

Macro Forum insights and perspectives

June 2018

Welcome

Welcome to the latest edition of Insights and Perspectives, the quarterly newsletter from the Actis Macro Forum. In this edition we consider the possible implications of Latin America's year of the ballot box. No fewer than 8 presidential elections are taking place this year, in countries representing around 70% of the continent's GDP and population. Macro Forum members Nico Escallon and Bruno Moraes from our Mexico City and Sao Paulo offices respectively, share some of their thoughts on how this may play out, and how some of the current noise and uncertainty may disguise a more stable underlying outlook.

We also have an article co-authored by Michael Turner, Max Lin and Stuart Jackson, members of our Nairobi, Beijing and London teams, looking at the impact in East Africa and elsewhere of the "One Belt, One Road" policy adopted and sponsored by Chinese President Xi Jinping. With President Trump's trade war with China seemingly ratcheting up, we consider whether Africa could provide another option for Chinese exports of goods, and perhaps more importantly, capital.

Finally, a trade war impacting around US\$650 billion of trade is not something any investor can afford to ignore. In this context it is clear that China's response matters more than any other factor. We expect them to absorb much of the tariff effect through reduction in margins, as the loss of employment associated with lost trade volume would present significant social challenges. In addition to the emphasis on programs like One Belt One Road, there is likely to be a continued focus on import substitution activities discussed in previous editions of this publication.

In his article, Editor-in-Chief Ewen Cameron-Watt considers the many factors impacting on investment conditions in growth markets in the current volatile external environment, and points us towards a conclusion that whilst concern is justified, some of the fundamentals appear healthier this time around than in previous crises, notably the strong and steady influence of the Chinese economy and its currency on global markets.



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Emerging Markets

Same Old Story?

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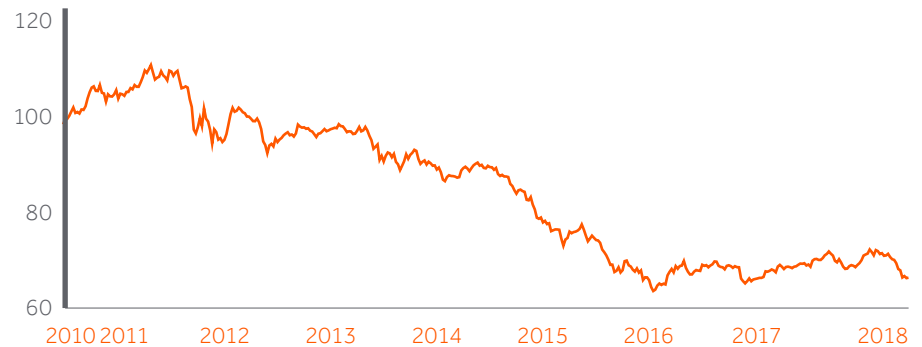


By now Emerging Market investors know that weakening currencies spell danger for returns. Bouts of extreme global volatility such as those which swept through the asset class in 1997, 2001 and 2008 had enormous impact on economies, businesses and capital markets. More regional crises such as that set off by the commodity slump in 2014-16 have similar effects on specific areas. And self-imposed wounds brought on by domestic policy mishap or political events (think Turkey and Argentina in recent months) have very specific country impacts.

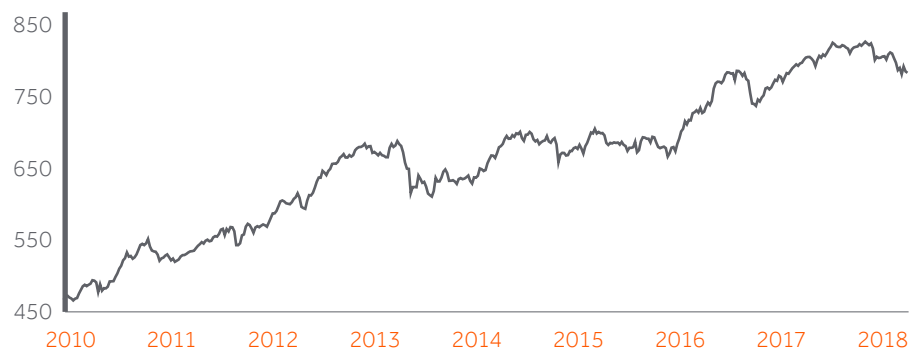
The reasons vary by country but have one central theme, the vulnerability of countries which rely on portfolio flows to plug financing gaps left by shallow domestic financial systems. Whilst this has been the case for decades, the bulls argue that distinct regional and country differences exist which require closer examination.

Clearly global financing conditions have tightened materially in recent months as seen in rising US interest rates and declining central bank balance sheets. The tidal wave of liquidity which allowed many

JPM EM Currency Index



JPM EMBI Global Total Return Index



Source: Bloomberg, Cross Border Capital

third and fourth tier borrowers easy access to global capital flows has begun to abate both because the QE gusher is abating and because increases in global economic activity are pulling money out of financial

assets and into capital investment and working capital needs.

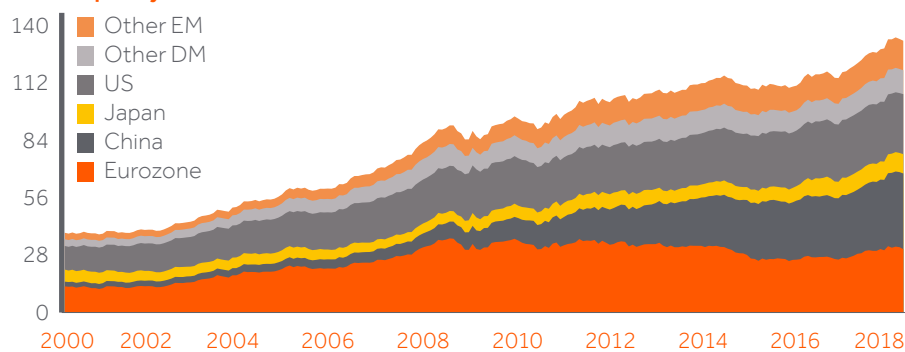
The immutable rule of a tide going out—that you see who has been swimming without trunks on, also applies. In recent months there have been serious sell downs in the Turkish lira and Argentine peso whilst on a lesser scale South Africa, India and Brazil have seen their currencies start the familiar slip which has presaged difficulties in the past.

The bonds of recent frontier issuers such as Tajikistan and Iraq stand well below their issue prices. There have been substantial flows out of EM assets—US\$12.3bn in May alone according to the Institute of International Finance. Is this the beginning of another difficult time for EM investors?

