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For the past three years I have been based out of the United States, publishing our magazine and launching the Emerging Market Investors Association, and only recently have I returned to my home away from home, Argentina. I had almost forgotten how much I missed living and working in emerging markets, and Argentina does not disappoint. The mix of frustration matched with optimism, particularly regarding the current and future administrations of the country, makes for an extremely interesting investment landscape. The contrarianism of these regions – in which Baron Rothschild’s adage, “Buy when there’s blood in the streets” still holds true – is starting to find acceptance in the world of traditional investment.

This year many of my interviews and interactions have dealt with the concept of countries in (or at the brink of) crisis, and how much of an opportunity that can be for the informed investor. A member of EMIA told me some of the best returns come when a country goes from terrible to just slightly better. With the end of the commodity super-cycle, China slowing down its external spending machine, and the US raising rates, emerging markets will have to accelerate the development of local and regional markets, which in turn will begin counteracting potential crises. The window for investment into emerging and frontier markets does sometimes close, only to open somewhere else.



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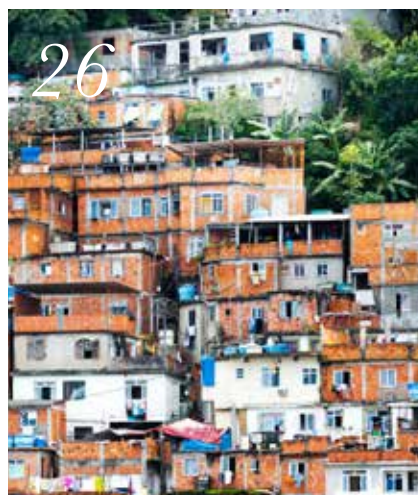
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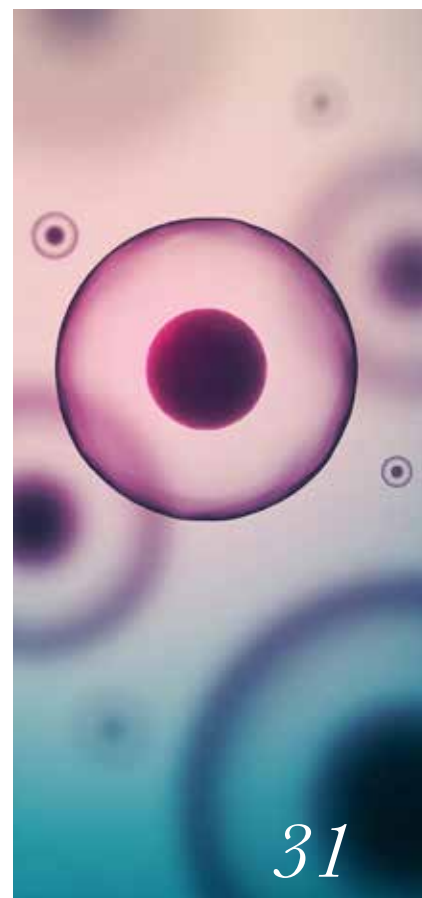
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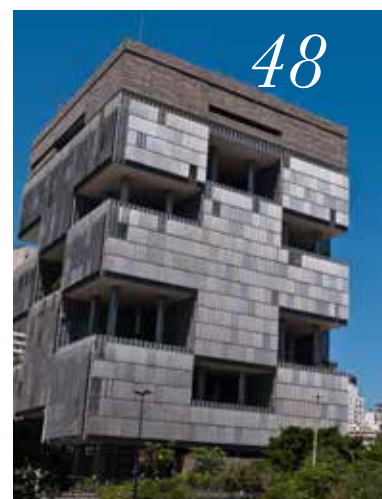
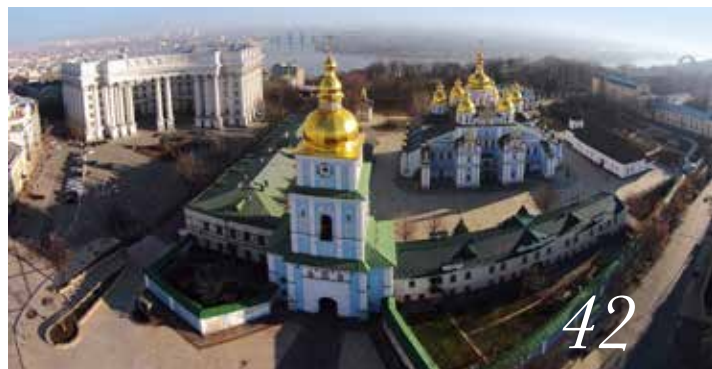
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Collapsed oil prices, multiple regime changes, and ISIS terrorism might seem ample deterrents to even the most adventurous investor, but Ahmed Maan Tabaqchali, CIO of Asia Frontier Capital's upcoming AFC Iraq Fund, insists there is opportunity in Iraq.

OPPORTUNITIES IN IRAQ

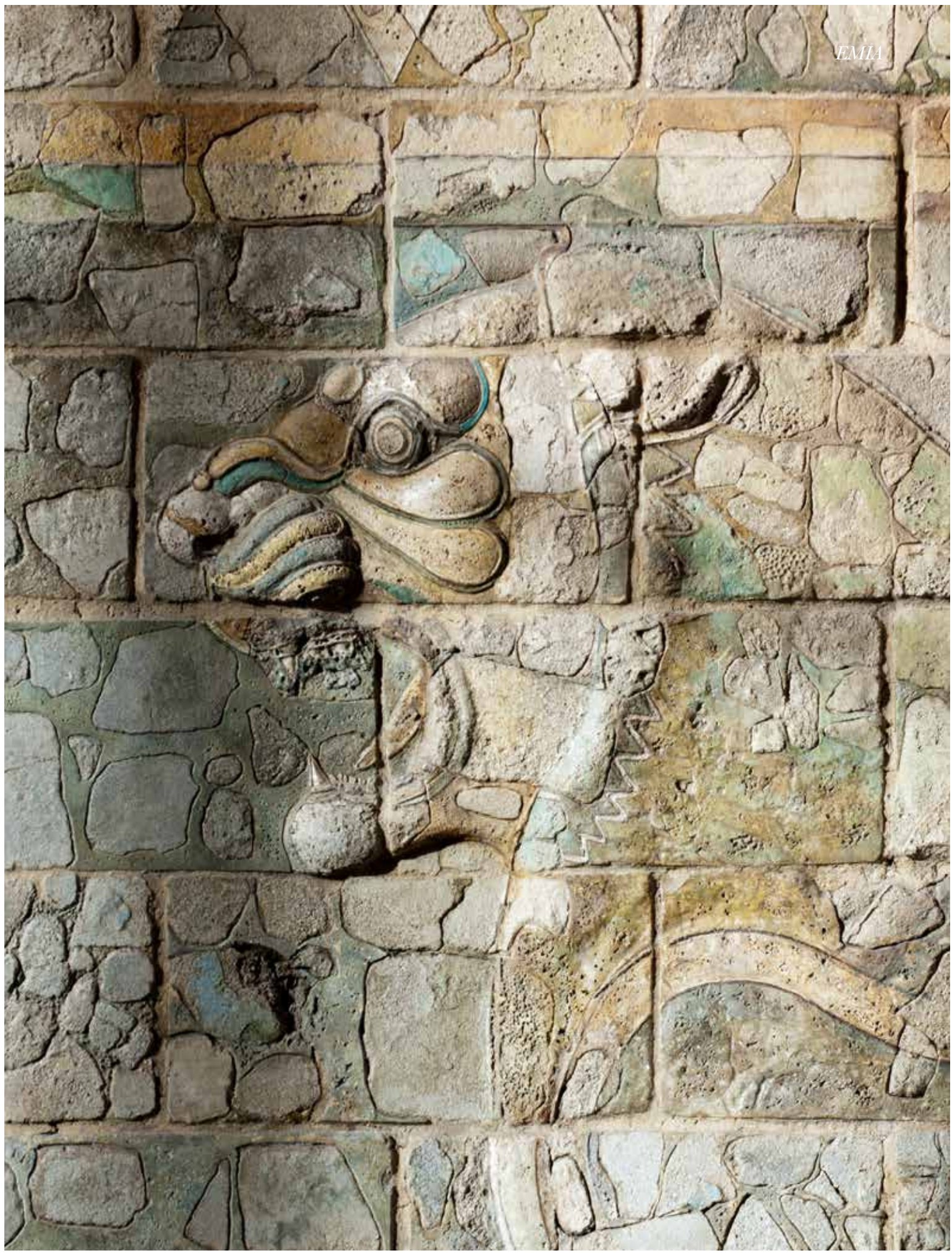
“Almost every post-conflict market gives you phenomenal returns,” Mr. Tabaqchali says. According to him, the primary reason one sees terrorist groups like ISIS growing in the Middle East is that economic growth in the region has fallen far behind other developing economies and as a result increased socioeconomic inequalities which in addition to demographic pressures, as a result of extremely young populations, has fueled socio-economic tensions. Reports by the IMF about the financial sector development in the region say that it severely lags other developing nations, and that investment in infrastructure is needed. The role of banks in Iraq is almost non-existent, and most businesses rely on self-financing from family and friends.

“If you look at the one driver of all economies, it is that they use banks and draw on credit; that has yet to happen,” says Mr. Tabaqchali. “But Iraq has a very young, quickly growing consumer population. It has resources other countries don’t get close to. Massive things can happen, corresponding to the risks. You need to go in looking at the long-term picture, seven to ten years.”

Regional differences

To the foreign investor, the Arab countries of the Middle East may seem homogeneous, but according to Mr. Tabaqchali this is far from the case.

First, there are the countries of the Gulf Cooperation Council – Kuwait, Saudi Arabia, Qatar, Oman, UAE,



and Bahrain – which are relative newcomers to the world stage. The discovery of oil has transformed them, and they have small, sparse populations. They therefore have massive resources spread over small populations.

Then there is Egypt, which has a large population and has seen economic development for the last few thousand years because of the Nile. But Egypt is resource poor with a large population. There are countries that lack extraordinary mineral wealth like oil, such as Jordan, Syria, and Lebanon.

And finally, there are countries “in between,” Iran and Iraq. They share a great deal with Egypt because they’ve had development – rivers, civilization, and history. But they also share with the Gulf enormous mineral wealth.

The potential of Iraq

What sets Iraq apart from other Middle Eastern countries? “Over the last 35 years it’s been in a state of conflict,” notes Mr. Tabaqchali. “If you go back to before 1980, it was probably one of the most advanced countries in the region. Back then, the places to be were Iraq, Iran, Egypt and Lebanon. Iraq was incredibly wealthy; it was agriculturally self-sufficient and big on the regional stage.”

“Then there was a devastating ten year war with Iran, that has claimed the lives of a million people between the two nations, which for a country with a population the size of Iraq is huge. You had the invasion of Kuwait, and the devastating war with the US in which the infra-

structure was damaged. Then you had 14 years of some of the most crippling sanctions one can imagine on the planet. After that you had the US invasion, or liberation, depending how you look at it. What was not destroyed by sanctions and neglect was completely wiped

out in the 2003 war. And then you had the civil war in Iraq as a result of American policies. And so in 35 years the country was almost sent back to the dark ages. Last year, a third of Iraq was taken over by – I don’t want to say medieval, because that would be doing medieval people a disservice. Five percent of the population is dislocated as a result.”

