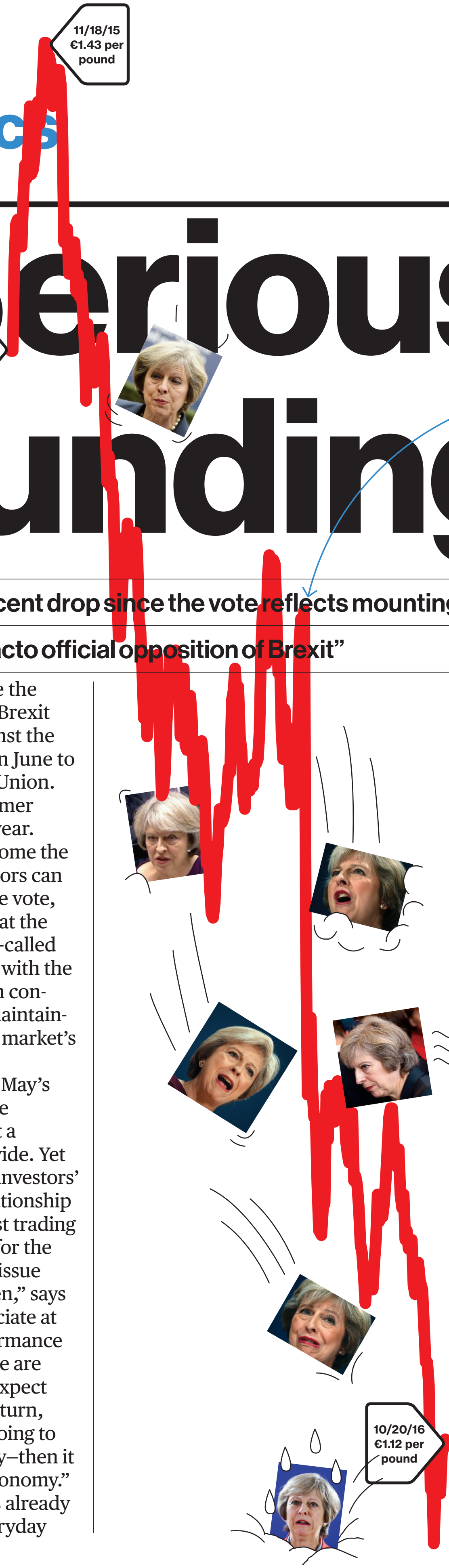
October 31 — November 6, 2016

A Serious Pounding



▶ **The currency's 18 percent drop since the vote reflects mounting fears of a hard exit**

▶ **The pound is "the de facto official opposition of Brexit"**

The U.K. currency has become the most prominent victim of the Brexit debate, falling 18 percent against the dollar since the British voted in June to withdraw from the European Union. The pound is the worst performer among major currencies this year.

The reason? Sterling has become the main vehicle with which investors can express their dismay, first at the vote, then at signals by politicians that the government is heading for a so-called hard Brexit, an exit agreement with the EU that puts more emphasis on controlling immigration than on maintaining maximum access to the EU market's 500 million customers.

U.K. Prime Minister Theresa May's government has highlighted the increased competitiveness that a weaker exchange rate can provide. Yet the drop in the pound reflects investors' concern that a scaled-back relationship between the U.K. and its biggest trading partner will ultimately be bad for the British economy. "The biggest issue here is why the pound has fallen," says Swati Dhingra, a research associate at the Centre for Economic Performance in London. "If it's because there are bad fundamentals, or we can expect the economy to go into a downturn, or because trade barriers are going to rise—and that seems most likely—then it doesn't necessarily help the economy."

