

Copper Investments in Chile versus Cyprus

A Country Risk Report

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Table of contents

I. Introduction

A. Why copper for the EU ?

B. Why Cyprus versus Chile ?

II. Copper production

A. In Chile

1. The importance of copper in Chile

2. Production and reserves

3. Principal producers in the sector

B. In Cyprus

1. Current status

2. Responsible mining

3. Main status and current account

III. Country Risks

A. Cyprus

1. Political factors

2. Economic factors

a) Strengths

b) Weaknesses

3. Environmental factors

B. Chile

1. Political factors

2. Economic factors

3. Environmental factors

IV. Conclusion

I. Introduction

As the EUs urge to discover new resources for its continuously rising need for copper becomes more and more of a matter, some representatives decided to ask for professional help. This is where we come in - a consultancy that is specialized in analyzing specific country risks and advising their high profile clients on matters as such. The following is meant to give the EU an overview and our advice on copper investments in Chile versus Cyprus.

A. Why copper for the EU ?

The reasoning behind the EUs urge for new copper resources or the expansion of old ones has multiple reasons, which we would like to elaborate on in the following.

1. Copper can become Europe's climate currency

Bernard Respaut, Chief Executive of the European Copper Institute (EIC, 2023), emphasized that the publication of the Critical Raw Materials Act demonstrates the European Commission's recognition of copper's crucial role in enabling the EU's transition towards a climate-neutral continent. Copper is classified as a strategic raw material, given its significance in electrification and primary decarbonization technologies. The anticipated doubling of copper demand by 2050, driven by the increasing popularity of wind farms, solar PV, and other net zero technologies, necessitates greater copper availability in Europe (EIC, 2023). However, current challenges include lengthy permitting procedures and a complex regulatory environment, hindering the realization of copper's potential. Despite these obstacles, copper can play a substantial role in reducing the EU's carbon emissions by 25% by 2050, equivalent to the emissions from 436 million cars, due to its high conductivity and efficiency in energy systems, power cables, and electronics (EIC, 2023).

2. The Russia-Ukraine conflict : finding new alternatives to Russian copper

The US and Europe impose sanctions on Russia, affecting various metal sectors, including copper. Russia is a significant exporter of copper-related resources, producing 4% of the world's refined copper (Nasdaq, 2021). The impact of the Russia-Ukraine crisis and sanctions on copper trade worldwide includes reduced market demand for Russian copper-related items, especially in Europe and the US. Russia's logistical challenges and customs clearance issues will result in decreased copper exports in the near future (Fang & Shao, 2022). Additionally, copper smelters in Russia may limit output due to the previous export tariff policy and increased stock levels. As a result of the conflict's logistical issues in the Black Sea, the supply of copper cathode in Europe experiences a short-term decline, affecting shipments from Kazakhstan and Uzbekistan to European countries like Turkey, France, and Britain (Fang & Shao, 2022).

3. An environmental hazard

Between February and December of 2022, Russian exports to the EU decreased by 51%, but there is still room for imports to decline much further (LME, 2023). The ongoing import of goods from Russia not only helps to indirectly support Russian aggression in Ukraine but also seriously pollutes the country's internal ecology, which has an outsized impact on global warming.

A quick look at the list of industrial facilities with a negative environmental impact that fall under the first, highest hazard category, reveals that a sizable portion of them are businesses that produce goods that are imported by the EU. The businesses on this list account for at least 60% of all pollution emissions in Russia. The main copper exporter enterprises are on the list (SMM, 2022).

B. Why Cyprus versus Chile ?

The comparative analysis of Cyprus and Chile in the context of copper exports to Europe highlights the significant disparities in their copper production capabilities and market positions. Chile, as the world's largest copper producer, enjoys a dominant position in the global copper market due to its extensive reserves, advanced infrastructure, and favorable investment policies. In contrast, Cyprus has limited copper production and faces challenges in competing directly with Chile in exporting copper to Europe. However, opportunities may exist for Cyprus in niche markets where it can leverage its unique capabilities to produce higher-value copper products or offer specialized services tailored to specific European industry demands. Understanding trade relationships, market dynamics, and regulatory frameworks is crucial for stakeholders to navigate these challenges and identify collaborative opportunities to facilitate copper exports from Cyprus to Europe.

II. Copper production

A. In Chile

1. The importance of copper in Chile

This highly sought-after metal, one of the very first metals that humans have worked, is utilized in various applications worldwide, including electrical wires, musical instruments, coinage, buildings, transportation, and plumbing.

Copper is frequently referred to as Chile's "salary" and is a foundational element of the nation's economy (Ebert & La Menza, 2015). More than 5.6 million tonnes of copper were mined in Chile in 2013, making it the top producer in the world (more than 30% of global production), ahead of the United States, Peru, and China. More than 50% of its exports and almost 20% of its GDP are currently attributed to mining (Ebert & La Menza, 2015). Copper mining takes

place in the center and especially in the north of the country, in the very arid desert of Atacama. Chile would have reserves equivalent to 200 years of operation.