Even given the presence of ISIS and political turmoil, however, the GDP is seen to have declined by about 2% in 2014 (GDP is estimated

around US\$230 billion). According to Mr. Tabaqchali, this shows how powerful the country’s economy is, although its infrastructure is “completely behind the times.”

“That is how Iraq differs from other places, but also where the opportunities are,” says Mr. Tabaqchali. “The whole Middle East is, in a sense, very much still a developing market. There are massive uncertainties, but also opportunities with decent levels of exposure. Where there is more development with lower risk, there are obviously also lower rewards.”

Real economy vs. stock market

The stock market has been around since 1994, when it was set up under a previous regime, but has only been really active since 2004. There are about 80 companies in the market; with most of the market capitalization in banks (50% of total), telecom (about 34%), hotels

“The whole Middle East is, in a sense, very much still a developing market. There are massive uncertainties, but also opportunities with decent levels of exposure. Where there is more development with lower risk, there are obviously also lower rewards.”



(5.6%), Industrial (4.9%) and others making up the rest. There are a large number of companies that are non-operational. The market capitalization is under 3% of GDP, and an average day is about US\$1 million. There are two trading sessions – a continuous trading session followed by one in which pre-arranged transactions take place, taking the number up to US\$2 or 3 million. But since this is not part of regular or continuous trading, Mr. Tabaqchali does not factor it into his calculations. By that definition, he said, it's a "very thin market, with a risk that is therefore often high."

According to official figures, foreigners make up 20% of the market, but this includes the holdings of foreign-majority owned banks and foreign majority owned AsiaCell. There is probably about US\$200 million in foreign funds invested in Iraq.

Iraq's stock exchange is located in Baghdad. The market operates a T+0 settlement and therefore funds need to be transferred before trading can take place. Market capitalization was US\$9.8 billion at the start of 2014, hit US \$10.4 billion in May, dropped by 22% following the ISIS invasion to US\$ 8.1 bn in July and ended the year at US\$8.2 billion. Market cap was about \$6.6bn

by end Feb 15 (see chart showing the RSISX Index, developed by Rabee Securities, vs. the market cap from 2013)

Localized security risks

Within that, says Mr. Tabaqchali, there is a "universe of difference." Hotels are 5.6% of the market, but some stocks went up over 40% by year's end. On the other hand, some banks were up, and others fell 30% to 60%. As the market isn't big, there are a lot of special cases, and one must take special cases into account when trying to discount market behavior during the period.

In addition, as in other developing markets, the stock market does not reflect the real economy. In the whole Middle East, with the exception of Saudi Arabia, hardly any oil companies are reflected in the stock market, as almost all of them are government owned while large family businesses that are big players in the non-oil economy are not listed

"In Iraq, looking at the headline risk, you might balk and say you don't want to be there," says Mr. Tabaqch-

ali. “But although risk is very high, it’s localized plus perceived risk is much higher than actual risk. Iraq’s Kurdish region, which is safe, is different from Baghdad, which in turn is different from the south, where oil exports actually went up in 2014. There is also the real estate market, which differs in risk according to the zone. None of this is clear from just looking at stocks. Reading headlines can give you an idea that is completely off the mark in a place like Iraq.”

It is also important to take into account FDI. The World Bank and its investment arm, the IFC, have invested a combined US\$1.6 billion up to February 2014 with the IFC investing about US\$150 million a year in Iraq. The World Bank puts money into development projects, whereas the IFC invests more on the private side, such as telecoms, cement plants, hotels, and dairy farms in the north of Iraq. In the south where oil is transported by trucks, in addition to aging pipelines, a trucking logistics company from Jordan got funding from the IFC to support its contract to provide such services to the Iraqi southern port of Um Qasir.

Delays in the stock market effects of localized changes have a market-distorting effect. “Sometimes too much information is just as bad as no information,” says Mr. Tabaqchali. “People skim headline news and don’t read carefully. Today there’s a feeling that the world is over-supplied by oil. If you look at the big picture, the collapse in prices has begun to force companies to cut production. But that change will take six months to a year to materialize, and that’s not clear from just reading headlines.”

A young consumer market

“In Baghdad there’s a huge hunger for all consumer items,” says Mr. Tabaqchali. “You can get whatever you want to there. My nieces and nephews there are

buying the latest iPhones. Whatever you want is available.”

According to him, even with the collapse in oil prices, Iraq still has investment-worthy resources. Oil production is increasing, and can potentially be over 3.5 million barrels a day in 2015 and might reach 6 million barrels per day by 2020. It has the fifth largest oil reserves in the world, and its oil is the cheapest to extract. Iraq’s population is seen at about 36 million in 2014 and very young-about 56 percent of the population is under the age of 25, and two-thirds of that is under the age of 15. GDP per capita is increasing significantly.

Mr. Tabaqchali willingly admits challenges. The majority of consumption is imported goods. Very little is actually produced in the country. There’s no infrastructure. Many companies in Iraq are non-operational, facades run by the government to hire people. Previous governments just hired people; it was the easiest way to transfer oil wealth. 50% of the working population is employed by the government and SOEs (state owned enterprises).

Yet for the intelligent investor with a handle on local dynamics, Iraq contains a great deal of untapped potential: “The GCC has accumulated a surplus over the years; its population can still weather lowered oil prices for years to come. Its accumulated surplus already makes them wealthy beyond description. Where there aren’t surpluses, there are massive young populations with governments working on diversifying away from oil. That’s the case with Iraq, and that’s where the opportunity lies.”



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Companies Matter More than Countries

 **Emily Sarah Hersh**

When investing in emerging or frontier markets, the only hard and fast rule is that the rules can and will change. There is no secret, easy get-rich-quick scheme to apply, and if someone tries to offer you one, run. Fast.

A question I hear frequently from investors looking to get exposure to emerging markets is what country they should invest in. The answer is not simple, and it is in fact not the right question to be asking. Unless you're invest-



ing in government bonds or some other state-issued fixed income instrument, you're never investing in a country – you are selecting either a company or a project, and that company's location in a country is just one of several critical factors to consider.

Emerging markets each come with their own unique set of challenges, and a great business in one country can fall flat on its face in another – sometimes even neighboring – country.

Nevertheless, there are some guideposts to keep in mind with regard to countries when selecting the right company or project.

Returns are not necessarily correlated with growth

Countries with high growth rates aren't always home to the best investment opportunities. Remember that growth rates reflect how fast a country's GDP is growing. GDP can be measured a few different ways but essentially reflects consumption, investment, government spending, and net exports. High levels of government spending or a spike in global commodity prices can cause growth to

rise quickly with little to no positive impact on the business environment. Tech startups frequently come from former Soviet states with flat growth.

Rather than look for countries with high growth, take a look at the growth rate to evaluate the risk in the country where you are considering investing. See if one component, like exports or government spending, weighs too heavily on the total metric. A stable growth rate over differing market conditions is a good sign that your investment will be safe even if global market conditions shift unexpectedly.



Is it the right market? Use common sense

A great business in one country might not succeed in another. Before undertaking a thorough due diligence that involves a market analysis, use your brain. Are you considering a retail business in a country with a small, low-income population just because it has low taxes and strong growth rates? A company that relies on selling consumer goods to a broad consumer base needs that base more than it will benefit from lower taxes or fewer barriers to entry. Similarly, a company that regularly requires imported parts and machinery is not a good pick in a country with high import tariffs or other non-tariff barriers.

Before investing your time and money in hashing through IRR calculations and evaluating hopeful forward-looking financial statements, take a step back and ask yourself the following: is this a good idea and is this country the right place?

Due diligence can mean different things

When taking a bold step into a frontier market, it is critical to expect

a significant sophistication gap between the investor materials you expect from a US or European company, and what you will receive. To find out meaningful information about your potential investment, you need to dig deeper and not rely on detailed financial projections that you're unlikely to receive in the first place. Expect to have to put

Make sure you understand clearly how the money will enter and exit the country, and if any restrictions or minimum time requirements exist.

together some financial material on your own.

Make sure you understand clearly how the money will enter and exit the country, and if any restrictions or minimum time requirements exist. Factor in how foreign currency risk could affect your position.

Find another foreigner successfully doing business in the country, and have a chat about the industry

you're looking to enter. Chances are you'll learn more valuable information from that meeting than from reading every industry report ever published. Start reading the local news in the selected country to get a feel.

Work with a locally based advisor to do independent third-party verification of the material presented to you, sometimes even if it has been presented by a regulated entity. Regulatory bodies in frontier markets sometimes are not as vigilant or reliable as their OECD country counterparts.

Are your local partners' interests aligned?

As a rule of thumb, good companies in emerging markets are the product of great local people combined with equally impressive foreign partners that combine local market knowledge, industry know-how, technology, capital, and hard work to create success. If the only local "partners" are really nothing more than service providers or very uninvolved consultants, be careful. Locals who peddle their connections as professional service provision do not have a stake in the success of the business, and I have seen these "consultants" charge exorbitant monthly retainers for setting up meetings that obfuscate the company's goals,

create a snarled operating environment, and take otherwise good companies down expensive and mistake-riddled roads.

A successful company has good local partners whose fates are aligned with the success of the company. Watch out for local “consultants” whose only role is to act as gatekeepers to government officials or other service providers. These companies are not in control of their situation and become beholden to individuals who at the end of the day are not stakeholders.

A good company has at least one good local partner who is a true stakeholder. A good consultancy combines both local and international expertise and experience and provides a reliable service rather than making itself indispensable.

Involvement – Passive vs. Ownership

Before you make an investment, ensure that your role within the company is clearly defined. Are you just providing capital? What percentage of the company’s total capital are you providing, compared to the percentage of the gains to which you are entitled? Does your control over decision making reflect how much of the money you are providing, and do

you have adequate transparency to make those decisions?

An extremely common phenomenon I have seen among investors in South American countries is trickling into an investment that turns into a full-blown project. At first the foreign investor is just providing a small percentage of capital, but then circumstances require that the investor either shell out more dough or risk losing the investment entirely. Within a few years this investor has bought out unreliable local partners who put the project’s success at risk, an expensive process in itself, and then faces the even harder and more expensive task of taking full control of the project and finding new local partners. While I’ve had the pleasure of helping these clients turn these projects around, make sure you have a contingency plan in place before this happens to you.

If you are entering as a minority investor, still make sure that your rights as an investor are protected and you maintain adequate visibility to make the decision to cut your losses early on if things don’t go well. If you are providing a more significant percentage of the company’s capital at the outset, make sure that your visibility and decision-making power reflect this, as well as your percentage of the project’s returns. If you are taking control of a distressed company or project, make sure that the price you are paying justifies this, and the

majority of the investment goes to turning the show around rather than paying out past leadership.

Are there risks you missed?

Be patient when entering a frontier market, and take the time necessary to get comfortable before making a decision. The best part of frontier markets is the frontier part – if you need a few more months to understand the local regulatory environment or the company culture, take them. Things move more slowly in emerging markets and it is exceptionally unlikely that hordes of highly liquid investors will charge past you and cut you out of an opportunity if you have the cash and are willing to make an investment. Do a few background checks on your potential local partners, commission a specific market study, and compare your options.