We suspect that these are passing clouds rather than full scale crisis. Why?

Firstly, by contrast with the 3 big global crises (1997/2001/2008) the domestic savings bases of EM countries are far bigger.

Total Liquidity (\$bn)



Source: Cross Border Capital

World Pension Assets (% share)

US\$ Trillions	2007	2017	%ch	2007	2017
Large Developed Economies	28.15	43.02	52.8%	97.5%	96.3%
Emerging Markets	0.73	1.64	124.7%	2.5%	3.7%
Total	28.88	44.66	54.6%	100.0%	100.0%

Source: OECD/ CrossBorder Capital

Not least the balance sheets of EM central banks are in general very healthy. The largest single EM-China, whilst struggling with domestic debt issues arising from mis-allocation of capital owes these monies to itself and not to foreign creditors.

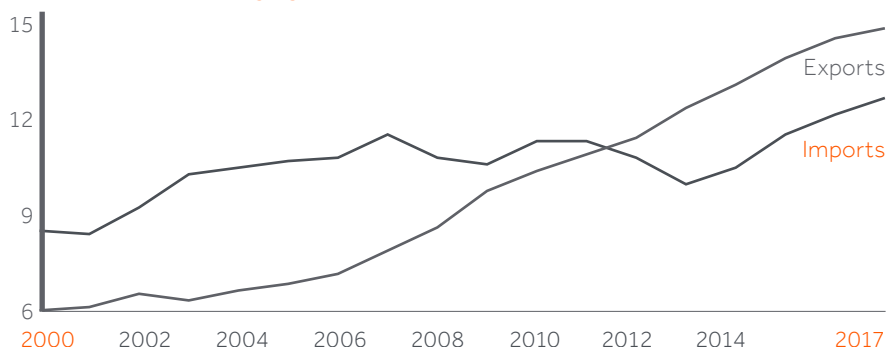
Secondly, the sheer size of the Chinese economy means that it can form a source of demand for client nations. The rising share of trade for Asian countries with China means that policy makers from Tokyo to Colombo are increasingly more interested in targeting their currencies against the RMB as opposed to the dollar. We expect this to be a multi decadal process.

Thirdly, strong Central Bank balance sheets mean that these banks are under less pressure to raise rates as capital flows out unless there are significant spikes in domestic inflation. This is obviously more the case for the richer EM countries where domestic savings can absorb capital outflows. In Asia for instance last year nearly 75% of US\$ finance raised came from domestic savers and currency volatility in many LatAm countries with large savings bases (think Mexico/Chile, Colombia, Peru) remains historically low.

At Actis we fully acknowledge the importance of exchange rates and run our own models of currency values. At present despite some volatility we cannot see any major currencies which are noticeably over valued whilst the RMB appears undervalued which in turn is helping the financing conditions for many Asian countries.

Our portfolio companies in general are not reporting material changes in business conditions although many are rightly watching the development of trade diplomacy with considerable concern. Political developments over the summer include key elections in Mexico and Brazil (covered elsewhere in this edition) and continuing pressures for reform in Africa (covered in our sister publication African Voices). Our base conclusion and long term investment conviction is that EM fundamentals, whilst vulnerable to externalities (in particular trade diplomacy) are not in danger of collapsing even though individual countries face specific challenges in less propitious funding markets than those of the last 18 months.

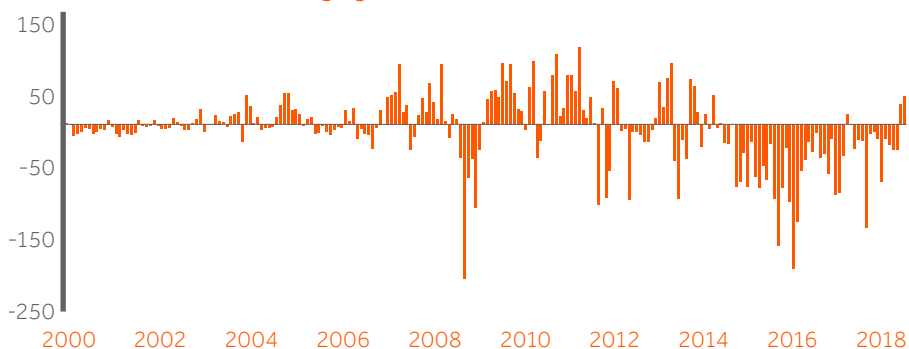
Chinese Trade with Emerging Asia



Note: Chinese Trade with Developed Asia declines as % over time

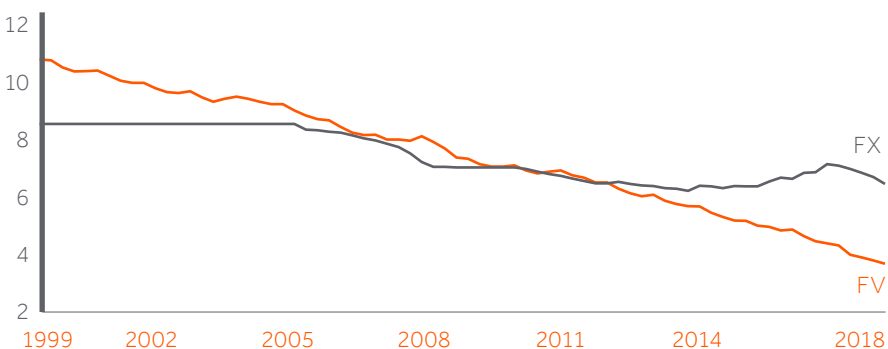
Source: Cross Border Capital

Net Financial Flows into Emerging Markets (\$bn)



Source: Cross Border Capital

China FX vs FV



Source: Bloomberg and Actis methodology for Fundamental Value

Latin America's Electoral Fiesta

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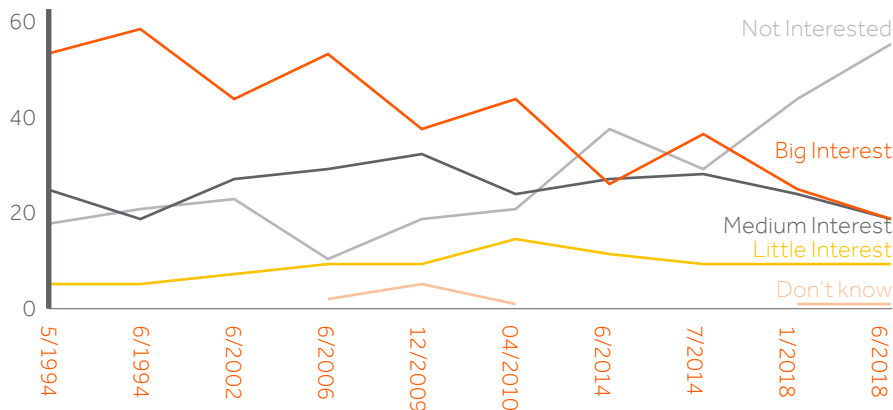


Latin America will face an unusually busy election season this year. All but one of the five largest economies in the region will renew their president, with eight elections taking place in total (seven if we do not count Venezuela's attempt). Chile kicked off the cycle in late 2017 and Colombia, Mexico and Brazil will follow over the next few months. Economies producing over \$4 trillion in GDP, around 70% of the region's total output, will change leadership. By the end of the year, two out of every three Latin Americans will have a new president. Even football is taking a secondary role in the news.