2. Production and reserves

According to Trading Economics' 2023 report, Chile produced 440.4 thousand tonnes of copper in march. According to this historical record, Chile is now the largest copper producer in the world, accounting for more than 40% of global production. The current copper market is "technically in balance, with demand slightly higher than supply," according to Baldo Prokurica, the mining minister, and Jorge Cantallop (Cochilco, 2023). Cochilco maintains its copper pricing estimates at US\$3.05 per pound for 2019 and US\$3.08 for 2020 in light of this favorable climate.

3. Principal producers in the sector

State-owned Codelco (Corporación Nacional del Cobre), the largest producer of copper in the world (10%) and responsible for one-third of Chile's total production of red metal (1.842 million tonnes in 2017), dominates the mining industry in Chile (ITA, 2023). With exports worth more than US\$70 billion, Chile is the 42nd-largest export economy in the world. Among these exports, copper ore and refined copper are in first place with 16.6 and 14.9 billion dollars in revenue each, followed by 2.41 billion in crude copper (ITA, 2023).

B. In Cyprus

1. Current status

In response to a resurgence in interest in copper production in the nation, Venus Minerals has compiled an enormous geoscientific database across Cyprus, representing more than €100 mln in activity at today's prices (Financial Mirror, 2021). Due to this, the corporation has been able to maintain control of valuable mining and exploration licenses in the most promising regions of the nation.

It is crucial to thoroughly investigate the chosen projects by carrying out various soil tests, test drillings, ground and mineralization modeling, as well as scoping and optimization studies in order to identify and evaluate all these elements. In order to do this, Venus Minerals employs ground-breaking innovation and technology that is consistent with its overarching business plan (Financial Mirror, 2021).

2. Responsible mining

Modern technology has sped up recovery and reduced environmental footprints. Rehabilitating the land is essential to ethical mining. Technology for land rehabilitation has advanced to a high level, and it is now more accountable, better administered, and subject to strict regulations than ever before (Venus Minerals, 2021).

It is important to note that numerous government agencies continuously keep an eye on the repercussions of mining operations, including noise pollution, water contamination, and air quality. Mining firms in Cyprus must abide by all applicable EU regulations, some of the harshest in the world, as the country is an EU member. For businesses to have a sustainable future, they must embrace transformation. Technology is the driving force behind the sector's change because it can considerably improve mining production and safety while also becoming a key economic contributor to Cyprus (Financial Mirror, 2021).

Innovations, in particular artificial intelligence, robotics, remote operations, machine learning, and automation, will revolutionize how modern exploration and mining is conducted while also assisting the sector in overcoming significant challenges in an era where rapid technological advancements are constantly influencing the future of mining.

3. Main status and current account

The corporation cited Cyprus as an example of a country that may resume its position as a significant producer of copper, the third-most-used metal in the world and a key component of the Green Transition. It said that presently, more than 400 copper alloys are employed in diverse applications across a wide range of industries (Financial Mirror, 2021).

III. Country Risk

A. Cyprus

In order to determine whether Cyprus is a right candidate for EU investment in copper mining, it is essential to assess the country's political, economic, and environmental conditions. This risk analysis will examine these factors and provide an informed analysis to support informed decision-making by investors.

1. Politics

The island of Cyprus has had troubled events within its population. The northern part is predominantly composed of a Turkish related population while the southern part identifies as Greek (Britannica, no date). Both parts claim the island and have never come to a solid solution on how to split the island. This led to several conflicts over the decades, leading to the division of the island in 1974 into a northern and a southern part (Britannica, no date). The southern part was declared Cyprus and has been internationally recognized as a state (Coface, 2022). Since 2004 it has been part of the EU (BBC, 2023). The northern part declared itself as the Turkish Republic of Northern Cyprus (TRNC) in 1983 (Britannica, no date). It has never been internationally recognized as a state and in fact is only recognized as such by Turkey (Coface, 2022). Even though there have been many attempts in doing so, even by the EU, the differences between both parts have not been solved to this day (Coface, 2022). Still, the military expenditure of Cyprus has decreased over the past two decades (The World Bank, no date). A little increase can be seen in 2022 for the first time since 2001 but this increase is not due to a

conflict within the island but rather because of the EUs guidelines in face of the Russian invasion of Ukraine (APNews, 2023). Cyprus is generally located in a tense geopolitical area with Syria and Turkey as neighbors. In February 2023 Nikos Christodoulides got elected as new president, replacing Nikos Anastasiadis, after 10 years in office (France24, 2023; BBC 2023). It has been a long time agenda of Christodoulides to unite the island but with the uprising economic problems of Cyprus, such as a growing wealth gap and rising costs of living, it is more probable that he will focus on that (France24, 2023; BBC 2023). Another political challenge remains the refugee question. Cyprus has continuously struggled for years to manage the significant number of refugees that came to the island with the start of the conflicts in Syria (Jégo, 2023). On a brighter note Cyprus had a Human Development Index (HDI) of 0.896 in 2021 which places it on rank 29 worldwide and has improved from 0.716, so by 25.1% since 1990 (UNDP, 2022).