If you take just one thing away from this article, let it be this: Know your corporate structure. In most emerging markets, your corporate structure (corporation, LLC, etc.) will not be as simple as in your home country. There might be physical books that are legally required to be updated a specific way and kept in a certain location. There might be bureaucratically maddening import/export registrations that must be kept up to date at all times, requiring someone to take a monthly

trip to a tiny provincial government building that is only open once a week. There might be bearer shares.

I tell my clients that your corporate structure is like your vehicle in a potentially hostile environment – it's there to protect you. Double and triple checking that you're not putting money into a company that has tax or regulatory liability that will create expensive future problems is vital. It's like checking your truck's tires and fluids before driving across the desert: do it twice, bring a spare, and don't skip steps.

A company with preventable liabilities will stop you in your tracks faster than a flat tire in the Atacama Desert. A good advisor will serve as a satellite phone and get you out of trouble, but you'd be better off avoiding it.

Investing in emerging markets is where the action and high returns are. When done properly it is the most rewarding venture in the world, so do some research, roll up your sleeves, and get ready for an exciting ride.

About the author

Emily Sarah Hersh is a Managing Partner and COO of DCDB Group. She works primarily out of the company's DCDB Research office in Buenos Aires, Argentina, and specializes in projects involving resource extraction and commodity export.



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Economic Recovery in Greece, but Huge Political Uncertainty

 **By Petar Chavdarov in Bulgaria**
CEIC Analyst

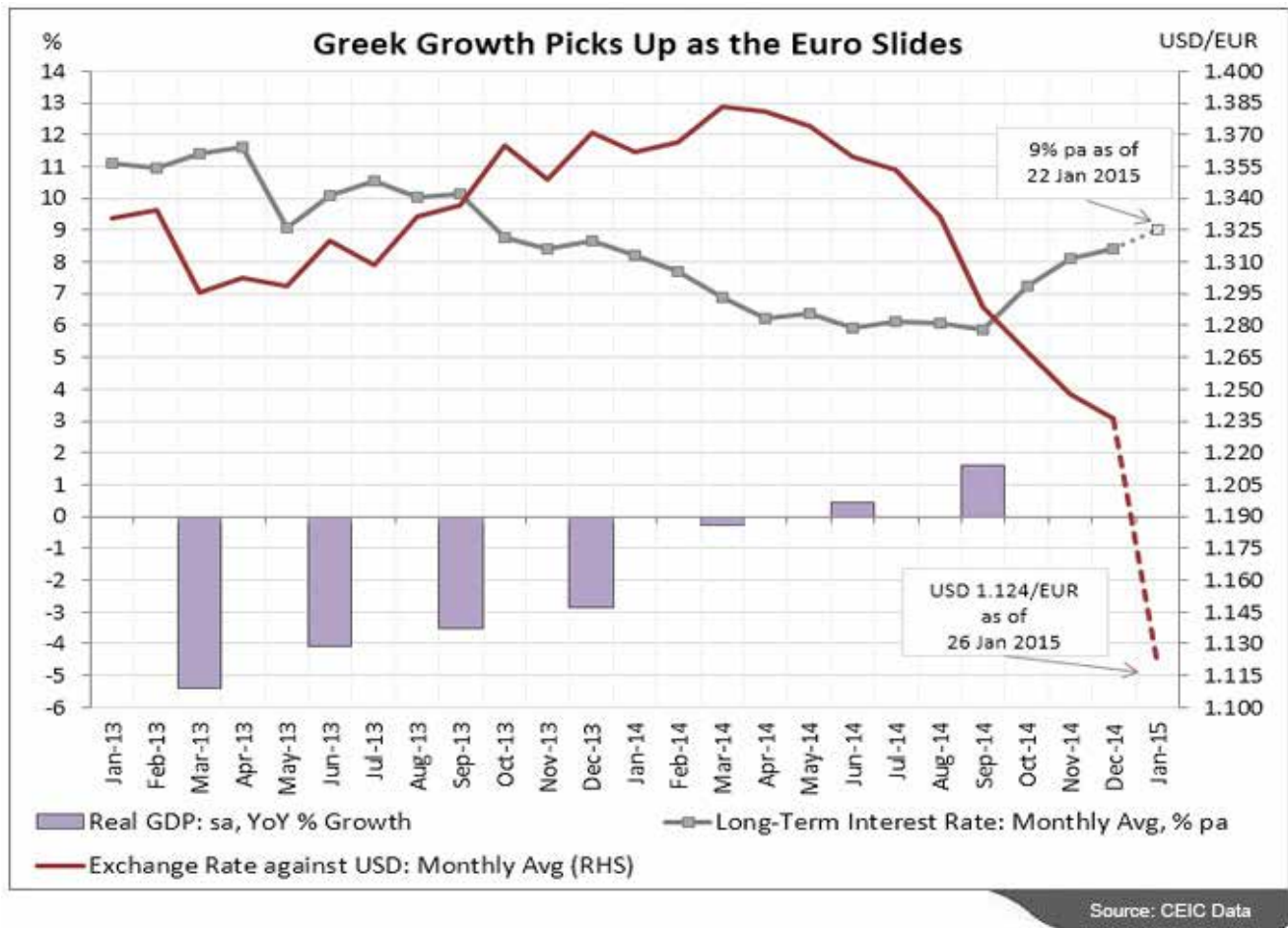
Seasonally-adjusted real GDP reached EUR 46.9 billion in Greece during the third quarter of 2014, marking a 0.7% increase compared to the previous quarter and 1.6% on an annual basis. The positive trend in Greek GDP started in the second quarter of last year when the economy grew by 0.4% compared to the same quarter in 2013. This was the first time in 24 quarters a positive GDP growth rate was recorded. The main drivers have been tourism revenues and the recovery in private spending.

However, the economic woes of the country are still present, shaken by the political and economic uncer-

tainty stemming from the victory of the far-left party Syriza in the parliamentary elections held on January 25th, which is considered pivotal in the country's post-1974 democratic history. The party opposes the austerity measures proposed by the Troika of lenders, thus bringing the country closer to an exit from the euro area – although Syriza is ruling out the option – and laying the ground for radical changes in economic policies, including a new debt restructuring programme to restore Greece back to health.

Invariably the financial markets have reacted negatively, fearing the consequences. Greek govern-

ment bond yields have been rising since October 2014 to reach an average of 8.42% pa in December 2014, and continued their upsurge in January this year above 9% pa for 10-year government bonds, contrasting with the falls to record lows in other Eurozone sovereign debt yields. Growing fears that the country might abandon the single currency (although still an extreme scenario), highlight the prospect of its total government debt default, so selling government securities is again on the agenda of investors. Greece is already in partial default and its huge debt stock will possibly see more write-offs, whether the “Grexit” transpires or not.



The uncertainty has also seen the Athens Stock Exchange index (ASE) plummeting during the past few months. The free fall of the stock exchange index began in April last year and by end-December it had reached 826.18, decreasing by 14.2% on a monthly basis and 28.9% compared to the same month of the previous year. It subsequently fell further to 782.88 by January 21st, 2015, and despite the

slight pickup a few days later, landing at 813.55 on January 26th, the day after the election, the prospects of stabilisation look grim, given the situation in Greece and in the wider Eurozone.

Falling consumer prices in the Eurozone and the depreciating currency are also fostering bearish sentiment among investors. The euro depreciated to an average of 1.2359 against

the US dollar in December 2014, a nine-year monthly average low. The single currency dropped by 0.9% compared to the previous month, and by 9.8% on an annual basis. The plunge continued into 2015, as the exchange rate dropped below USD 1.12/EUR by late-January. Due to the slump in oil prices, inflation in the euro area has been eradicated, delivering annual deflation of -0.16% in December 2014.

Mineral Mining Helps Sustain Vital Economic Stability in Jordan

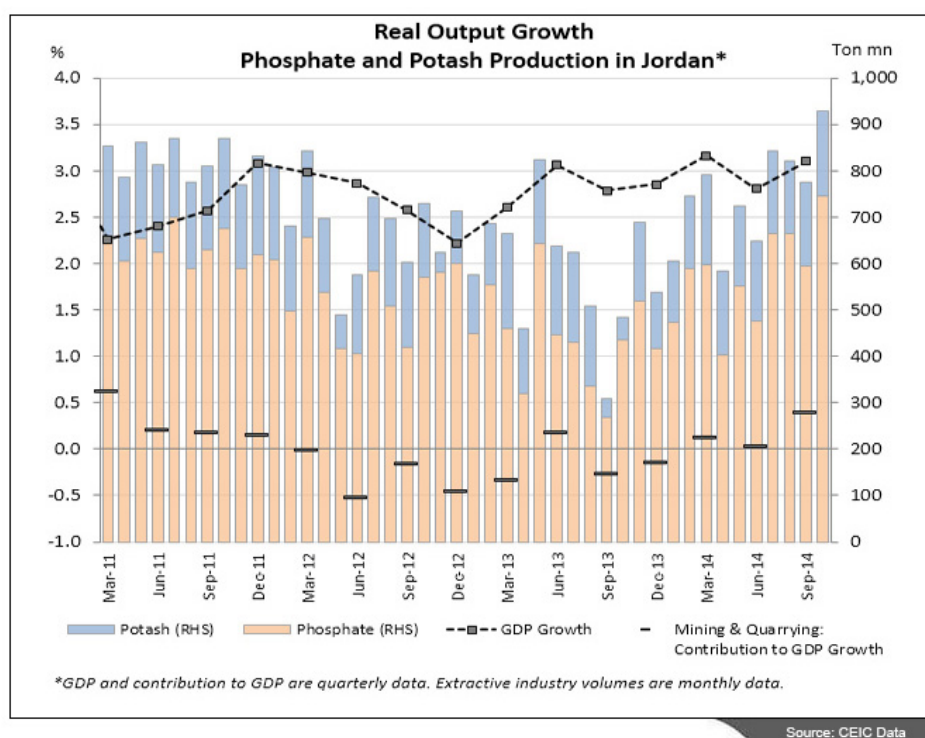
 **By Stoyan Kiryazov in Bulgaria**
CEIC Analyst

The extraction of phosphate and potash ores, mainly used in fertilizer production, is an integral part of the Jordanian mining and quarrying sector, and is of international significance as the country is one of the world's largest producers. Phosphate pro-

duction reached 746.2 thousand tons in October 2014 – its highest level in reported history (going back to 1975). Potash volumes remained stable at an average of 170 thousand tons per month from the beginning of 2014, hitting 182.9 thousand tons in October and clos-

ing in on the record 2011 annual average of 188 thousand tons.

Despite having registered a mostly negative contribution to gross domestic product (GDP) growth for the period 2012-2013, the mining and quarrying industry has historically been an important driver of output growth in the country. In the third quarter of 2014, mining contributed 0.4% to a real GDP growth rate of 3.1% year-on-year. While global demand for mineral products faces major risks amid a strong US dollar and a downtrend in commodity prices in general, should international conditions prove favourable, phosphate and potash production, and the related fertilizer exports, will continue to be important sources of income for the Jordanian economy in 2015.