The pound's depreciation is already starting to feed through to everyday life in Britain. Prices for iPhones and Microsoft software have gone up, and a spat over the proposed price hike of a cherished breakfast spread, Marmite, became a national obsession in October. (Its supplier, multinational Unilever, books its revenue in euros but sells its Marmite in pounds.) Inflation rose at an annualized rate of 1 percent in September, and some economists see it reaching 3 percent next year, from virtually zero in 2015. That's bad news for a country that relies heavily on consumer spending and has seen wage growth stagnate. Brits are also facing some shocks in the cost of their vacations: The pound has lost as much as 19 percent against the five currencies used in their favorite travel spots.

The pressure on Britons' wallets hasn't so far dented the popularity of May, who swept to power upon David Cameron's post-Brexit resignation. According to an October poll by market-research firm Ipsos Mori, 48 percent of voters are satisfied with her job as leader.

David Bloom, global head of currency strategy at HSBC, calls the pound "the de facto official opposition of

Prices are rising on Microsoft software and iPhones—there was even a Marmite scare ▶

PHOTOS: AP PHOTO (1); REUTERS (4); REX/SHUTTERSTOCK (2); DATA COMPILED BY BLOOMBERG

◀ Brexit"—meaning its drop is doing more to temper the government's stance on the shape of future relations with the EU than anti-Brexit politicians are. Since the pound has remained at depressed levels, there's been "a little bit of softening around the hard edges" of the government's rhetoric supporting the weak pound, he says.

If the currency continues its swoon, the government could find it harder to keep ordinary Britons happy. Prime Minister May might back down on sharp limits for immigration rather than lose trade links with the continent. "A hard Brexit seems to me to be the thing that's really spooking markets," says Andrew Goodwin, an economist at Oxford Economics. "If the pound does sell off, that's going to push up inflation, and that's potentially going to reduce the popularity of that sort of argument with people."

The British see a squeeze on their finances coming. In the Ipsos Mori poll, 55 percent of respondents said the devaluation would be a bad thing for the country, and only 14 percent said it would be a good thing. Half of respondents said they expect their standard of living to decline because of Brexit.

Much will depend on the government's ability to forge new trade deals. One possible bright side of the pound's fall is its potential to spur the long-sought "rebalancing" of the U.K. economy toward investment and external demand and away from consumption at home. Economists expect the U.K.'s account deficit, now near an historic high, to narrow as exports improve. Yet some are skeptical. "If we're going to make it harder to trade with our biggest trading partner, it's going to be very difficult to replace any exports lost to the EU with other countries," Goodwin says. "The idea of rebalancing is a silver lining amongst some pretty big clouds." —*Jill Ward and Lukanyo Mnyanda*

The bottom line The British government says the pound's drop will turn the U.K. into an export dynamo. Others say it heralds economic pain.

Quoted

"If I have to meet with the devil, I don't have a problem with that. But there have to be witnesses."

Henrique Capriles, a leader of the Venezuelan opposition, on the Vatican's offer to mediate a meeting with President Nicolás Maduro's representatives

Balance Sheets

Gulf Rulers Try Fighting Deficits With Taxes

▶ **The United Arab Emirates will hire professionals to institute a VAT**

▶ **"It seems unlikely that personal income taxes will be applied"**

The United Arab Emirates, like many of the oil-rich Arab nations in the Persian Gulf, has for years avoided taxing their citizens yet maintained generous subsidies on fuel and other commodities. Most corporations aren't taxed either, unless they're the oil and gas companies or banks that fund the region's version of the welfare state. The drop in crude prices, however, has turned budget surpluses into deficits. Now the U.A.E. is setting up a federal tax authority, its first, to collect a value-added tax—a tax designed to draw from every level of production and consumption—to bolster its finances.

The U.A.E. is expected to post a deficit equal to 3.9 percent of its gross domestic product this year, widening from a 2.1 percent deficit in 2015, the International Monetary Fund says—compared with a 5 percent surplus in 2014. Dubai and Abu Dhabi are among the U.A.E. sheikhdoms planning to introduce a VAT in 2018 at a rate of about 5 percent. The U.A.E. and neighboring Gulf Cooperation Council states aren't yet levying taxes on individuals or most companies. But Saudi Arabia, a council member, said in June it was mulling taxing expatriates in the kingdom. U.A.E. residents pay housing fees, government service charges, and road tolls, which some consider an indirect tax.