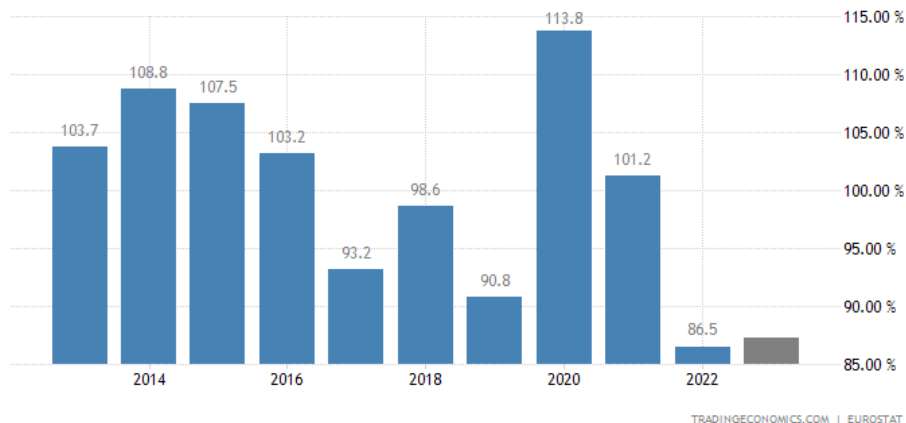
Cyprus is on rank 51 out of 180 in 2022 of Transparency International's corruption perception index (CPI). The CPI has worsened for years (Transparency International, 2022). Reasons for that are Cyprus' golden visa policy, which allowed non EU citizens to basically buy a citizenship of Cyprus and other corruption scandals the country has faced (France24,2023; Julija, 2023). The golden visa program has been stopped in 2020 (Julija, 2023).

2. Economics

To make this part more clear the economic situation will be separated into strengths and weaknesses.

a) Strengths

When it comes to the strengths of the Cyprus economy there are quite a few. Cyprus has a very attractive fiscal system for corporations with a corporate tax rate of only 12.5%. Only Ireland has a corporate tax rate as low as the one of Cyprus within the EU (Allianz, 2022). Another economic advantage of Cyprus is that they have a highly skilled and English speaking workforce (Coface, 2022; Allianz 2022). Cyprus has a very beneficial central geographic position with access to the Asian, European and African markets (Coface, 2022; Allianz, 2022). After being hit by a financial crisis in 2013 Cyprus managed to recover its economy (Allianz, 2022). It is known to have had a relatively good management of the COVID pandemic (Coface, 2022). To put the mentioned in a few numbers: Cyprus had a trade openness ratio of 170.31 in 2021, which is nearly double to the global average ratio of 89.24 (The Global Economy, 2021). The real GDP increased by 5.8% in 2022 compared to 2021, which is more than prognosed (European Commission, 2023). Due to their good pandemic management tourism reached 80% of the 2019-levels in 2022 and is estimated to reach before pandemic levels this year again (European Commission, 2023).



Cyprus Government Debt to GDP

The graph shows that the government debt to GDP ratio has decreased after the financial crisis in 2013 with a little high due to the pandemic in 2020 again. But even after that the biggest decrease since the crisis 2013 can be seen in 2022. Further, the HICP inflation reached a 4 decade high in 2022 with 8.1% but is estimated to decrease in 2023 as gas and oil prices lower again (European Commission, 2023).

b) Weaknesses

So far so good on the strengths but what are the weaknesses? Cyprus has a weak industrial diversification with an overly focus on the services sector. Their main industries with a total output of 84% are tourism, construction, natural gas and finance (Allianz, 2022). They have a high level of public and private debt and slow legal processes and poor enforcement of contracts (Coface, 2022).

It was estimated that the Russian invasion of Ukraine would have a high impact on the Cyprus economy as Russia and Cyprus have tight economic bonds (Skaliotou, 2022). Russian, Ukrainian and Belarussian tourist make up a big part of all tourist, which could have impacted the important tourism sector (Skaliotou, 2022). But as the numbers show, that was not the case. Further Russia is one of the biggest sources for foreign direct investments (FDI) in Cyprus, making up 8.1% on average between the years 2018-2020 of all FDI in Cyprus (Skaliotou, 2022). So far it does not seem like the impact is as big as estimated with the GDP growing more than predicted and other factors like the unemployment rate even decreasing in 2022 (Trading Economics, 2022). But as of today (May 10, 2023) Cyprus has still not published numbers that show the actual impact the Russian invasion of Ukraine had on the economy of the country. Further, with Russians having dual citizenship, because of the golden ticket policy, it might be even harder to predict the dimensions of Russia's influence and its economic impact on Cyprus.