The Philippines Leads the World in Nickel Production

 **By Claudia Carbonell in Philippines**
CEIC Analyst

Since 2011, there has been an unprecedented nickel mining production boom in the Philippines, outgrowing traditionally large nickel producing countries such as Australia, Indonesia and Russia. According to the US

Geological Survey, the Philippines' production grew at a compound annualized growth rate (CAGR) of 40.4% between 2008 and 2013 to 440 thousand metric tons (17.7% of total world production in 2013), to become the world's largest nick-

el producer during 2012 and 2013. In contrast, total world production only grew by 9.1% (CAGR) in the same period. Following the Indonesian government's move to ban the exports of unprocessed ores, the Philippines emerged as the chief supplier of nickel ore to China's enormous nickel pig iron (NPI) industry.

The Philippine's rise in nickel production contributed positively to its economy as gross value added (GVA) of the nickel mining sector grew to 0.19% of GDP during 2012 from 0.06% of GDP in 2008, before falling moderately to 0.15% of GDP in 2013. Its year-to-date GVA has risen again to PHP 20.97 billion (0.23% of GDP), as measured during the first nine months of 2014, surpassing its previous annual record in 2012 of PHP 19.91 billion.



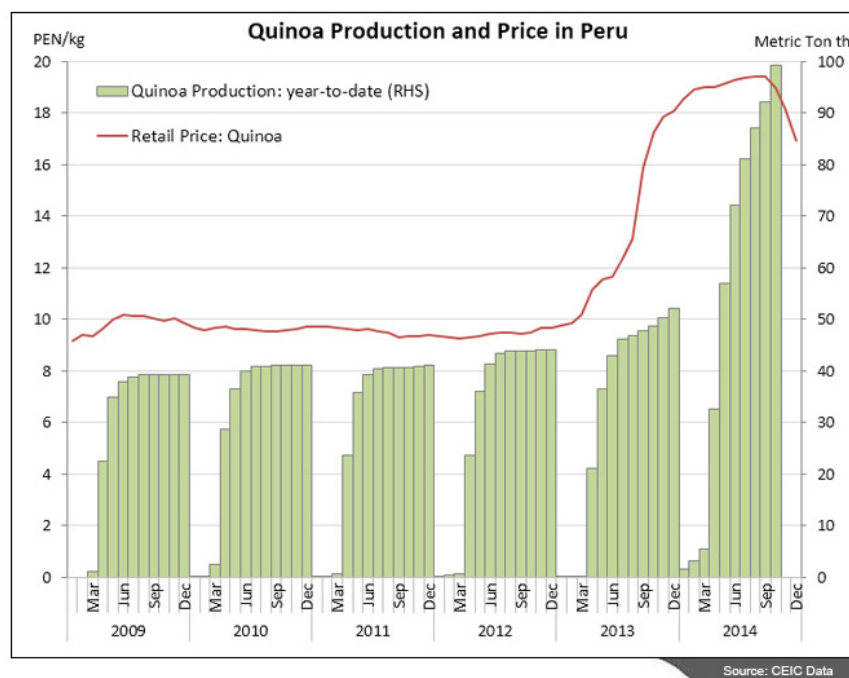
Sharp Rise in Peru's Quinoa Production

 **By Woon Khai Jhek in Malaysia**
CEIC Analyst

It is estimated that Peru will double its annual production of quinoa in 2014, a type of grain native to the Andean region. Having already produced 99.3 thousand metric tons (MT) during the first ten months of 2014, representing 103.8% growth over the same period of the previous year, the year-to-date production is already a large step up from the levels in 2012 and 2013, which were respectively 44.2 thousand MT and 52.1 thousand MT. The increased quinoa production growth stems from a 24.0% expansion of sown area to 57.1 thousand hectares in 2013. The extensive cultivation and production of the cereal are also largely in response to surging global demand, which is attributable to recent recognition that quinoa is one of the world's most nutritious foods. Although the rise in demand provides new opportunities for this Latin American economy (hitherto

driven by its huge copper industry), excess external demand has pushed quinoa prices upwards to an unaffordable level for its citizens, who are the traditional consumers of the grain. Retail prices of quinoa hit a peak of 19.41 Peruvian Nuevo Sols (PEN) per kg in August 2014 (about

USD 6.5/kg), jumping from PEN 9.50/kg two years ago. By the end of December retail prices had moderated somewhat to PEN 16.94/kg. In comparison, packed superior rice only retailed for PEN 3.65/kg in December 2014.



Eurasian Currencies Fall, Hurt by the Russian Rouble

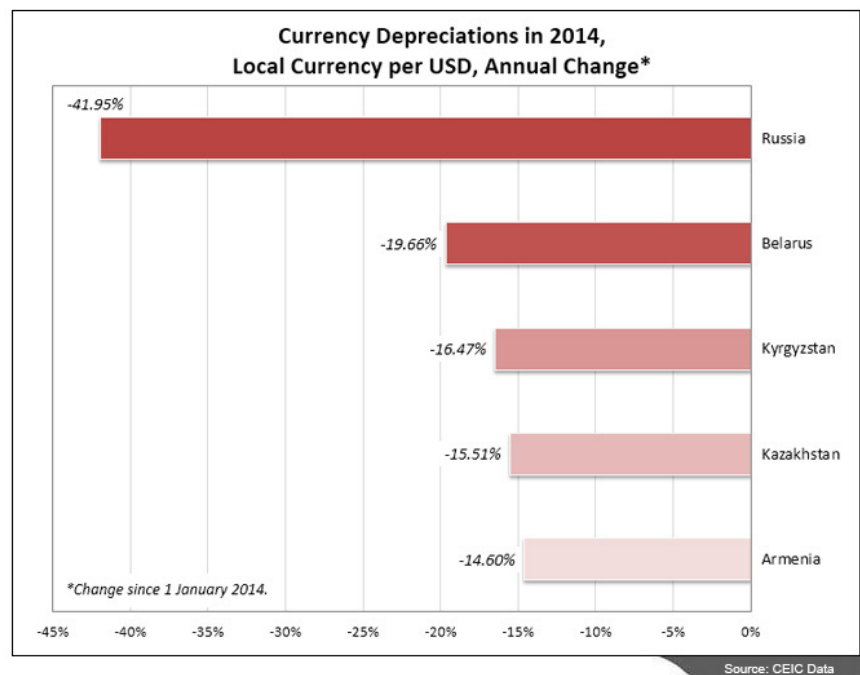
 **By Kamen Parushev in Bulgaria**
CEIC Analyst

As the Russian rouble struggles amid the plummeting price of oil and Western sanctions, it is also dragging down the currencies of the newly-created Eurasian Economic Union (EEU). The economic alliance, which came into effect on January 1st, 2015, was established by four member states – Armenia, Belarus, Kazakhstan and Russia, while Kyrgyzstan is expected to join the pact later this year.

The EEU is heading for a rough start, however, as Russia's economic woes are already hurting the sovereign currencies of its member states. In 2014 the Russian rouble lost more than 40% of its value against the US dollar. This event had major spillover effects across the region, leading to sharp, synchronised depreciations

of a number of currencies, such as the Belarusian rouble (-19.66%), the Kyrgyzstani som (-16.47%), the Kazakhstani tenge (-15.51%), and the Armenian dram (-14.60%). Thus, the EEU countries may face

further economic challenges, such as higher inflation rates and diminishing disposable income, as the downfall of the currencies in the alliance continues into 2015.





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About the Author

CEIC Data, www.ceicdata.com a product of Euromoney Institutional Investor, was established in 1992. CEIC specializes in providing high-quality and comprehensive macro-economic, industrial and financial time-series data for over 128 countries. Our reliable datasets, many of them only available electronically via CEIC, are sourced from 1000 primary sources, including national statistical offices, central banks and financial exchanges. In addition to our headquarters in Hong Kong, CEIC operates in more than 30 offices worldwide and has over 100 professionals supporting its several thousand subscribers across global banking, financial, corporate, consulting and academic institutions.

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Microfinance: a Questionable Investment for LPs

 **Felix Villalba**

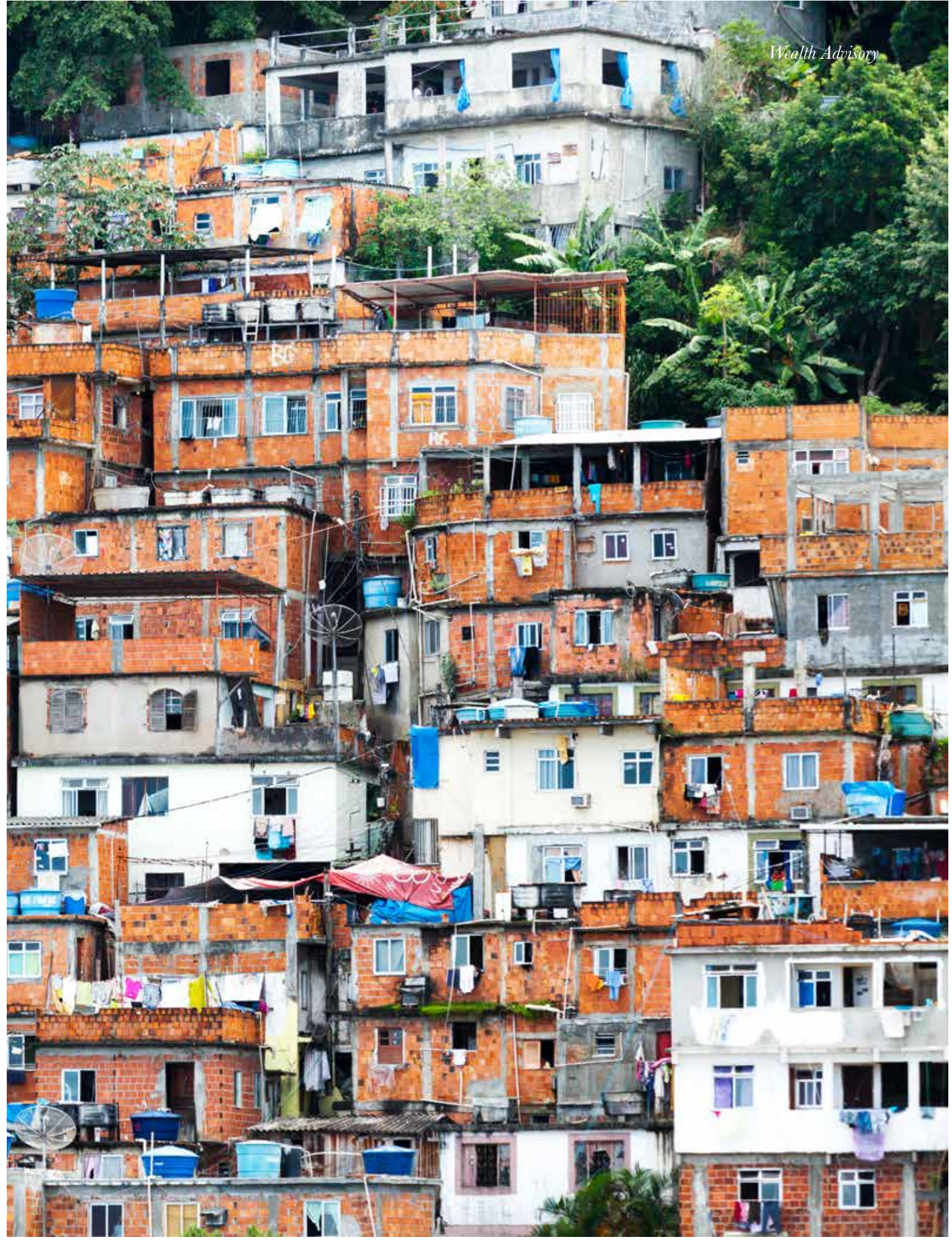
Earlier this year I traveled as a consultant to a hedge fund interested in investing in microfinance in Mexico. I have significant experience in financial services, mainly leasing, factoring, private label credit cards, and inventory financing. However, I had not worked with microfinance. An LP/Angel investor invited me on this trip to Mexico to accompany the newly minted GP and give him advice on how to do business in Latin America.