The IMF is among organizations that have said countries in the region should undertake fiscal changes to make up for falling oil revenue. Kuwait plans to impose a 10 percent corporate income tax. The U.A.E.'s Ministry of Finance is advertising about 30 staff positions for its tax authority on its website, including a compliance and enforcement director, auditors, analysts, and accountants. **Deloitte** is advising the Emirates on the body's structure and enforcement mechanisms, according to two people familiar with the matter who asked not to be identified because the information isn't public.

Setting up a tax authority "is a significant step and shows commitment for fiscal reforms," says Monica Malik, chief economist at **Abu Dhabi Commercial Bank**. The Ministry of Finance declined to comment. Deloitte, in an e-mailed statement, would neither confirm nor deny its involvement, saying its business depended on client confidentiality, so it wouldn't "discuss rumors."

Imposing a VAT marks a profound shift in philosophy for the U.A.E. Dubai, in particular, has used a low-tax profile and tax-free zones to attract foreign multinationals and solidify its position as the Gulf region's trade and financial hub. The promise of tax-free living has long been a draw for expatriates, though high education and housing costs increasingly offset the benefits.

The U.A.E. is also exploring other

CLOCKWISE FROM TOP LEFT: IMAGINECHINA; STR/AFP/GETTY IMAGES; FRANCK VOGEL (3); CHIANG RAI TIMES; IMAGINECHINA; ILLUSTRATION BY SIMON ABRANOWICZ

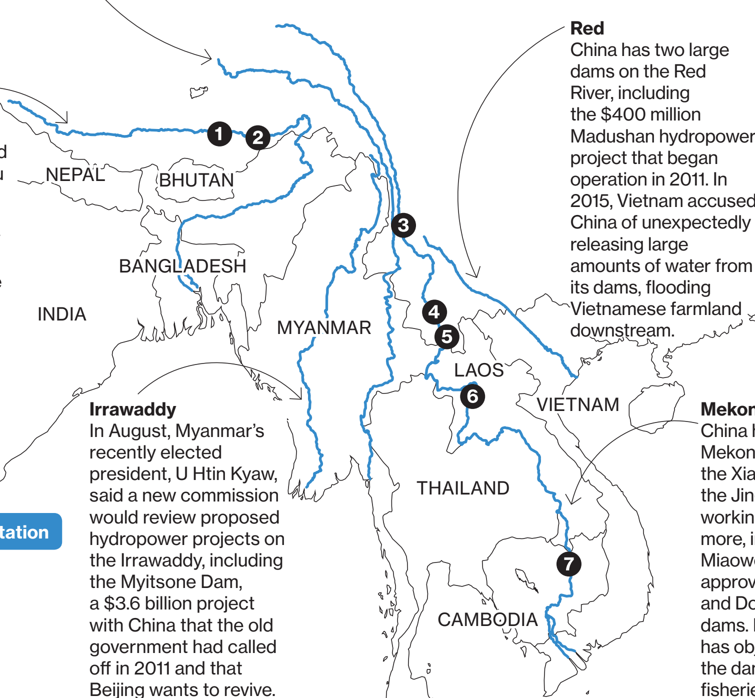
Resources Water Fights

As Asia's populations grow and its weather becomes more extreme, fresh water is becoming a source of conflict. Because many Asian countries depend on water from rivers that originate in Tibet, China is involved in most of the disputes. —*Bruce Einhorn*

❶ Yarlung Zangbo project

❷ Zangmu hydropower station

❸ Miaowei dam



Indus
India plans to review the 1960 Indus Waters Treaty with Pakistan and is examining whether it can further dam and exploit the Indus, which flows through disputed Kashmir into Pakistan's territory. Islamabad has said it would treat India's abrogation of the treaty as "an act of war."