The elections take place at a time where the environment is strongly defined by two factors. The first is a marked increase in public anger over corruption, amid a plethora of scandals that initiated in Brazil and Central America and spread from Patagonia to Tijuana, holding to account previously untouchable figures including heads of state. Second, and related to the prior point, is a sense of disillusionment with democracy across the region, affecting the credibility of traditional parties and politicians.

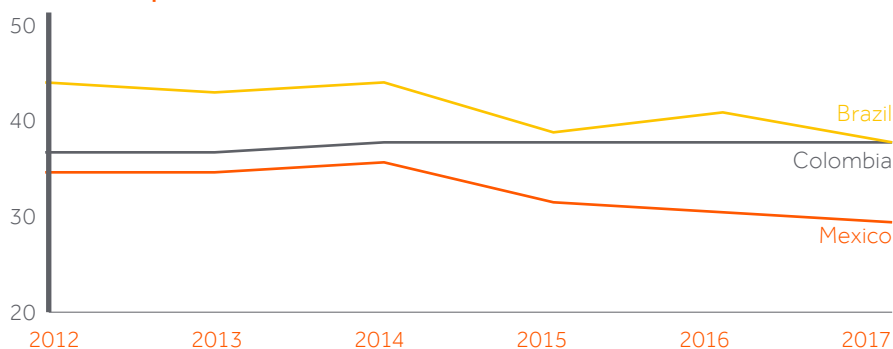
There are parallels with the political rearrangement in the developed world. The feeling of disenchantment is giving rise to political outsiders riding the mood. These candidates are coming from across the political spectrum, running more on a banner of change from the establishment, as opposed to a unified policy wave similar to the "pink-tide" movement observed in Latin America in the 2000's.

Degree of interest in the World Cup in Brazil



Source: Datafolha

Fears on Corruption



Source: Transparency International

Election Timeline

2017

- 19-Feb:** Ecuador's presidential and legislative general elections
- 02-Apr:** Ecuadoran presidential runoff
- 22-Oct:** Argentine legislative midterm elections
- 19-Nov:** Chilean presidential and legislative general elections
- 26-Nov:** Honduran presidential and legislative general elections
- 17-Dec:** Chilean presidential runoff

2018

- 04-Feb:** Costa Rican presidential and legislative general elections
- 04-Mar:** El Salvador's legislative elections
- 11-Mar:** Colombian legislative elections
- 01-Apr:** Costa Rican presidential runoff
- 19-Apr:** Cuban presidential transition of power
- 22-Apr:** Paraguay's presidential and legislative general elections
- 20-May:** Venezuela's presidential election
- 27-May:** Colombian presidential general election
- 17-Jun:** Colombian presidential runoff
- 01-Jul:** Mexican presidential and legislative elections
- 07-Oct:** Brazilian presidential and legislative general elections
- 28-Oct:** Brazil's presidential runoff

Source AS/COA Online

The stakes for Latin America are not small. The region has tracked the commodity slump and recovery, which affected many of its economies over the last 3 years. Asset prices have followed: between mid-2015 and the end of 2017 the MSCI LatAm index rose by over 50%. The political sphere has also experienced a shift toward the center-right, with recent elections in Argentina, Peru and Chile counteracting the move towards the left of a handful of economies over the past decade.

Purging corruption would certainly be a windfall for the region. It is one of the longest lasting endemics in Latin America, with a tangible effect on private investment. But a sudden and aggressive backlash comes at a cost. The scandals have held back economic activity, disrupted the political order and polarized the electoral landscape. Extricating the issue while maintaining a functioning political system is the key balance to strike. The role of strong institutions, an independent Central Bank and adequate governmental checks and balances, already well-established in most major Latin American economies, will be crucial in navigating this transition.

The overall trend points to a welcome deepening of the democratic system across Latin America. For the first time in a major election cycle, the majority of the voting population is now part of the growing middle class, as opposed to living in poverty. This will make room for a continually more pragmatic and educated population, one that is less suggestible and ideologically influenced. The decision will be theirs to drive the next wave in Latin American politics.

We now dive more deeply into the election cycle in Brazil and Mexico, Latin America's two largest economies and major investment destinations for Actis, to offer a view of how the elections are seen from the street.

Mexico

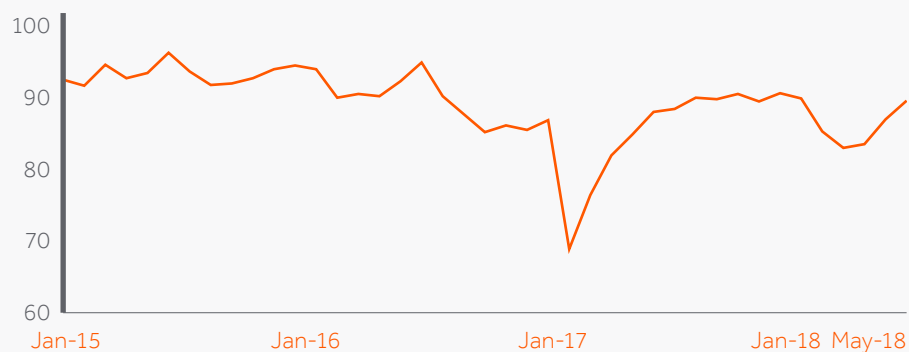
In a widely sweeping electoral event, Mexicans go to the polls on 1 July to elect their President for the next six years, as well as to fill over 3,000 seats at the federal, state and municipal level. In unison with the regional thematic, elections take place at a time where demand for change is the main driver of decision making at the ballot box.