The LP that invited me on this trip presented this as a great money making opportunity while doing “something good for poor people.” The thesis sounded compelling, especially coming

from a Cornell professor. However, I was surprised to find myself in Mexico with the poorest of the poor and accompanied by a greedy, inexperienced, overly aggressive fellow who had no interest in anything oth-

er than the 100 percent-plus annualized internal rates of return charged by these Mexican microfinance institutions (MFIs). My advice to the LP: one has to be careful where one places money because it is not just about the returns.

We visited some of the potential customers: poor people living in cardboard homes and struggling to make ends meet. They struggle day in and day out to put food on their table. I was sick to my stomach thinking that these lending institutions were making 100%-plus per year on the backs of these miserable folks. Financial products are not easy to understand, so it was clear to me that these lenders are taking advantage of their target market’s ignorance.



The ethics of lending at such high rates to the poorest of the poor: shame, shame, shame!

Primer on microfinance

Real microfinance as defined by its founder, Nobel Laureate Muhammad Yunus, is supposed to be a “social business” whereby the money invested is neither charity nor a handout, but never a way for investors to get rich fast. The money is not charity because it comes back to the lender and can be redeployed time and time again. Therefore, this capital can do more good for many others who need the capital desperately to invest in their small business and escape the miserable conditions they experience. It is not a one-time donation. On the other side of the spectrum, microfinance cannot be solely for profit, or it edges into the territory of getting rich on the misery of others.

Micro credits are designed as group loans. These lending groups are typically 10 to 12 women and include a lead person and even a treasurer in the group. Each individual is assigned a credit line, and all in the group are mutually responsible for each other. This setup creates the commitment against loan default that an unsecured lender requires, so microfinance loans typically have default rates of less than 2 to 3 percent. The loan officer is a key

ingredient in these loans, as they are required to organize the groups and help them manage the intricacies of being a borrower. This is no easy task when dealing with people who may at best know how to read and write.

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One does not need to have grown up in a developing country to realize that people who lack basic education are therefore in many ways as helpless as children are. Well-educated individuals can easily take advantage of the less fortunate under the right circumstances. It is therefore the responsibility of GPs and LPs to realize that investing in

“socially responsible” investments can get them into trouble. As an LP you have to do your homework and not end up with a similar situation to the one I found in Mexico with this particular GP. This GP could not have cared less about the welfare of people who cannot access traditional financing, and only had one thing in mind: high returns for investors. That is a great goal if you are not “investing” in a place where you could hurt the needy.

Mexico’s microfinance industry

Microfinance loans in Mexico are typically marketed with weekly pesos-per-thousand repayment schedules. For example, a 16-week loan is to be repaid weekly at 72 pesos for every 1,000 pesos borrowed. This amortization schedule translates to one of the least expensive, but it is still an insane 88.2% annualized real interest rate. No wonder that Banco Compartamos is one of the most profitable banks worldwide, and that Muhammad Yunus does not want to be associated with that name. All this immense profitability (Returns on Equity north of 50%) rests on the backs of the poorest of the poor. If you are a pension fund, would you like to be on the news with the headline “Vulture Pension Fund Steals from the Poor” or worse?

Mexico is a country with a very large gap between rich and poor. As an investor in emerging markets, it is best to be careful and not end up participating in the widening of this gap.

Populism in Latin America

In Latin America populist movements are gaining force, rooted in a mix of socialism, widespread ignorance, desperation, and misery – and fueled by power-hungry politicians and overly aggressive investors. While well-run capitalistic democracies solve many of these issues, they only do so if governments provide some basic protections, and those with capital pay close attention to how and where they deploy that capital.

Not all of Latin America is like Mexico. In Colombia, for example, there are usury rules in place for microfinance, precisely because of the realization that unabated capitalism can go awry. The usury rate in Colombia for micro credit is currently about 50 percent.

US investors coming into Latin America (or any other emerging market) with the sole goal of making money no matter what, and with overly aggressive GPs that ask tons of questions but listen to no answers, will never understand that they are sowing the seeds of populist governments in Latin America

(like Venezuela). There is serious responsibility in investing. There are serious positive or negative consequences.

Not all of Latin America is like Mexico. In Colombia, for example, there are usury rules in place for microfinance, precisely because of the realization that unabated capitalism can go awry.

Counter arguments

There are many who try to justify this situation. Here are some of the arguments:

Inflation-adjusted rates are lower. Look up Mexico's inflation average (it's only 4%).

Competition increases with more investment. Again, this is flawed because it ignores the differences between oligopolies and perfect competition. In emerging markets, all money-related industries (financial services) tend to behave more like oligopolies. As such, they will by definition have the tendency to treat customers unfairly. In the case of MFIs the customers are the most needy human beings. These are people who struggle to meet the most basic of human needs. Many of them live in “casas de ojalata.” Most of them have a very limited level of education. Presenting complex issues to them can and does confuse them. This is fodder for abuse because they simply lack the ability to compare financial products.

In visiting potential customers, this was clear when one group leader thought that microfinance would be better for her than her credit card. She said she liked the fact that with microfinance she would receive hard cash but the credit card was for “spending.” She could have easily received cash through her credit card as well, and this would have saved her over 30% in annualized interest. It was clear she did not realize the cost of money involved in her decision. This individual sold clothing out of her modest home to help her family survive.

Costs per loan. Many argue that the cost per loan for MFIs is simply too high given that the loan amounts are so small and the structure requires

a lot of handholding. However, all one has to do in Mexico is look at the enormous Return on Equity of Banco Compartamos to realize that this is simply not true. Any further analysis is simply unnecessary.

You can do business with the poor while earning a fair profit. But you cannot simply focus on maximizing profit when doing business with the poor. And you do have an ethical responsibility to avoid harming others in business, especially when it comes to the desperately poor. If you are an LP and you are offered

to invest in microfinance in Mexico, beware that you will be investing in something that your constituents may not agree with. If you “invest” in this, it should be with a charitable slant. Making double-digit IRRs north of 15 to 20 percent on the backs of the poorest of the poor will only get you in trouble in a region of the world with growing populist movements. In fact, I’m glad I did not charge a dime for my recent “consulting,” and if I were to profit from it, I would be inclined to donate the proceeds, beyond covering my costs.

MFIs should by definition be not-for-profit endeavors or have a limited profit that provides for average market returns on investment. Microfinance should *not* be associated with hedge funds dedicated to profit maximization and looking for above-average returns. It is simply unethical.

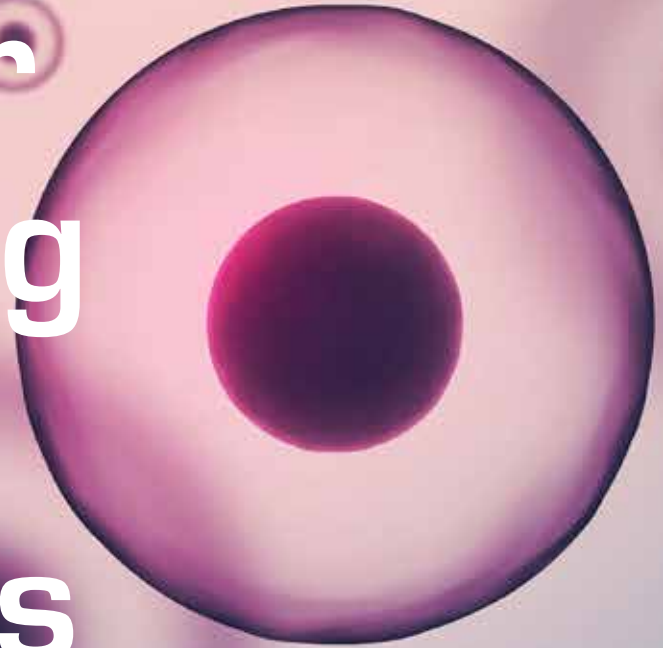
About the Author



Felix has over 15 years of experience on both the operating side and the investment side of business transactions. After his MBA, Felix worked for captive financial services companies at Dell and Whirlpool, and later spent over five years as CFO with two venture backed technology companies. Dell’s successful effort to start Dell Financial Services marked Felix’s official involvement in the venture industry in 1997. It was after that when he joined an Austin Ventures backed company that later led to his joining Pacesetter Capital Group. At Pacesetter, Private Equity firm, he was Vice President and served as Portfolio Manager for several inherited deals, some of which required intervention strategies. In 2009, Felix formed his own Private Equity management firm, Accordo LLC and raised Accordo Fund 1 and 2 placing investments in residential and hospitality developments in Colombia.

Felix is a graduate of the University of Notre Dame with three degrees, a Masters in Business Administration, a B.S. in Civil Engineering, and a B.A. in Economics. He successfully completed the Harvard Business School’s Executive Management Development Program.

New Research Tools for Emerging Market Investors



 **Anthony Vinci**

New technologies are heralding a renaissance in emerging market research. Traditionally, emerging market research has been hamstrung by poor availability of data and a general lack of proper infrastructure. This is changing as new technologies, ranging from smartphones to widely available satellite imagery to mini-drones, provide entirely new avenues for collecting data. Emerging markets investors who take advantage of these technologies will have a distinct competitive edge.

Emerging markets often lack the basic infrastructure for effective data collection, including reliable communication or transportation infrastructure. “Brain drain” and a lack of educational institutions can leave certain countries without the human capital to perform research. In parallel, government-collected data in emerging markets may often be methodologically weak, biased, or, in many cases, completely lacking.

This state of affairs has often left emerging market investors with few choices for data and research. The United Nations and other international NGOs may provide some modicum of professionally collected data, but this data does not necessarily meet investor demands. More often than not, emerging market investors turn to bespoke data collection by due diligence firms or market researchers. These companies can provide a quality research product, but it is often expensive and the datasets may not meet the scope or timeliness that investors demand.

The spread of new technologies around the world over the last decade is changing the face of data collection and research in emerging markets. Let’s review of some of these new technologies:

Smartphones

The smartphone is at the heart of great change in emerging mar-

kets. The lack of a requirement for fixed-line telecom infrastructure has allowed the cellular phone to spread rapidly nearly everywhere around the world. Lower priced smartphones have meant that this technology too has spread. Indeed, projections point to there being two billion smartphones in the world by 2016. Compared with the price of computers, smartphones are much less expensive and require far less electricity; they are in effect becoming one of the primary means for accessing the Internet in emerging markets. More access to the Internet at the local level in emerging markets prompts more access to local information by those outside of emerging markets.