Salween
China has yet to move ahead on plans to build five dams on its part of the river. The Upper Thanlwin (Mong Ton) Hydropower Project in eastern Myanmar, near the border with Thailand, includes a proposed 231-meter-high dam. The $10 billion project, backed by Chinese and Thai companies, is unpopular among the ethnic minority Shan people who live in the area to be flooded.

Brahmaputra
China this year finished the $1.5 billion Zangmu hydropower project, and on Oct. 1 it said it's blocking a tributary of the Brahmaputra (known in China as the Yarlung Zangbo) for a $740 million project to be completed in 2019. The Chinese media dismissed foreign concerns about "an imaginary water war."

Red
China has two large dams on the Red River, including the $400 million Madushan hydropower project that began operation in 2011. In 2015, Vietnam accused China of unexpectedly releasing large amounts of water from its dams, flooding Vietnamese farmland downstream.

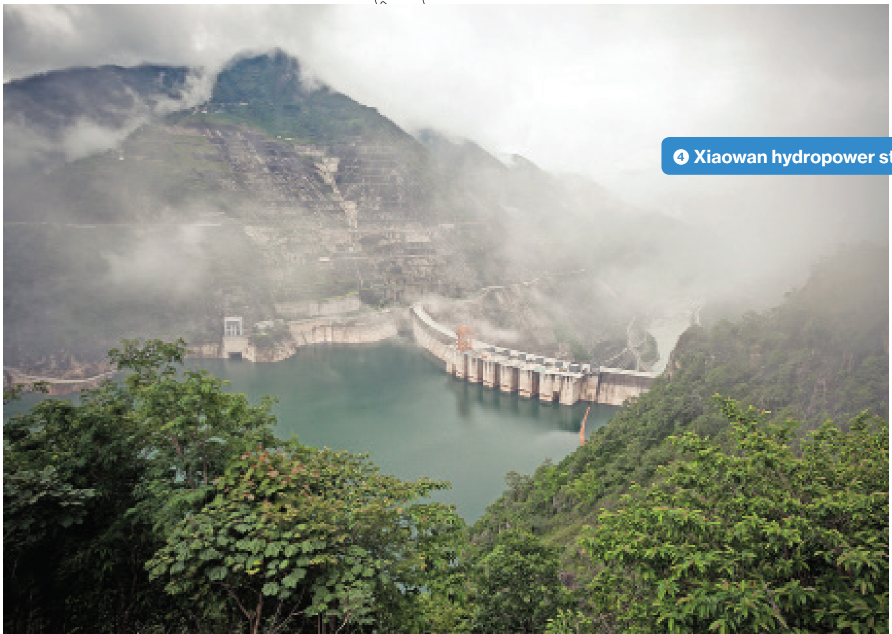
Irrawaddy
In August, Myanmar's recently elected president, U Htin Kyaw, said a new commission would review proposed hydropower projects on the Irrawaddy, including the Myitsone Dam, a $3.6 billion project with China that the old government had called off in 2011 and that Beijing wants to revive.

Mekong
China has six large Mekong dams, including the Xiaowan and the Jinghong, and is working on several more, including the Miaowei. Laos has approved the Xayaburi and Don Sahong dams. But Vietnam has objected, saying the dams will disrupt fisheries and river flow.

❺ Jinghong hydropower station

❻ Xayaburi dam

❼ Don Sahong dam



❹ Xiaowan hydropower station

◀ tax options, but "it seems unlikely that personal income taxes will be applied in the near term, as authorities will want to assess the impact of VAT before applying new taxes," says Raza Agha, the London-based chief economist for the Middle East and Africa at VTB Capital. "There may also be logistical challenges to implementing too many new taxes simultaneously." —*Zainab Fattah and Stefania Bianchi*

The bottom line The U.A.E. and other Gulf states are experimenting with value-added taxes and other levies to offset budget costs.