Looking at the data from afar, a desire for change feels unwarranted. The macro backdrop is decidedly strong. Unemployment is at historic lows, inflation is controlled and the economy is growing steadily, albeit moderately, on the back

of a strong US economy. Additionally, NAFTA appears to be moving in the right direction despite occasional setbacks on the global trade stage, most recently at the G7 summit, and delays imposed by the US electoral calendar.

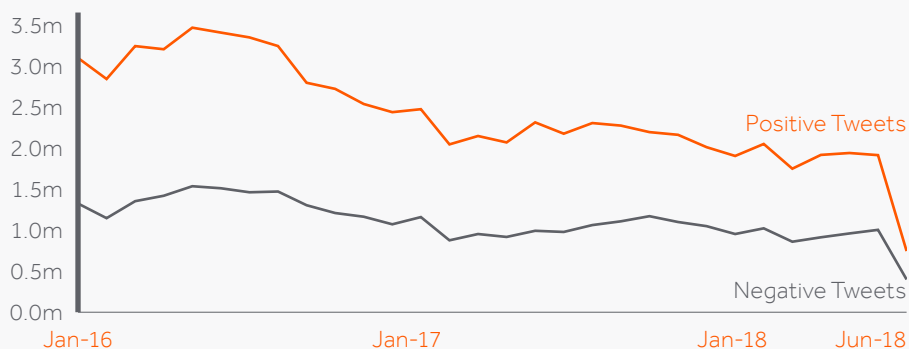
However, a deeper dive shows Mexicans feel much better about their personal situation than the direction of their country. Topping the list of concerns is generalized frustration with shortcomings in the rule of law, corruption and security. In conjunction with what is being observed in the broader region, voters are exhibiting a new set of priorities beyond just the economy and financial stability.

Mexico Consumer Confidence



Source: INEGI

Mood of Tweeters in Mexico

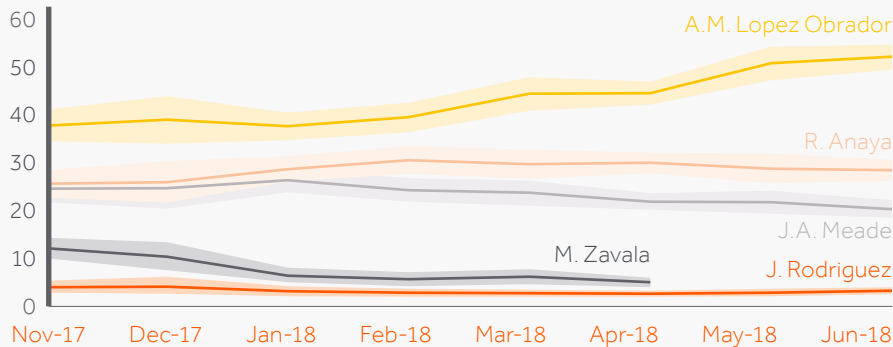


Source: INEGI

Andres Manuel Lopez Obrador (a.k.a. AMLO), the left-leaning candidate running for office, remains comfortably in the lead with most polls attributing a probability of over 90% to his winning. However, a large undecided swath of the vote (c. 20-30%) and recent electoral history show that poll results can quickly tighten or reverse by election day, making this a race to

observe through to the end. Hurt by the unpopularity of traditional parties and the desire for change, his contenders, Jose Antonio Meade of the incumbent PRI party and Ricardo Anaya from the conservative PAN party, have not been able to shake each other off to consolidate a second place position to contend AMLO.

Mexico Poll of Polls



Source: Oraculus

So, who is AMLO? For the first couple of decades in his regional political career, AMLO came up as part of the incumbent PRI party, splitting off with its more left-leaning faction, the PRD, in the late 1980's. He progressed as a party leader, yet has only held public office once as Mayor of Mexico City in 2000-2005. Alongside his progressive social agenda, he espoused restructuring municipal debt to keep the deficit in check and implemented significant infrastructure projects, leaving office with one of the highest approval ratings in recent history. Since then, he has been unsuccessfully dedicated to running for President on an anti-establishment platform. This is his third attempt after coming close to victory in 2006 and attempting again in 2012.

Three main factors have helped this time around. The first has to do with the unpopularity of the traditional PRI party, currently led by President Enrique Peña Nieto, crippled by corruption allegations and security concerns. The PRI has had a near monopoly on power for nearly a century, only interrupted by two PAN party presidencies in 2000-2012, after over 70 years of PRI rule. The duopoly has been breaking at the seams over the past twenty years, with this election looking like the potential final blow. The second factor has to do with the more moderate tone adopted by AMLO's campaign

vis-à-vis his prior attempts at office. The script includes job creation, growth, lower spending and progressive fiscal reform while seeking open conversation with the private sector and relatively technocratic cabinet nominations to assuage concerns. Finally, the Trump administration's more adversarial role on commerce and immigration have provoked an openness to more nationalistic views in the context of a country that is today one of the most outward looking in the world (e.g. Mexico holds the most free-trade agreements globally).

The election comes at an important juncture. Consolidation of positive adjustments to strengthen Mexico's fiscal position, continuity of structural reforms, and consummation of a NAFTA 2.0 deal will all be strategic drivers for Mexico's growth path in the next decade. At the same time, a new leader will need to attack corruption and tend to the security issue near the US border. Arguably, for the first time in its modern history, Mexico will need to address these important matters in the context of political discord. A government majority that speaks in concert on most policy fronts will be a thing of the past. Morena, AMLO's party, will become a relevant force in Congress, living alongside the more traditional PRI, PAN and PRD parties. The risk though, looks more weighted towards legislative gridlock as

opposed to drastic policy U-turns. The role of Mexico's strong institutions will take center stage in successfully navigating through this process.

Postscript: As investors and portfolio managers, there are key tactical considerations to keep in mind around the election, both in the short and medium term. More immediately, we expected to see volatility in the FX and rate markets in the months leading up to elections, just as had been observed in the 2006 and 2012 election cycles. Both of these have materialized, with the Peso devaluing by c. 12% against the US Dollar over the past quarter and spreads widening, exacerbated by a global emerging market sell-off that has affected other emerging market currencies. In anticipation of this, we sought to close the acquisition-financing bond offering for our Saavi Energia acquisition ahead of this window. The team successfully funded the transaction straight into the bond, closing the financing one week ahead of the share transfer in April, anticipating the expected market volatility. Second, we could expect to see a temporary slowdown in investment pace related to new electricity auctions in the first year while the government transitions. We have sourced proprietary M&A and sector consolidation opportunities which are coming to us on the basis of our track record in market and could make up for a potential lull during this period. In the longer term, the investment proposition remains robust and aligned with our global energy strategy. Our focus is on enabling win-win scenarios for all stakeholders by investing in leading power generation companies that provide cost-efficient, clean and reliable electricity. All these are desired energy policy characteristics for any incoming government.