Translation

Foreign language understanding is the great obstacle of emerging market research. Traditionally, researchers have been forced to enlist the help of interpreters. New translation technology is changing this status quo. Google Translate offers dozens of languages for translation, and now Skype is offering an early version of instantaneous translation. While this technology is admittedly still rough, it is easy to imagine a world in which translation does not stand in the way of research. This will greatly open the realm of possible data sources for any emerging market investor, regardless of their language skills.

Data collection

New mechanisms for collecting data from local sources are on their way. Bespoke research is great for investors because it provides exactly what you need and gives a competitive edge by being unique. But it can be expensive and slow. My company, Findyr, for example, takes advantage of the proliferation of smartphones to collect data on the ground around the world. Findyr allows users to task locals in over 100 countries to collect data, perform offline consumer surveys, and even take photos and videos. Imagine, for instance, requesting a targeted inflation index based on a basket of goods you choose in cities like Gulu, Uganda, or Chengdu, China. Such technology is an entirely new way for investors to obtain on-the-ground information more efficiently, for less cost and much faster than through traditional means.

Social media data

Social networks and social media provide entirely new datasets, which lend themselves well to emerging market research. Twitter feeds, for example, are now regularly used as an avenue to track trends and public opinion in near-real time. This is something that anyone watching CNN in the United States will no doubt be aware of. Such datasets are also available for most emerging markets. Indeed, a new trend in social media is for non-US

social networks to form organically in emerging markets. Sina Weibo, for example, is a massive Chinese social network. Investors who can tap into these datasets will have a significant advantage over those who only rely on US-based social networks.

Satellite imagery

During the Cold War, satellite imagery was once the most secret of secret data sources, but now it is ubiquitous. Google Earth and similar satellite image sources provide unbelievable access to high-quality satellite imagery. More generally, geospatial analysis software has heralded an entirely new approach to organizing and analyzing information. It's likely that any emerging market researcher has used satellite imagery at some point during their research process, even if only to quickly determine the location of a city or view a geographical area. But satellite imagery and geospatial data is about more than just finding locations. Tracking changes in satellite imagery over time, for example, can give lead-turning insight into economic changes on the ground. New companies like Skybox and Planet Labs are meeting this demand by launching smaller, more agile satellites that will give users ongoing ground imagery in near-real time.

Drones

Drones present a new and unique avenue for market research. Aerial

reconnaissance has long been the purview of the military. Now it is becoming a real option for any researcher. Unlike satellite images, drone footage can provide real-time images and full-motion video in a much more agile manner and at a lower cost. The inclusion of different sensors on these drones beyond standard photos and videos, such as hyperspectral imaging, opens up their value even further. Although the US Federal Aviation Administration has been slow to regulate drone use, they are legal in many emerging markets.

Gaining a competitive advantage in emerging markets

Many investors who turn to emerging markets are seeking a competitive advantage and outsized returns. Such investors are accustomed to ambiguity and making decisions with less information than their developed market investor brethren. However, there is significant room for emerging market investors to increase their competitive advantage through the use of new technologies. Smartphones, social networks, satellite imagery, and drones all provide a means for obtaining on-the-ground information even in locations where traditional communication and education-

al infrastructure may be lacking. Those investors who embrace these technologies to their fullest will no doubt be the investors who outperform in the coming years.



About the author

Anthony Vinci is the Founder and CEO of Findyr, the global marketplace for local information. Previously, Mr. Vinci co-founded Frontier Data Corp, a company focused on providing micro-economic data from frontier and emerging markets. He has spent over 15 years working in the technology and market research industries. Mr. Vinci obtained his PhD in International Relations from The London School of Economics, and he performed fieldwork throughout Africa and the Middle East.

Sailing in Turbulent Waters:

Strengths and Opportunities in Unstable Scenarios

 **Javier Canosa**

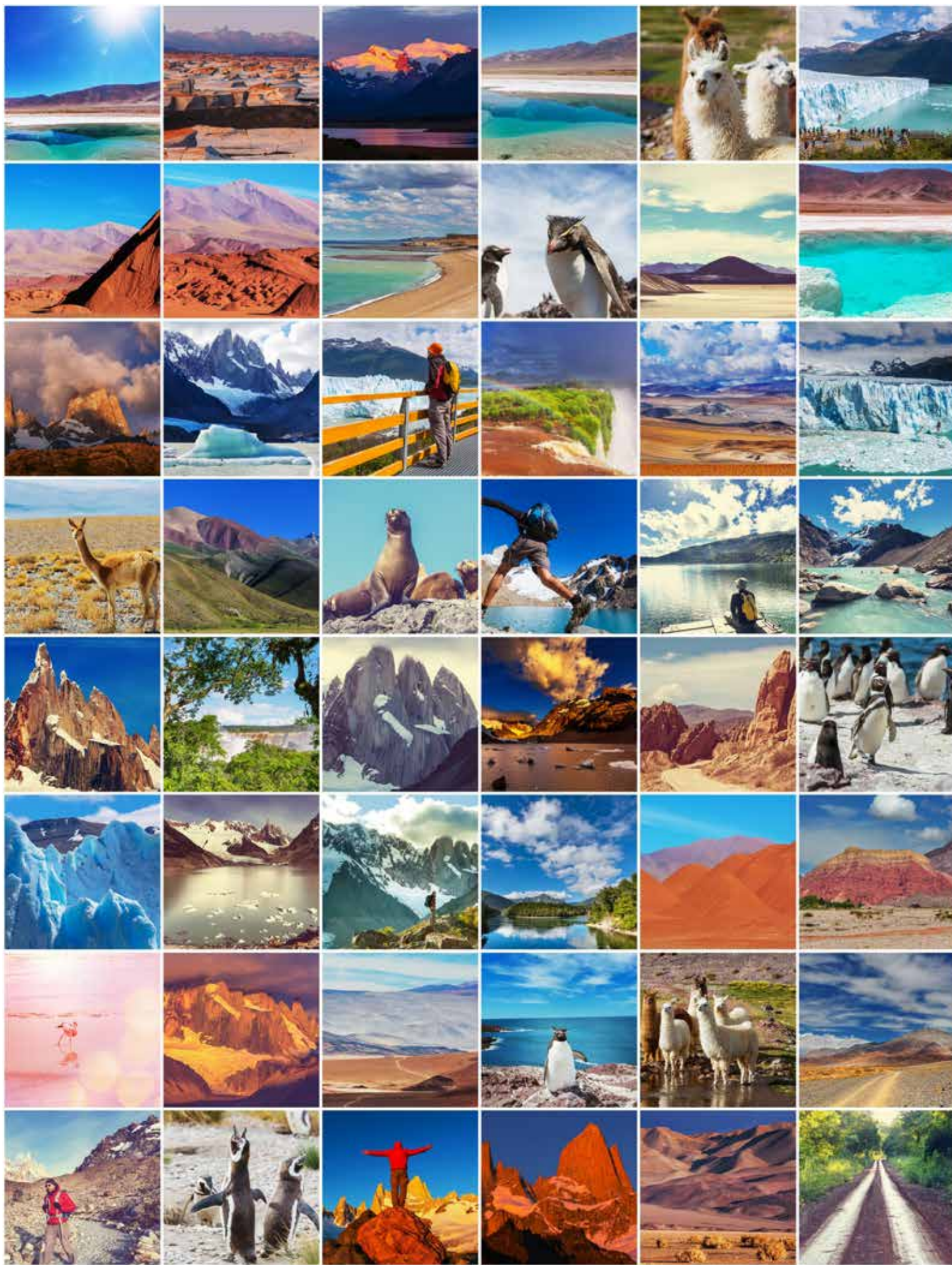
In the last couple of years I have been listening to the same questions: What is going on in Argentina? What are the opportunities in Argentina? Is now the time to get in? What can we expect for the next two years in Argentina?

First, I like to remind people that in Argentina the long term is one or two years and the short term means the current month, so any analysis should necessarily be short-term oriented, bearing in mind the ba-

sic fundamentals of the Argentine economy – great agriculture potential, good living standards, attractive real estate, tourism potential, mining potential, etc.

Now, let us briefly recall how this story began; how the exchange controls came about. In October 2011 – after winning the presidential election with 54% of the vote – the Argentine government imposed exchange controls “in order to comply with international anti-money laun-

dering standards.” This meant that before purchasing foreign currency, individuals and companies resident in Argentina needed to prove the “origin of their funds and have sufficient economic capacity to acquire foreign currency.” Soon these arguments became insufficient and the control system became more professionalized, limiting many of the customary foreign exchange operations in any country such as imports or acquisitions for savings.



These exchange controls soon brought about different rates of exchange because most of the transactions in foreign currency required government approval. In principle we had the official rate (applicable to certain transactions, exports, certain credit card expenses), the unofficial rate of exchange that applies to transactions between parties where there is no intervention of the government, and soon other rates of exchange came about, such as the “contado con liqui,” explained below.

From the beginning of the exchange controls, there was a method for legally acquiring foreign currency: the purchase with local currency (through a local Argentine stock broker) of bonds or shares in the local Argentine stock market, the subsequent assignment or transfer of such bonds to a foreign broker institution, and the ultimate sale of securities in a foreign market. In order for this system to operate you need an Argentine bank account, a US bank account, an Argentine brokerage account, and a US brokerage account.

The system is quite simple, and the use of it implies the existence of an underlying rate of exchange between the dollar and the peso for these types of transactions. Basically, the price in pesos of securities (ADRs or bonds) that are also traded in other markets normally reflects this differential rate of exchange, which is of course higher

than the official rate of exchange and lower than the unofficial rate of exchange. To convey this, currently (February 12, 2015) the official rate of exchange is ARS8.70 per US dollar, the “contado con liqui” rate of exchange is ARS12.42, and the unofficial rate of exchange is ARS13.20 per US dollar.

How to access the different rates of exchange

Naturally, these parallel exchange rates work both ways and can also be used by foreign investors willing to enter the Argentine market and invest in Argentina. Therefore, provided that the conditions of the rules are met, foreign investors may be able to access the Argentine market at a rate of exchange substantially higher than the official rate of exchange.

What assets can be purchased like this? Any peso-denominated asset in Argentina, such as real estate, private equity, securities, capital goods, machinery, etc. – even as collateral for other obligations.

Of course, it may be a little bit more complicated when applied in reverse (specifically the “contado con liqui”) because the funds would not have been generated in Argentina by a non-Argentine entity and therefore one would need to have

the foreign entity registered in Argentina as a branch of the foreign entity with the investable assets. Why is this? Well, the reverse process would be the following: let us say a US entity has US dollars in its bank account, then this entity purchases securities (public bonds or Argentine ADRs), subsequently this entity transfers to the same entity in Argentina such securities and then sells the securities in Argentina.

The issue is how to open a brokerage account for a non-Argentine entity. The only way a non-Argentine entity would have to operate in Argentina is as the branch of a foreign entity as set forth in section 118 of the Argentine companies law.

The foreign entity needs to obtain certified copies of its bylaws, minutes approving the opening of a branch in Argentina, and the appointment of a legal representative in Argentina (with sufficient powers to operate the branch). In addition, the foreign company seeking to exploit this differential rate of exchange will have to prove it has economic activity and/or substantial assets in its home jurisdiction. If it cannot prove substance, or if the company was incorporated in an International Financial Center (or offshore center or low or zero tax jurisdiction), the company could be registered as a “special purpose vehicle” (SPV) of another company or an individual with substantial assets in its home jurisdiction.

