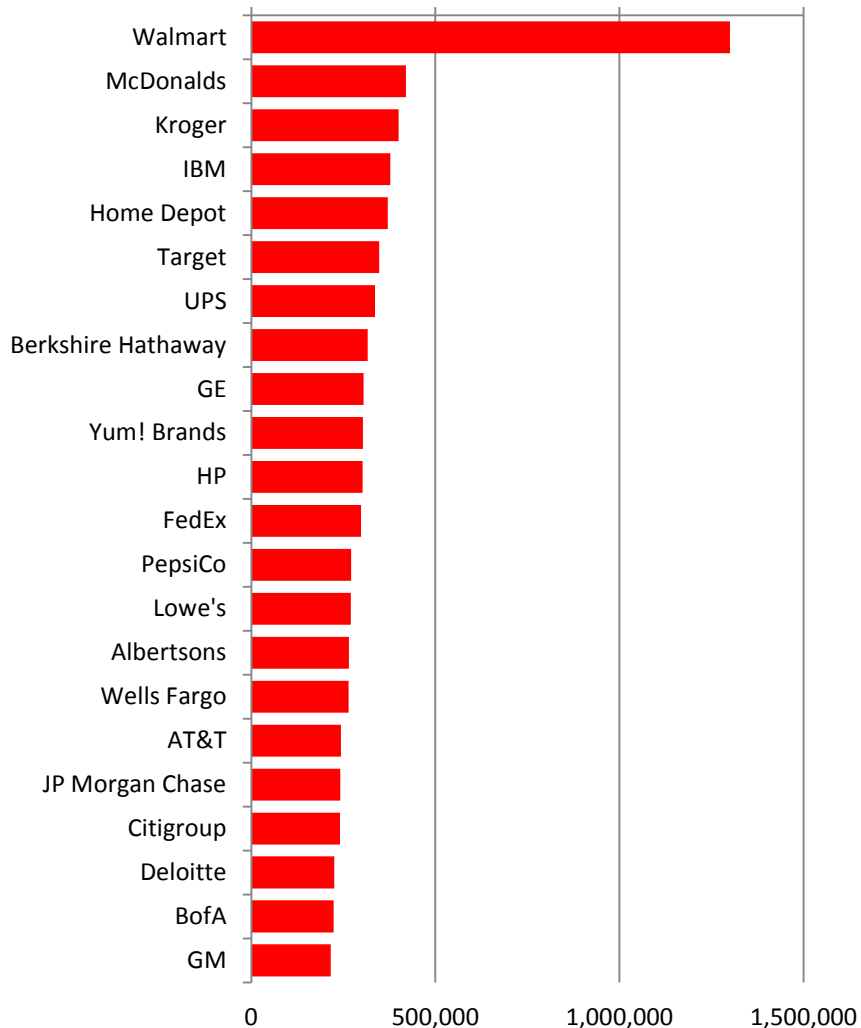
U.S. share in imports from major trading partners



Source: NBER, ScotiaFX Strategy.

The top employers in the US have strong vested interests in Mexico

Top employers in the US



Walmart, Mc Donald's, IBM, Home Depot, UPS, GE, HP, PepsiCo, FedEx, AT&T, Citigroup, GM – among others, all have substantial operations in Mexico.

These should be “natural allies” in Mexico’s negotiations

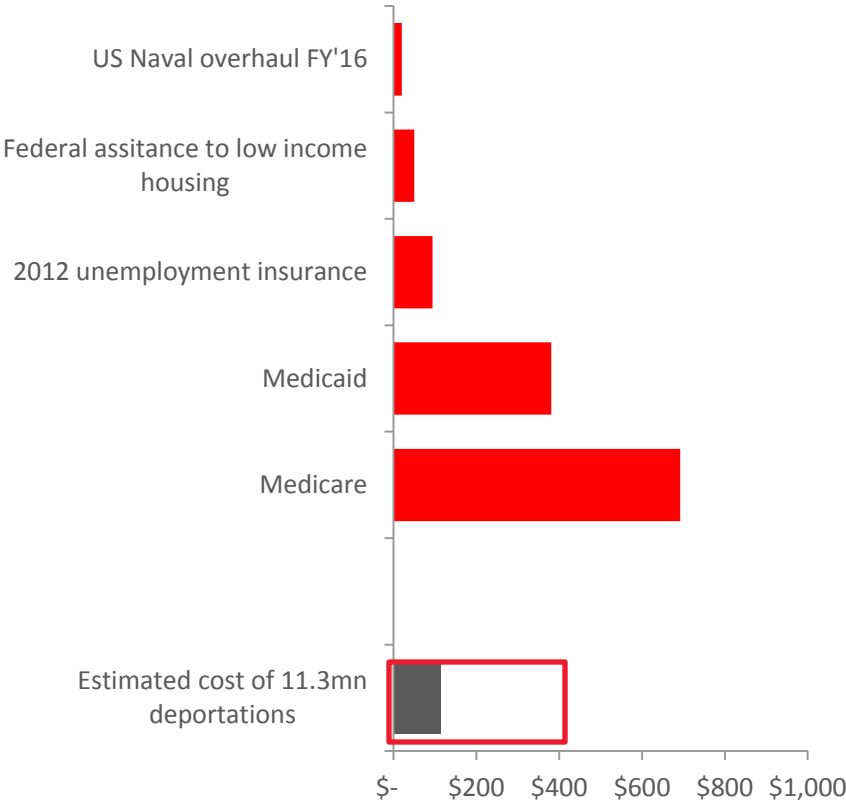
Fate of NAFTA has broad range of possible outcomes