Brazil

On October 7th Brazilians will head to ballots to elect a new president for the next 4 years, a period that will be instrumental for the country's stability from economic and social standpoints. However, the upcoming election brings a set of unique characteristics and understanding how this can affect the results in October, will help the reader digest the news popping up daily.

By contrast with the 2014 presidential election, political reform has introduced new conditions limiting campaign funding and time allocation for electoral advertisement on TV. Candidates have an expenditure cap (R\$70m for presidential election and, if necessary, additional R\$35m for run-off candidates) and will no longer count on corporations to fund their campaigns, having only two alternatives to raise funds:

1. Individuals, with a cap of 10 minimum wages, and
2. Federal state funds of c.R\$2.5bn, proportionally distributed to parties following their representatives in the Lower House and Senate.

Unsurprisingly, parties from the establishment such as MDB (current president Michel Temer), PT (former presidents Dilma Rousseff and Luis Ignacio "Lula" da Silva) and PSDB (former president Fernando Henrique Cardoso) are the largest recipients from such funds. Following the same rationale, the advertisement time on TV will also be allocated according to the relevance of each party measured by the seats each party secured in the Lower House 2014 election.

Whilst MDB, PSDB and PT remain the leading parties in terms of funds and television time, the boundaries imposed by the political reform represents a watershed in Brazilian presidential campaigns by limiting spending

and airtime. Moreover, the growing importance of social media in a country where two thirds of the population have access to internet, including 130 million Facebook users (4th country in quantity of users) and 120 million on WhatsApp is a game changer. Candidates with limited budgets are using social media to boost their profile. Jair Bolsonaro and Marina Silva, from hitherto fringe parties have the largest number of followers on Twitter and Facebook.

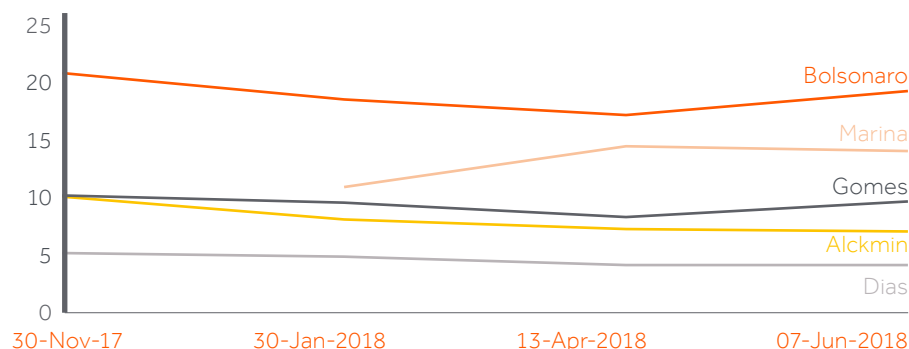
From a social standpoint, the corruption scheme unveiled by the Lava Jato operation has changed the political landscape. Fighting corruption has become one of the most important demands from Brazilian voters, followed by healthcare, security and education.

Additionally, the population shows a lack of confidence and credibility in establishment candidates, mirroring other LatAm countries and mature economies such as US, France and Italy. Notwithstanding this, some particular features remain. According to recent polls the majority of the voting population can be considered more conservative in terms of social values (leaning towards right-wing candidates) which changes when compared to economic policies, favoring greater government intervention, especially on issues related to the labour market and government support, to private corporations in distress.

On the economic front, structural reforms to stabilize the fiscal deficit and boost productivity remain essential. Public debt at 75% of GDP, is high by EM standards. The primary surplus partially offsets substantial public expenditures, mainly on social security which if unaddressed will see public debt rising to over 90% of GDP in the next 2-3 years. Essential investments in infrastructure are needed, mainly in logistics and energy, yet local sources of funding such as development banks lack capacity. Foreign capital is needed to bridge the funding gap but the lack of structural changes may impact the ability of the country to attract long-term investment capital.

The combination of campaign spending reforms, social media impact and the demands from Brazilian voters seem to favor new leadership. Despite the center-left preference of Brazilian voters in terms of social values, the new President will need to approve the structural reforms to

Brazil Poll of Polls



Source: Bloomberg

Main Problems of Brazil in 2017	2016		2017	
Problems	%	Ranking	%	Ranking
Unemployment	52%	1°	56%	1°
Corruption	40%	3°	55%	2°
Health	48%	2°	47%	3°
Public Safety/Violence	33%	4°	38%	4°
Quality of Education	14%	5°	13%	5°
Cost of Living/Prices/Inflation	7%	10°	13%	5°
Drugs	13%	6°	12%	7°
Poverty/Hunger/Misery	10%	8°	10%	8°

Source: CNI. Confederação Nacional da Indústria

put the country back on track, stabilizing inflation and bringing GDP sustainable growth. Therefore, the ability in building consensus will be key, mainly in an election where Brazilians will also vote for two-thirds of Senate and Lower House representatives.

Remember, Brazil is not for beginners. The months before presidential elections tend to introduce more volatility in the local capital market. This time, both external and domestic factors are contributing to this.

Locally, after being accused of corruption, Mr. Temer lost credibility and ability to pass reforms and spent the last few months fending off accusations. More recently, a truckers' strike nearly halted the country for a week, culminating in the resignation of Petrobras's CEO, exposing the weakness of Mr. Temer and his cabinet, and suggesting that the transition period until the next president takes the office won't be as smooth as expected.

Externally the combination of US rate rises and tightening funding conditions have buffeted weaker emerging market countries. Whilst we believe this is a passing phase it is the more vulnerable economies which are bearing the strain as we report elsewhere (page 3).

The Brazilian Real has depreciated by c. 11% since the beginning January, being currently traded around 3.70-3.80. Following the currency over-devaluation, the Central Bank has carried out a full roll-over of FX swaps, increasing FX swap inventory to \$42bn, until elections in October it may surpass \$100bn. The investment pace is also slowing down with foreign and institutional investors taking a more bearish approach that contributed to IBOVESPA index losing c. 15% in LCY over the last month.