All those documents need to be translated and filed with the Public Registry of Commerce in Argentina (PRC) in order to obtain registration of such foreign entity before the PRC.

Once the company has been registered it will have to be registered with the tax authorities, demonstrating sufficient evidence of the existence of an actual domicile in Argentina.

After registration before the PRC and the tax authorities, the company may go ahead and be able to open a brokerage account and a bank account in Argentina and carry out the reverse operation of the “contado con liqui.”

Looking ahead

The “contado con liqui” demonstrates the existence of two legally applicable rates of exchange (the official rate and the “contado con liqui”), which provides Argentine companies and individuals with a mechanism for accessing foreign currency, and allows foreign entities or individuals to access local currency at a more favorable rate than the official rate, promoting investments in Argentina.

The risk associated with this operation is that there could be a run against the local currency, and the value of the assets could depreciate in the short term (Argentine rules

provide for a 72-hour hold on the securities), or that there could be a political conflict, and the investments entered into in Argentina might not be considered “capital investment” and would not enjoy the protection of the bilateral investment treaties executed by Argentina.



About the Author

Javier is a partner in the BA firm Canosa Abogados. Javier's practice develops in corporate law issues, advising several national and foreign companies in various corporate matters, including investment vehicles, corporate management, directors' duties and responsibilities, audits, risks' detection and distribution, documents, policies and corporate contracts, and design and implementation of a suitable corporate form for each business.

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SPECIAL TAX ZONES IN BRAZIL



 **Adler Martins**

The Brazilian federal and state governments offer some tax benefits to promote the incorporation of new companies in areas that need economic enhancement. Below we present a list of the most important tax programs that can be chosen when establishing a business in Brazil.

Manaus Free Zone

- Import tax reduction, provided the product has one of its industrial stages in the Manaus Free Zone (MFZ) (art. 7§, Decree-Law n. 288)
- Exemption from PIS/COFINS import tax if the products imported are going to be industrialized in the MFZ (art. 5§, Act n. 10.996)
- Exemption from IPI tax (art. 9§, Decree-Law n. 288)
- A reduced rate of 3% COFINS and 0.65% PIS on a company's gross revenue if imported products are going to a company also in the MFZ (arts. 3§ and 4§, Act n. 10.996)
- A reduced rate of 6% COFINS and 1.3% PIS on a company's gross revenue if products are destined for a company outside the MFZ (arts. 3§ and 4§, Act n. 10.996)
- A reduced rate for state vat (ICMS) of 12% for products imported to the MFZ (art. 1§, Act n. 2369)
- Exemption from the Freight Surcharge for the Renovation of the Navy Merchant (AFRMM) until December 31, 2015 (art. 4§ Act n. 9.808)

Santa Catarina State

- ICMS (state vat) deferment on goods to be sold within the state intended for the construction of projects that fall within the rules of the "Pro-employment program"
- ICMS deferment to the next stage of the sales process if the products are destined for distribution centers in South and Southeast regions (art. 12, Act n. 13.992)
- Extension of deadline for payment of the ICMS (up to 24 months) if a company sells its products to distribution centers in the South and Southeast regions (art. 12, Act n. 13.992)

Sudene/Adene area

- Reduction of corporate income tax by 75% for a period of 10 years (art. 1§, Decree nº 6.539/08)
- priority sector companies may apply 30% of the income tax due on reinvestment projects (art. 115, Normative Instruction SRF nº 267)
- Accelerated depreciation for purposes of computing the income tax (art. 31, I, Act n. 11196)
- PIS and COFINS credits can be used until 12 months after the acquisition of new equipment (art. 31, II, Act n. 11196)
- Exemption from the Freight Surcharge for the Renovation of the Navy Merchant (AFRMM) until December 31, 2015 (art. 4§ Act n. 9.808)
- (Benefits, except for the first one, are valid only until 2018)

Espírito Santo State

- Espírito Santo State offers a range of tax incentives that are not expressly authorized by the CONFAZ, which regulates fiscal policy. Due mainly to the "fiscal war," Brazilian courts are discussing whether benefits not authorized by the CONFAZ will be considered unconstitutional. Therefore, all the benefits offered by Espírito Santo State should be considered risky until the final decision is rendered.

About the author:



Adler Martins is a Law graduate from one of Brazil's greatest Law Schools: The Federal University of Minas Gerais (UFMG). He is also a MBA by Fundação Getúlio Vargas. Presently attending Masters Course credits (LLM) at Pontifical Catholic University of Minas Gerais and a Post Graduation Course in Financial Planning at São Paulo City University. He can speak English, Spanish, Portuguese, German and some Chinese (Mandarin). Adler has working experience in Argentina, Mexico, India, England, China and Dubai, aside from extensive experience in Brazil.

He is the co-founder of UFMG's group on the study of International Trade Law (GEDICI) and has represented UFMG at the Vis Arbitration Moot, in Austria. He is also a pioneer in legal research of contracts among Brazil, Russia, India and China.

Mr. Adler has lectured on Foreign Investment Regulation in Brazil to audiences in Brazil and India. Recently, he lectured about Brazilian Import Regulations at the Ecommerce expo 2011, in London, as a guest speaker. Currently, he works advising companies and entrepreneurs on how to do business in Brazil.



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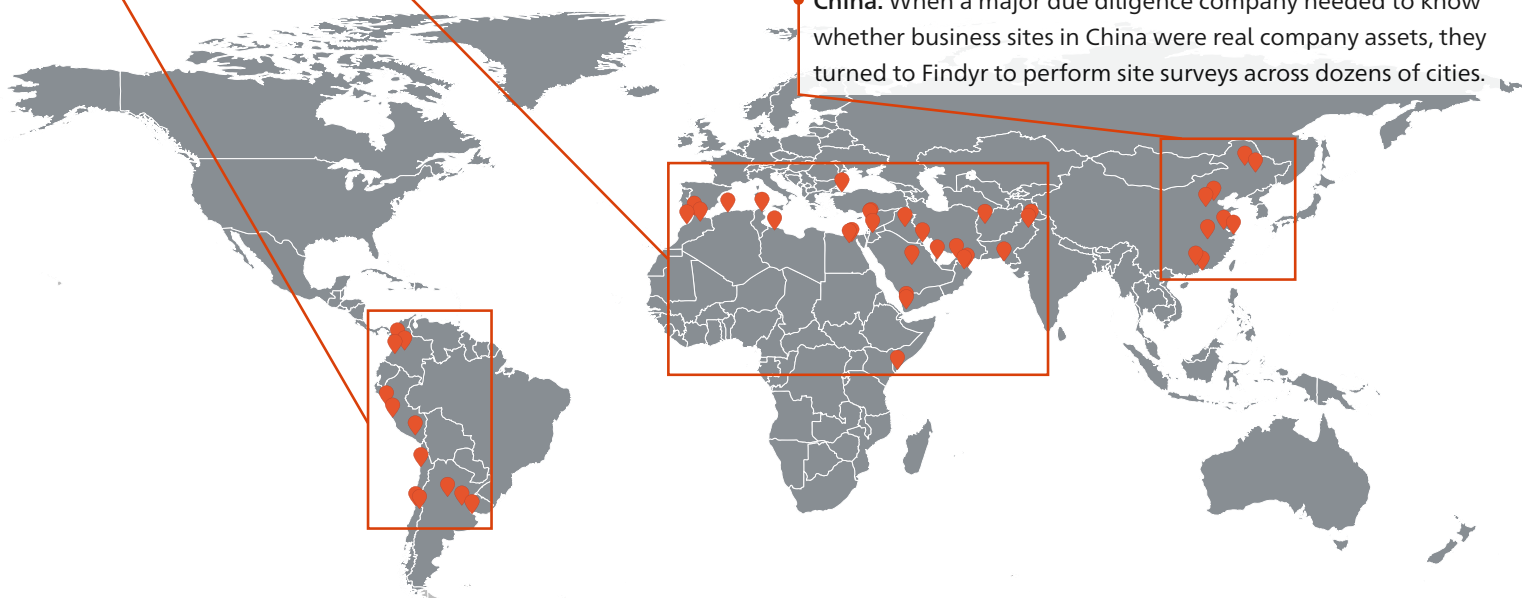
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The Ukraine Crisis: Redrawing the Boundaries of International Trade

 **James Knight**

It may be easily forgotten amid the stalled peace negotiations and political brinkmanship, but the spark that lit the fire in eastern Ukraine, provoking a conflict that has claimed more than 5,000 lives and displaced thousands more, was a dispute over a trade deal. Kiev's Independence Square was first flooded with protesters in November 2013, when then-President Ya-

nukovich abruptly canceled talks with the EU over an opening of Ukraine's markets, shortly after meeting with his Russian sponsors in Moscow.

While the localized, armed element of the conflict, which exacts a miserable human cost on Ukrainians of every ethnicity around the cities of Donetsk, Mariupol, Debaltseve and

The Ukraine crisis is leading to a redrawing of the boundaries of international trade for all parties in the conflict



elsewhere, is brutish and difficult to control through peace talks, and a political dimension sees a tug of war between Europe and Russia for Ukraine's future, on a global level the conflict plays out primarily in the commercial arena.

Both Russia and Ukraine have been forced into a reassessment of their trading links since tensions began to mount – no more so than with each other. Data compiled by the consultancy VimesVC suggests that Ukraine's exports to Russia dropped by 23% in the first half of 2014. As the country's biggest trading partner, the adjustment for Ukraine was always going to be

difficult: while exports to the EU increased by 14.4% over the same period (better business than any aid package, which would eventually have to be paid back), this still leaves the country facing a 10% drop in foreign exchange earnings, while having to finance a war at the same time.

Struggle to adapt

This has left mid-sized Ukrainian companies casting around for customers, but often armed with business practices that have not changed for decades. "The transition for heavy industry is a true baptism of fire for firms that, all of

a sudden, have to find new markets, compared with the relatively cosy relationships they had Russian clients, many of which dated back to Soviet days," says Dmitriy Gilgur, Director of VimesVC.

Darwinian theory dictates that this repositioning process will see the dead wood removed, and the companies that survive will thrive. This may hold for the US shale industry in a world of US\$50/barrel oil, where markets are free and deep, strong legal safeguards exist, regulation is geared toward innovation, a premium is placed on technical innovation, and corruption is low. In Ukraine, less



so, and even companies that do want to change face challenges in securing foreign-denominated loans to upgrade infrastructure and equipment.

The reliance on Russia is nowhere more prevalent than in the defense sector, where Ukrainian factories are still manufacturing weapons for clients across the border. In June 2014, the value of arms contracts with Russia was estimated at US\$15 billion, with many Ukrainian firms too integrated into the Russian military industrial complex and its components requirements to be able to change. Conspiracy theories abound as to why President Poroshenko allows this to happen.

Lashing out, branching out

Russians too are starting to feel the pinch, with the ruble tumbling and capital flight accelerating due to the sharp drop in oil prices as much as the creeping political risk resulting from Putin's increasing belligerence. A recent briefing note from EM, a strategic communications consultancy focused on Russia and the CIS, reported far fewer diners these days at Moscow's fashionable eateries, with prices going up, quality going down, and many dishes leaving menus entirely. The disappearance of the food is being followed by an exodus of expats from the country.