- **Update and improve:**
 - Top priorities for Trump government look like: rules of origin (shut of China back door) and dispute resolution.
 - Add TPP update for new realities
- **Re-open, but avoid Pandora's Box:**
 - Given toxic politics, full re-open risks major step-back.
 - Common ground:
 - TPP: labor standards, intellectual property rights, environmental standards (maybe),
 - Trump's agenda: dispute resolution, rules of origin,
 - New reality: e-commerce, energy, telecoms....
 - Pre-established MOU can help curtail risks.
- **Look at NAFTA as 0-sum game:**
 - Walk-away

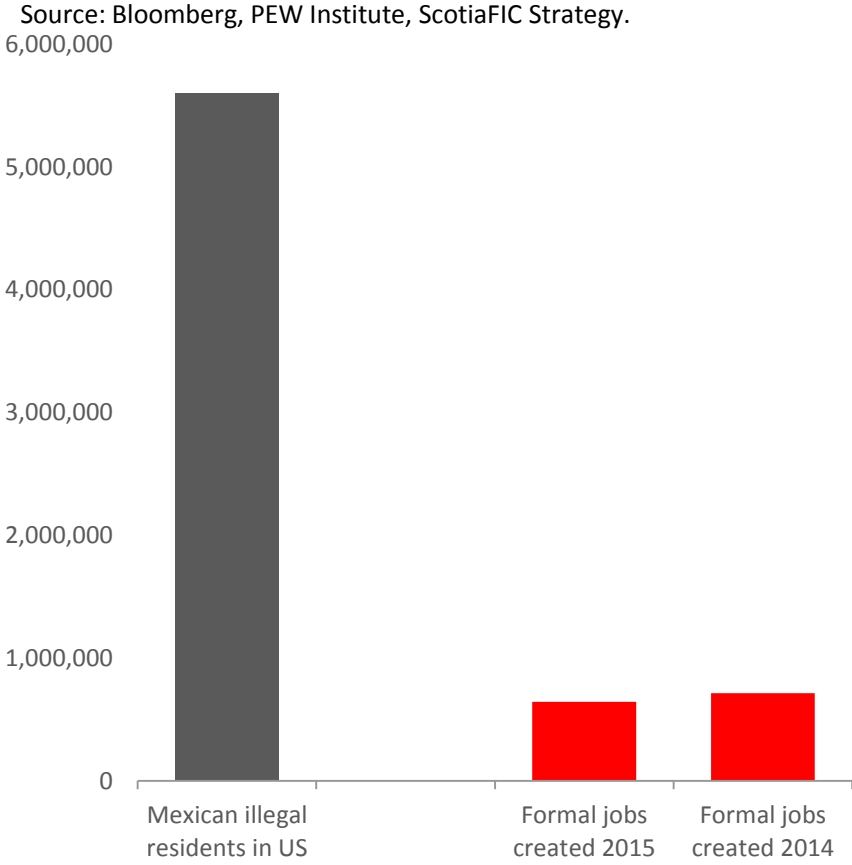
Proposed mass deportations look tough to fund – or absorb

Cost of deporting illegal immigrants residing in the US is estimated to reach up to US\$400bn ([according to the WSJ – follow this link](#)) – or at least roughly US\$150bn

Estimated cost of deporting the 11.3mn illegal immigrants vs cost of some US social programs /defense spending items (US\$bn)