In the fixed-income market, the slope of interest rate (CDI) and sovereign bonds yield have moved upwards, interest rate expectation for January 2020 increased by 78 bps and sovereign bonds yield for the same maturity, 112 bps. The beginning of official campaigns in August tend to shed more light on this scenario to the extent that candidates will present their governmental proposals – heightened volatility may persist throughout 2H18 being impacted by the quality of the

programs as well as the result of polls but, the investment community will be reacting in a more structured rather than speculative way.

Understanding the Brazilian puzzle is key. Brazil has 35 registered political parties whilst for this upcoming presidential election 17 pre-candidates announced intentions to run. This number will certainly decrease, as the official candidacies are only due by August 15th and alliances may be structured, decreasing the number of official candidates. This current presidential election presents a level of fragmentation last seen in 1989; back then Luis Ignacio "Lula" da Silva went for the run-offs with only 17% of valid votes, when he ended up losing to Fernando Collor de Mello.

It is important to consider that in a very fragmented scenario, candidates with modest number of votes can go through to the second round and, depending on their ability to make alliances and convert undecided voters, become strong contenders. Consequently, non-establishment candidates with more polarized views like Jair Bolsonaro (right wing candidate but with unclear economic view) and Ciro Gomes (left-wing candidate) started their campaigns gathering support from relevant social/economic groups (agricultural, LGBT, religious groups).

As it stands today, according to preliminary polls, Mr. Bolsonaro holds c. 19% of votes, followed by Marina Silva with c. 15% and Ciro Gomes with c. 10%. The center-right candidates Geraldo Alckmin (7%) and Alvaro Dias (4%) complete the list of candidates with more than 1% of voting intentions.

However, campaigns haven't officially begun and negotiations around coalition line ups will last until the beginning of August. Most importantly, 33% of voters are blank/null. In the 2014 presidential election, the blank/null held a similar percentage but decreased substantially towards 4% during the week of first-round election, impacting the results considerably in comparison to polls released in the same week. With a more fragmented landscape, the influence of swing voters can be a game-changer. Taking a closer look at the blank/null votes, around 2/3 are undecided voters, who may

form a better view through ideological and/or economic spectrum(s) during the days before the election, the remaining 1/3 are former voters of Lula, who haven't decided which candidate they will support.

In terms of the center-right wing, which today has around 6 presidential candidates, no alliance has been officially announced. PSDB, one of the leading parties has a leadership frontrunner, Geraldo Alckmin who does not command full support inside the party. Mr. Alckmin, (former Governor of Sao Paulo State and runner up in 2006 presidential election) embodies the old politics in an environment that calls for change. Joao Doria, who is running for Governor of Sao Paulo State, started gaining support inside PSD. Mr. Doria, besides being a successful businessman, was elected Mayor of Sao Paulo in 2015 and could be the consensus/renovation candidate from the center-right with more penetration than Mr. Alckmin. We don't expect Marina Silva, a center-left candidate who ran twice for president and was Minister of Environment in Lula's first mandate, to tie herself into an alliance in the first round; Mrs. Silva and her team believe that the chances to qualify for the second round, without making alliances, are significant.

In spite of the uncertainty surrounding the presidential run, at least until August 15th, we see 4 candidates emerging from the first round. Bolsonaro and Gomes as polarized candidates and 2 candidates from the center including Mrs. Silva (center-left) and one consensus candidate from the center-right, theoretically from PSDB party. Fragmentation coupled with the meaningful percentage of swing voters, put an emphasis on the ability of front-runners to attract the undecided. Building consensus in both Lower House and Senate aiming at passing essential reforms is important. Brazilians yearn to elect someone that represents change, the catalyst agent in the fight against corruption and end of the Jeitinho Brasileiro (the Brazilian way).¹

1 *The Brazilian way means finding a way to accomplish something by circumventing or bending the rules. Even though, on some occasions this approach may be associated with creativity coming from the need related to lack of support or help, the recent history shows that the Brazilian way has been translated in questionable actions and serious violations.*

Final remarks

Presidential elections never fail to dominate the media conversation and collective conscience in Latin America. The confluence of elections means the repercussion of such process is amplified, especially in today's hyper-connected world.

From a social spectrum, the latinos, from Patagonia to Tijuana, have begun to nurture a zero-tolerance culture against corruption along with disillusionment with the "old" democracy. Voters, spurred by social-economic improvements achieved over the last decade are more focused on assessing the potential candidates, improving the quality of debates and increasing the level of scrutiny, which makes this an unprecedented presidential election cycle in Latin America.

The presence of candidates with more polarized approaches find support in the current scenario marked by a call for renovation and higher level of ideological debate. However, this shouldn't be an element of disruptive change in the existing democratic system given growing institutional frameworks throughout the region.

As the region still demands investments in infrastructure, there may be bumps in the road; the changing political landscape and US rate rises have put pressure on currencies and may impact economic indicators in the short-term. However, the political tipping point that Latin American countries have reached with a more informed voting population calling for a change and mature institutions that diminish the chances of disruptive political regimes (as observed in the past), introduces a new component into the equation that will shape the future of such countries over the medium-term. Under this scenario, the improvement of economic indicators are equally important for the region, yet the idea of delivering sound economic performance at any cost is no longer an option. Otherwise, the consequences might be rather predictable, as observed by Eduardo Galeano: History never says goodbye. History says see you later.





LatAm Elections



Mexico

Election Date

1st July 2018

Main Candidates

Candidate	Party
Andrés Manuel López Obrador	MORENA
Ricardo Anaya	PAN
José Antonio Meade	PRI
Jaime Rodríguez	Independent

Incumbent President

Enrique Peña Nieto	PRI
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Brazil

Election Date

7th October 2018

28th October 2018

First Round

Second Round (if needed)

Main Candidates

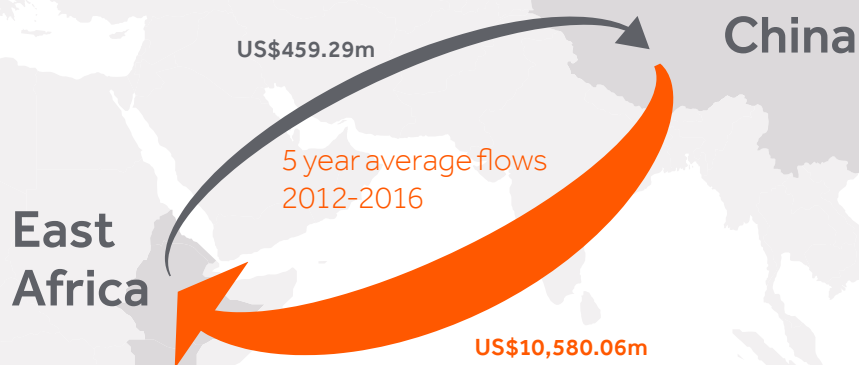
Candidate	Party
Álvaro Dias	Podemos (PODE)
Ciro Gomes	Democratic Labour Party (PDT)
Geraldo Alckmin	Brazilian Social Democracy Party (PSDB)
Marina Silva	Sustainability Network (REDE)
Jair Bolsonaro	Social Liberal Party (PSL)
Rodrigo Maia	Democrats (DEM)
Henrique Meirelles	Brazilian Democratic Movement (MDB)
Lula da Silva*	Workers' Party (PT)