Some of the most critical voices of the administration's handling of the economic and political crisis have come from the Russian business community. Mikhail Fridman, founder of Alfa Group, wrote in the Financial Times about the new paradigm of low oil prices, and the economic freedom to innovate that

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Russia still lacked. While careful not to openly criticize Putin, Rusal President Oleg Deripaska asserted glumly from Davos, live on News 24, that "The only positive thing is that we have clarity – clarity that everything is bad."

The closing of European markets over the Ukraine crisis has led to the pursuit of deals further afield,

taking Russian companies out into the world. In Africa, Rostec, whose Chief Executive Sergei Chemezov is under US and EU sanctions, has been active in Zimbabwe, forming part of a triumvirate of firms developing the largest foreign investment in the country, the Darwendale platinum project, and in February Uganda awarded the company a US\$4 billion oil refinery deal.

Russia is also looking for innovative financing solutions to its needs. In Argentina, a government-to-government deal was announced at the end of last year to lend/lease some of the country's aging long-range bombers to the Argentine Air Force in return for beef and wheat, thus conserving precious foreign currency reserves. Russia is working on locally denominated currency trades with both Iran and China, to decrease greenback dependency. Brazil's President Dilma Rousseff is known to value foreign diplomacy almost exclusively in terms of trade, particularly at a time of domestic stagnation, and her new administration has been scurrying to increase agricultural exports to its new best friend and partner.

Game within a game

Right now the answer to Kissinger's perennial question, "Who do I call if I want to call Europe?" would undoubtedly be "Angela

Merkel.” She is determined to face Putin down, because she grasps that a clash of cultures is happening on the EU’s doorstep that it can ill afford to lose, at a time when the continent is more nebulous and fractured than it has been for many years, shorn of confidence on the world stage and riven by parochial disputes. Yet the German business community has the most to lose from confronting Russia: the country is Germany’s third largest trading partner, and 58% of German firms said they had been hurt by sanctions. Opel and VW have scaled back their operations, and BASF has canceled a major natural gas deal with Gazprom. There is a domestic cost to taking on Putin, especially in eastern Germany where he is admired by large sections of the population. In France, the cost is more clearly material – the cancellation of the EUR1.2 billion deal to supply two Mistral-class assault ships could itself result in a fine of EUR250 million for breach of contract – in a cash-strapped economy with an increasingly unpopular president.

The pressure on European unity has been ratcheted up by the arrival of

a new Greek government. Obviously Greece has its own agenda with regard to debt negotiations with the rest of Europe, and will try to cash in by playing on its power to derail the overall strategy toward Russia. President Putin is a masterful manipulator of internal differences such as this for his own ends, capitalizing expertly on what Jochen Bittner has called Europe’s “guilty conscience.”

For now, though, the best weapon Europe has is still sanctions, despite the domestic cost they exact. Arming Ukrainian rebels would simply play into Putin’s hands and provide justification for escalating the conflict. As low oil prices continue to bite in Russia, the stand-off looks set to continue. All three parties will have compelling pressures to blink first. The only economic winners likely to emerge are the companies that can act independently of the conflict to redirect their resources to new markets, or that can continue to operate successfully without getting dragged into the politics of the crisis while finding the opportunities that exist within it to innovate or capture market share.



About the author

James Knight is a consultant with ten years’ experience of working in and with emerging market countries. He is a Senior Associate at Etoile Partners, a geopolitical consultancy specialising in strategic positioning and communications management. He has handled projects for Barclays Bank plc, the World Bank, the United Nations, and corporate clients in the financial and extractives sectors. He started his career as a journalist, working for The Sunday Times, Reuters, and The Economist, covering business, foreign investment and conflict. He holds a degree from Cambridge University.

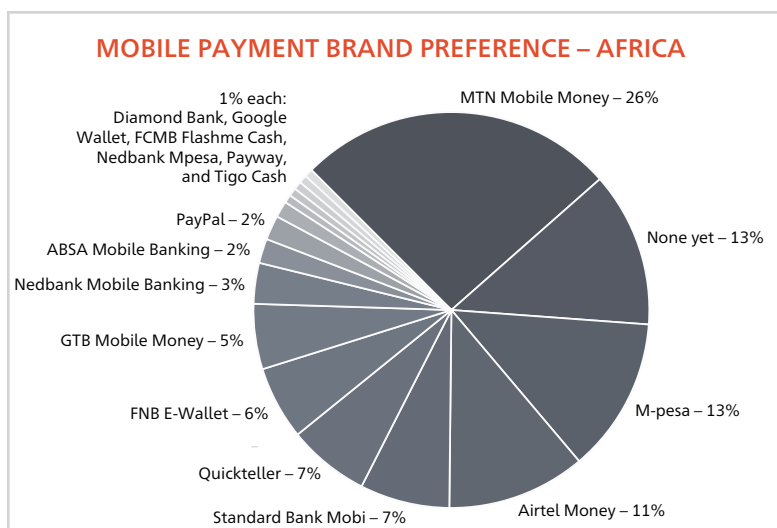
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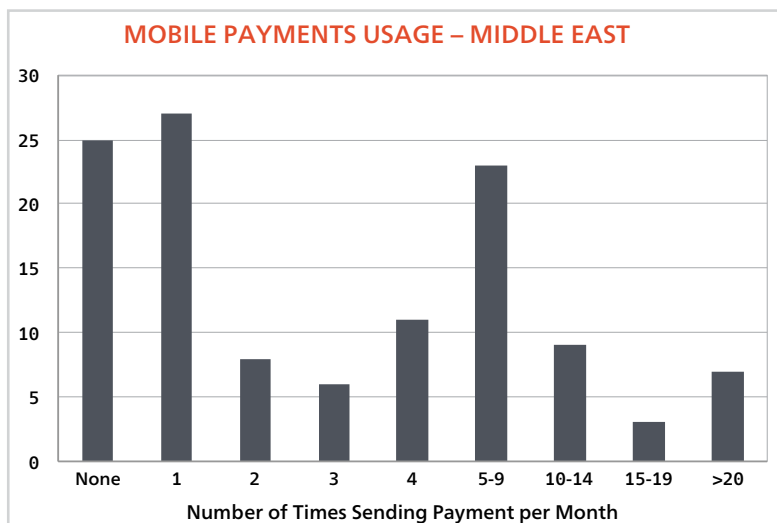
Mobile Payments in Africa

Africa has adopted mobile payments faster than most other continents but the market is still unsettled. Our surveys point to the popularity of several options, with MTN, Airtel and M-Pesa in the lead.



Mobile Payments in the Middle East

The Middle East has been relatively slow to adopt mobile payments. The majority of our respondents in Pakistan, Tunisia, Iraq and Turkey either never send mobile payments or send one payment per month.



About the Author

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Findyr will be showcasing recently collected emerging market data. This issue we are providing data on mobile payment preferences and behaviors from around the globe.

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Brazil's 'National Champion' Mired in Scandal

 **Ana Mano**

It was supposed to be different. When Brazil's state-owned oil giant Petrobras discovered some of the world's largest offshore oil reserves in 2007, then-President Luiz Inacio Lula da Silva said it was like winning the lottery.

The fact that Petrobras would manage this 5-8 billion barrel windfall of “pre-salt” oil – 18,000 feet below the ocean's surface – was heralded as a way to ensure that the people of Brazil would benefit directly from the discovery.

But eight years later, things are not looking so rosy.

According to a federal corruption investigation, the oil giant was used by a number of politicians, including some from the parties in the ruling coalition government, as a way

to receive bribes and kickbacks on a massive scale.

In return, an alleged cartel of Petrobras suppliers was allowed to rig bids and vastly overcharge the company for products and services. According to the company's unaudited estimate, the value of its assets may have been inflated by over US\$30 billion.

The probe has been dubbed “Lava-Jato” (Portuguese for “car wash”) in the local press, after a car wash chain that was used to launder money from the scheme.

Federal investigators are looking at contracts signed between 2004 and 2012, but evidence indicates that the kickbacks may have extended through 2014. Specifically, the federal investigation revealed that the Petrobras suppliers had paid bribes to high-ranking company executives through fraudulent bidding processes. The bribes, ranging between 1% and 5% of the contracts, were then channeled to political parties to fund election campaigns.

Blowing the whistle

A key figure in exposing the scandal is Paulo Roberto Costa, who headed the company's downstream operations for eight years. After striking a plea deal with federal prosecutors, he revealed how the bid-rigging and money laundering scheme operated.

The other key whistleblower is Alberto Youssef, who reportedly orchestrated the financial part of the scheme. Although he never worked for Petrobras, he implicated a number of Petrobras suppliers and managers as well as politicians in testimony to federal prosecutors.

Meanwhile, minority shareholders have accused the Brazilian capital markets regulator of negligence, claiming a gross lack of oversight



over the last decade. Other government agencies, particularly the country's federal audit court, also have been accused of an inadequate response.

It was only in early 2015 that the audit court froze the assets of certain Petrobras executives in connection with the 2006 acquisition of a refinery in Texas – a deal that resulted in an estimated US\$792 million loss for the company.

In December, criminal charges were brought against 36 individuals working for six construction firms – OAS, Camargo Corrêa, UTC Engenharia, Galvão Engenharia, Mendes Júnior, and Engevix. But the number of implicated suppliers has risen to 16, and the treasurer of President Dilma Rousseff's Workers' Party was questioned by police in February.

Rousseff chaired Petrobras's board for seven years through 2010, when many of the alleged irregularities supposedly took place.

Since these initial revelations, multiple defendants have agreed to talk to prosecutors, and the investigation is showing no signs of dying out anytime soon.

"It is only beginning," Federal Prosecutor Deltan Dallagnol said in an exclusive interview with PaRR in January.

The next step in the Brazilian investigation will involve filing "abuse

of office" claims against the firms and government officials, Dallagnol said. However, the ability to indict elected officials lies with Attorney General Rodrigo Janot.

This point will likely be of particular interest to the Workers' Party and its allies – the Progressive Party and the Democratic Movement Party – all of which face accusations of direct involvement in the scam.

Fallout

The result of all this intrigue hasn't been pretty.

Since the allegations came to light, former Petrobras CEO Maria das Graças Foster and a number of senior executives have resigned. The company's share price has fallen nearly 70% since 2010, when the firm raised a record US\$70 billion in a stock sale to fund pre-salt exploration.

Engulfed by this tsunami of sleaze, Petrobras has been downgraded by rating agencies, and PricewaterhouseCoopers has so far refused to sign off on the firm's financial figures.

Adding to these woes is the fact that US regulators are now involved. Last November, Petrobras said it received a subpoena from the US Securities and Exchange Commission (SEC), and US-based investors are suing over losses related to the irregularities.

This is one corruption scandal that is not going to be washed away anytime soon.



About the author

Ana Mano is a reporter for The Policy and Regulatory Report (PaRR), an intelligence and analytical news service that focuses on the development and adaptation of competition law around the world. PaRR's coverage spans North America, South America, Europe, the Middle East, Africa and the Asia-Pacific region. PaRR focuses on the intersection of global competition law with intellectual property, trade, and sector-specific change in which there is a direct impact on the fair market practices of governments and corporations worldwide. To learn more about PaRR visit: www.PaRR-Global.com

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