Number of illegal Mexican immigrants in US vs jobs created in Mexico

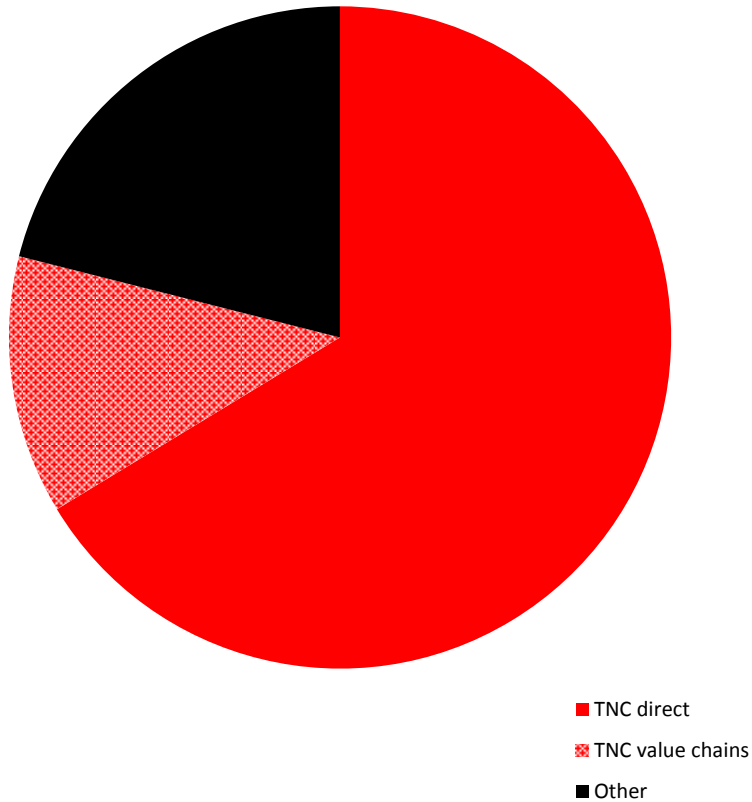


<http://www.wsj.com/articles/the-costs-of-mass-deportation-1458342018>

What if WTO finds its demise?

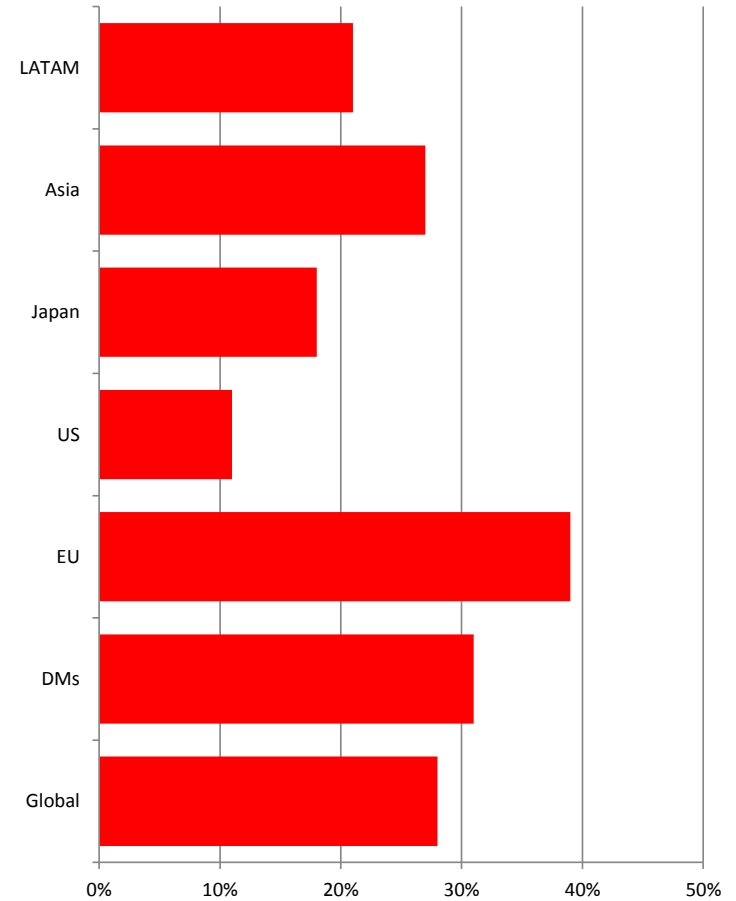
TNCs share of global trade value added (2010)

Source: UNCTAD, ScotiaFIC Strategy.



Domestic value added in trade as % of GDP (2010)

Source: UNCTAD, ScotiaFIC Strategy.



RUN FOR THE HILLS.....

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