**Although a popular vote, da Silva's jailing has effectively ruled him out of contention.*

Incumbent President

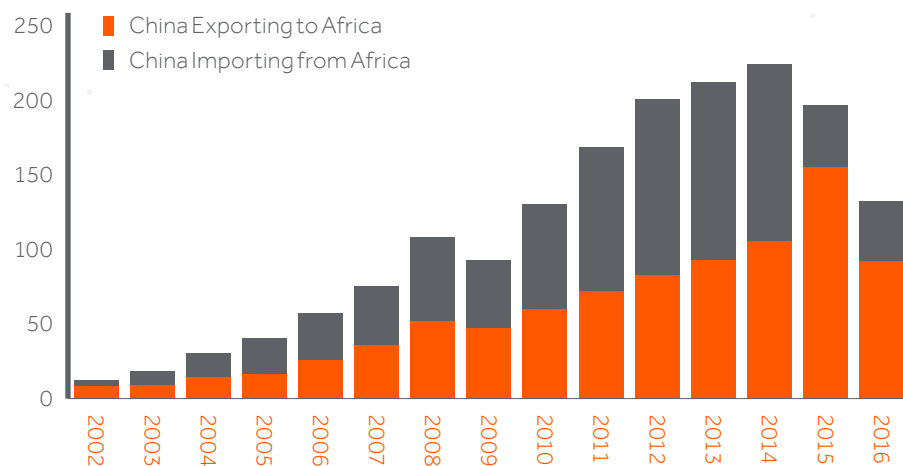
Michel Temer	Brazilian Democratic Movement (MDB)
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China-East Africa Trade Flows



Total China-Africa Trade

US\$bn



Source: UN Comtrade data, John Hopkins, China Africa Research Institute

One Belt One Road and East Africa

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Last year, Chinese ODI declined for the first time since 2003. While there are domestic reasons for this decline, as the Chinese government is concerned about potential capital flight, there are also geopolitical reasons resulting in increasing scrutiny and regulatory hurdles to Chinese ODI, especially in developed countries and in sectors thought to be strategic and sensitive, and where the Chinese investors are seen to be state related and investing for strategic reasons rather than financial.

At the same time, there is greater awareness that Chinese ODI has historically had below average returns compared to other major ODI countries. To counter both increasing scrutiny from Western countries and to increase financial return, the policy direction for Chinese ODI is increasingly focusing on making sure that the investment decisions are made based on solid commercial reasons and financial returns, and that investment entities not be seen to be linked to the Chinese government. Though that is always difficult to do when it comes to Chinese SOEs.

As a result, one of the new focuses for Chinese ODIs is to encourage leading companies from Chinese manufacturing and service industries to expand overseas, exporting manufacturing knowhow, extending sales networks, and reshaping the global supply chain. The New Silk Road Economic Belt connects China to Europe via either Near East and Russia, or Near East, Middle East and the Mediterranean Sea. The New Maritime Silk Road connects via the Indian Ocean and the Mediterranean Sea and links in Eastern

Africa. Both are also referred to as "One Belt, One Road" (OBOR) and have become a key development strategy for China, anticipating cumulative investment in the next decade of up to US\$1 trillion.

For all OBOR aligned countries as a whole in 2017, Chinese exports amounted to US\$774bn, an increase of 8.5%, representing 32% of Chinese exports, while imports increased at a more impressive 19.8% to US\$666bn, representing 39% of total Chinese imports. This is the first time that imports from OBOR countries increased faster than exports. This trend is expected to continue resulting in a declining Chinese trade surplus with OBOR aligned countries, as transportation infrastructure improves to allow China to increase imports of raw materials and the resources to ensure security of supply in an age of ongoing trade tension between China and US.

Africa a major beneficiary

Africa is one of the most significant beneficiaries of this OBOR initiative. Between 1992 and 2011, trade between China and Sub Saharan Africa rose from US\$1bn to a colossal US\$140bn. FDI has grown at an annual rate of 40%. China has recognized the potential of building business relationships with a continent that has 15% of the world's population but accounts for only 3% of global world trade.

From the Chinese perspective, there is a huge opportunity for companies to work with African countries. Compared to China's ageing demographics, Africa is projected to have 50% of the world's newly added working population by 2050. This aligns well with the needs of Chinese industries looking to export manufacturing knowhow, management skills and particularly funding that an industrializing Africa will need. In addition to the traditional resources and energy sectors, Chinese companies are increasingly finding success in infrastructure, labor intensive manufacturing, telecommunications and financial services such as mobile payment services. Chinese investments in Africa are moving from general merchandise trade to setting up manufacturing facilities, from EPC infrastructure projects to building and operating and financing infrastructure, and industrial parks.

According to McKinsey there are 10,000 Chinese firms operating in Africa today and 12% of Africa's industrial production (cUS\$500bn) is already handled by these firms.

It is in East Africa that we can see tangible evidence of the success of OBOR. Countries such as Ethiopia, and Kenya are an integral part of OBOR, primarily due to the established port infrastructure at Djibouti, the manufacturing capability available in Ethiopia and the regional connectivity via road, rail and energy within Kenya. Already, Chinese imports to East Africa via Djibouti averaged at a growth rate of 33% from 2009 to 2017, from a few hundred million dollars to US\$2.2bn today, serving the East African hinterland. This is not about mineral extraction, the networks that are being forged provide an outlet for Chinese goods.

African investment across all sectors

Major investments so far have been transactions within transport and infrastructure.

In Djibouti, Chinese investments included four port development projects and a 752km railway link to Ethiopia that will dramatically increase Ethiopia's access to maritime trade, and a US\$4bn project with PetroChina to develop its natural gas reserves. Another example is the 472 km standard gauge railway in Kenya completed in 2017 that links its capital with its port city Mombasa. At a cost of US\$3.8bn, its 90% funded with financing from China's Exim bank with the rest from the Kenyan government. The railway uses Chinese know-how, Chinese equipment and Chinese project and operational management.