Foreign Investment

A Gold Rush in Mexico's Deadly South

▶ **Canadians are investing in violence-plagued Guerrero state**

▶ **"We're very involved with our security folks"**

In Mexico's Guerrero state, the earth holds many secrets—some gruesome, some precious. The rolling hills are full of unmarked graves, a reminder that the southwestern state is known as Mexico's murder capital. But there's gold in the hills, too. Lots of it.

Guerrero is poor, but the mountains in its interior are rich in mineral deposits—iron and lead as well as gold. Although Mexico has long been a top destination for mining investment, drawing $21 billion in the past decade, according to government sources, gangs battling for control of Guerrero's opium crop have kept foreign companies away. That's starting to change. Toronto-based **Torex Gold Resources** has plowed $800 million into an open-pit mine that opened in April. Two other Canadian miners, **Timmins Gold** and **Minaurum Gold**, have plans to explore and develop their own deposits in the state.

Cocula, the closest town to Torex's El Limón-Guajes mine, is where the bodies of 43 college students were burned in a trash dump in 2014, according to federal investigators. The government alleges that a local mayor, in league with a drug cartel, had them kidnapped to prevent planned protests. "We're very involved with our security folks to keep track of the risks," says Fred Stanford, the president and chief executive officer of Torex, who makes a 12-hour trip from Toronto every six weeks or so to check on the property.

Torex expects El Limón-Guajes to produce an average of 360,000 ounces annually for as long as 12 years, which would probably make it the second-most productive gold mine in Mexico, according to Stanford. Torex's stock has more than doubled in the past year, aided by an 8.7 percent increase in the precious mineral's price.

Of the company's 1,800 employees and contractors in Mexico, 100 are security guards. Torex hauls the gold out by armored car along a 12-mile road with armed checkpoints that it built itself to avoid running into bandits along the winding dirt pass that climbs through the mountains toward Cocula. In February of last year, 13 people, including seven working at Torex's mine, were kidnapped by criminals linked to a drug cartel. They were freed days later with the help of federal police. Workers from **Goldcorp**'s nearby Los Filos mine weren't so lucky. Four went missing in March 2015; the bodies of three were found in a ravine.

Guerrero and Torex need each other. El Limón-Guajes, along with an adjacent deposit, are the Canadian miner's sole assets. Its investment is the largest the state has ever received. Torex plans to spend about $500 million more to start the neighboring project, Media Luna, within five years or so.

Guerrero needs the money. Drug-related murders and kidnappings have

Goldcorp's Los Filos mine—and yes, those are trucks

A Crimean souvenir

decimated tourism, once the lifeblood of its economy. The resort town of Acapulco has seen the number of foreign visitors plunge over the past decade. "Mining provides very-well-paying jobs in regions where people have few other opportunities," says Michael Harvey, chairman of the Canadian Chamber of Commerce's mining task force in Mexico. The Torex investment, he says, "is going to mean 20 to 30 years of jobs." *—Eric Martin, with Benjamin Bain, Danielle Bochove, and Jessica Brice*

The bottom line An $800 million investment in a gold mine by Toronto-based Torex is the biggest ever for Mexico's Guerrero state.

Geopolitics

Crimea Welcomes a Flood of Putin Patriots

▶ **For Russians, the thrill of annexation has yet to wear off**

▶ **"Drop whatever you're doing... and move to Crimea"**

From the Russian city of Perm, on the outer edges of the Ural Mountains, to the peninsula of Crimea, it's about 1,800 miles. By car, that's a good 40 hours, give or take a few. Undaunted, the Shvetsovs, Sergey and Irina, loaded their two kids into the backseat of their Lada and hit the road one day in early September. They drove west day and night to Moscow, where they picked up a federal highway heading south to the Black Sea, and finally reached the ferry that crosses the Kerch Strait.