By putting in place the infrastructure and transport networks, China is attempting to open up Africa to (Chinese) investment. Of the 54 countries in Africa, 15 of these are land-locked and with 90% of global trade being carried by shipping, the importance of regional integration to give all countries access to trade zones is pivotal to this strategy. Kenya's ability to provide import/export routes to Uganda, Rwanda, Burundi and the Democratic Republic of Congo have improved as a result of the Nairobi-Mombasa railway

It's not only transport networks. An example of Chinese leveraging of the manufacturing potential of Ethiopia can

be seen in the “oriental industrial park” located an hour drive from Ethiopia’s Addis Ababa, where companies in the steel and textile industries have set up shop there, attracted by tax incentives by the Ethiopian government to attract ODI – copied from China’s own rulebook for attracting FDI. Over 15,000 people work in the park for over 30 companies.

Leveraging the distribution potential of the port capabilities, China’s exports of smartphones continue to expand and in 2017, Transsion Holdings, the Chinese smartphone manufacturer, overtook Samsung as the number one smartphone by sales in Africa, selling more than 50m phones in the first half of 2017. Manufacturing is moving to the same industrial park as mentioned above in Ethiopia.

Chinese EPC (engineering design, procurement and construction) contracts have also grown dramatically in Africa. One of the largest US foreign direct investments in Kenya was the Kipeto Energy Wind Farm, providing 102MW of energy for an investment of US\$323m. CMEC, the China Machinery Engineering Corp is providing the EPC, responsible for the design, construction, installation and implementation of the facility for a contract value of US\$221m.

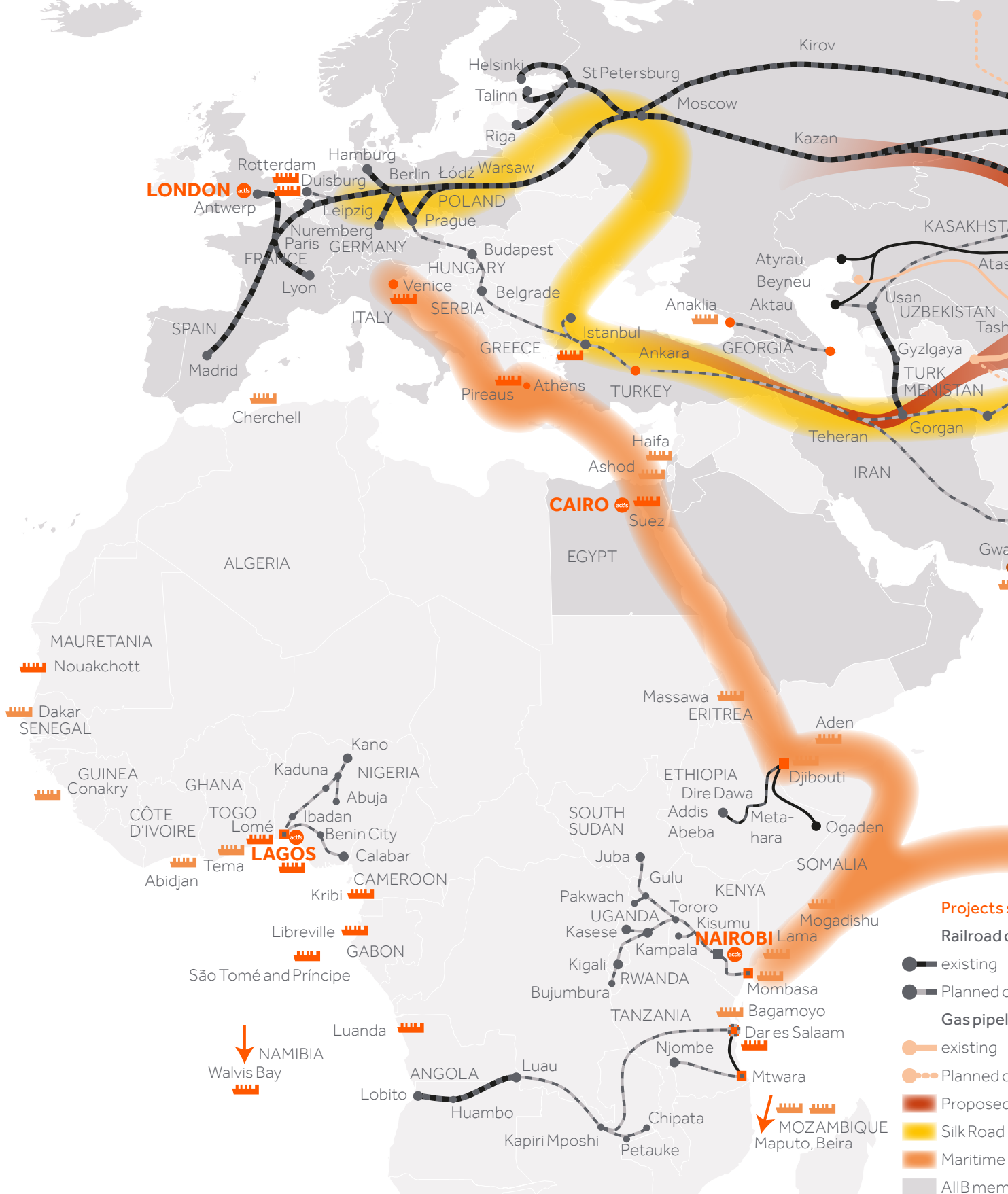
One of the largest Chinese EPC companies, Sinohydro was responsible for the construction of the Actis funded Garden City shopping mall in Nairobi. China has also made large apparel investments in Ethiopia, highlighted by the US\$250m investment to develop Hawassa Industrial Park that is aiming to employ 20,000 Ethiopians by 2019.

Finally, a Chinese private enterprise, Twyford Ceramic Company has become the largest ceramics manufacturer in East Africa producing 30,000m² of floor tiles every day with production capacity expected to double in 2018.

With Chinese government increasingly emphasizing its OBOR initiative at the center of its foreign policy agenda, this can be a Win-Win for both Africa and China, a true marriage of convenience. Africa’s infrastructure and industrial development deficit is neatly plugged by Chinese investment, providing China with a critical geopolitical axis, access to African markets and natural resources and linkages to western markets.



One Belt One Road



Source: MERICS China Mapping/Mercator Institute for China Studies



El Pelicano, Chile

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