They came for the same reason that thousands of other Russians are pouring into a chunk of land that until recently was part of Ukraine: to see President Vladimir Putin's newest acquisition with their own eyes and to stock up on cheap souvenirs glorifying the 2014 takeover. "Crimea Is Ours" T-shirts are wildly popular; the Shvetsovs bought three. So are "Putin the Liberator" magnets; the couple picked up a dozen. Crimea "needs a strong leader," says Sergey, a slender 41-year-old with a bushy mustache. "And Putin is a strong leader."

The peninsula was a summer retreat for the Russian aristocracy in czarist times and later for high-ranking Soviet officials. Today it's as much a destination for middle-class Russians as for the wealthy. On a weekday afternoon in September, tourists are packed tightly into the area's lone airport, sitting on suitcases scattered across the floor. Along the trendy southern shore, hotels are taking reservations into the dead of winter.

The annexation is bitterly contested by Ukraine and has been repeatedly condemned by the European Union and the U.S., which have slapped sanctions on Russian banks and on top officials. A two-year-old insurgency by Kremlin-backed rebels continues in eastern Ukraine, where the death toll is approaching 10,000.

With Putin and his aides heaping outsize attention on the peninsula—they visited recently to check on the progress of a new Crimea-to-Russia bridge, part of billions in investment Moscow has pledged—there is a palpable sense among many locals and tourists that the region is on the verge of a development boom. Shvetsov, having watched countless hours of news coverage about Crimea on state TV, says he's convinced the place is destined to be "the Next Big Thing." So big, says one local, it will eventually rival the French Riviera. "Drop whatever you're doing, wherever you are, and move to Crimea," says Sergey Bespalov, a part-time taxi driver, part-time grape farmer.

After the Ukrainian authorities were driven out two years ago, Bespalov, fearing the geopolitical tensions would keep tourists away, braced for a big falloff in business. The foreigners have stopped coming, as expected, but that's been offset by the surge in visitors from Russia. Bespalov figures that between the grapes and the taxi fares, he and his wife are doing at least as well as they did before, pulling in about 30,000 rubles ($483) a month.

Bespalov, like many Crimeans, speaks fluent Russian and says he always felt greater loyalty to the Kremlin than Kiev. The peninsula was part of Russia for the better part of two centuries until Nikita Khrushchev turned it over to Ukraine, then a part of the Soviet Union, in the 1950s. (One of today's best-selling souvenirs is a magnet saying "Khrushchev Gave It Up, Putin Took It Back.")

A decade before that handover, the region played a central role in World War II. First, Soviet troops repelled Axis forces trying to take Sevastopol, earning it the moniker Hero City; then, in early 1945, it was the site of the famed Yalta Conference, where Franklin Roosevelt, Winston Churchill, and Joseph Stalin met to draw the postwar map of Europe. The palaces that hosted Roosevelt and Churchill—spectacular, czarist-era retreats carved out of the rugged mountains overlooking the water—are obligatory tourist stops.

The region's vineyards have also become a big draw for Russian visitors. With the ruble down about 30 percent against the euro since the annexation, connoisseurs have been scooping up Crimean cabernet and merlot instead of ponying up for imported French and Italian wines. There are vintages for every budget, from a 2016 chardonnay for $4 to an 81-year-old Massandra pink muscatel for $1,100.

Anton Kazakov, a young ad executive from Moscow, was dining with friends at a popular fish restaurant in Balaklava late one night and boasting about a pair of $500 bottles he'd purchased earlier that day. They, too, were Massandras, a top local label, and dated from the 1960s. When the topic turned to the U.S. and Russia and the standoff over Crimea, Kazakov quickly lost interest. "I'm just here for the good wine," he said. *—Elena Popina*

The bottom line Crimea is reliving its glory days as a destination for Russian tourists, though now it's middle-class travelers who are flocking there.

FROM RIGHT: COURTESY GOLDCORP; MIKHAIL POCHUEV/ITAR-TASS; ILLUSTRATION BY SIMON ABRANOWICZ

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