3. Environment

When it comes to the environmental situation of Cyprus there are some issues. Cyprus is already affected by climate change (OECD, 2019). As one of the most water-scarce countries in the world it heavily struggles with its water management (OECD, 2019). Even though it has improved partly over the past years the EU still criticizes Cyprus water management and the quality of water as neither meets the standards set by the EU for its member states. The water

is supervised centrally by the council of ministers which shows the importance of water in Cyprus(OECD, 2019). With already high water demands it is doubtful that Cyprus can handle another water demanding industry like copper mining. Cyprus in general is at high risk for natural disasters due to its geographic placement (European Environment Agency, 2020). As climate change and rising temperatures will only decrease the water supply and increase the risk for future disasters, Cyprus will only be at greater risk for the effects of climate change (European Environment Agency, 2020).

B. Chile

Chile is a country located in South America with a stable democracy, a diversified economy, and a relatively high level of development. However, as with any country, there are risks and challenges that need to be considered when assessing the potential for investment or business opportunities in Chile. This risk analysis will examine the main economic, political, and environmental factors that have the potential to have an impact on the investment. By providing a comprehensive overview of the risks and opportunities in Chile, this analysis aims to support informed decision-making by investors.

1. Political Factors

In 2019, protests erupted in Chile due to an increase in metro fares which awakened broader anger regarding inequality and high living costs. These protests led to the government's commitment to boost social spending, impose higher taxes on the wealthy, and hold a referendum on creating a new constitution. In 2022, Gabriel Boric, a self-proclaimed moderate socialist, was elected president. He pledged to increase social spending and proposed a tax reform package in July 2022 to generate additional revenue equivalent to 4.1% of GDP once fully implemented, gradually from 2023 to 2026 (Malinowsky, and Fuentes, 2022)

The tax reform primarily focused on raising taxes on higher incomes, increasing mining royalties, and reducing tax exemptions and evasion. The government also presented a pension reform that would be financed equivalent to 6% of employees' wages and would be fully paid by employers (Coface). The combination of all the proposed changes was not taken well by the investors and companies. One indicator of this was the fact that companies in Chile's 57-member IGPA index (IPSA) paid a record 10.9 trillion pesos (\$13.2 billion) in dividends in 2021, and another 10.6 trillion pesos in 2022, more than double the prior two years (Thomson, 2023).

However, there are multiple reasons that make us believe that the above outlined concerns started fading away and will continue to do so. The proposed constitution was rejected due to it being too progressive. The government's tax bill was rejected on March 8, 2023 (FitchRatings, 2023). The mining royalty bill, which was the main concern for the investors, is still being negotiated as it received a huge push back from the copper companies. These developments in combination with Morgan Stanley's analysis makes us believe that the proposed tax, pension, and health system reforms will be less radical than initially thought (Attwood, and Fuentes, 2023). Additionally, in March of this year, Canadian-based company

Lundin Mining Corp announced its acquisition of a majority stake in Chile's Caserones copper mine for approximately \$950 million (Lundin Mining, 2023). This acquisition is seen as a strong indication of declining political risk in Chile, particularly because Lundin Mining Corp had previously expressed hesitancy to invest in the country until the political and regulatory environment improved. This development also highlights the positive outlook for copper in the energy transition and the attractiveness of acquiring existing mines rather than constructing new ones. It is also important to note that Chile experiences a lower level of corruption compared to many other countries in Latin America, with a ranking of 27th globally out of 180 countries in Transparency International's 2021 Corruption Perceptions Index (Transparency International). This places Chile in a similar position as the United States and second among Latin American countries in terms of perceived corruption.

2. Economic Factors

Current Account recorded a deficit of 9.4 USD bn in Sep 2022; however, this large account deficit registered in 2022 will partially ease this year, and the trade balance surplus will widen (CEIC Data). This is because imports will decrease due to lower demand within the country, while exports will continue to grow. Real GDP growth slowed down to 2.4 percent in 2022 (World Bank). The decrease in demand and the slowdown in GDP growth can be partially attributed to a contractionary fiscal and monetary policy approach that aimed to normalize consumption as part of the COVID-19 recovery. To control inflation and discourage excessive borrowing and spending by consumers and businesses, the Central Bank of Chile raised interest rates (Santander Trade).

According to the IMF, Inflation reached 11.6% in 2022 and is expected to decrease to 8.7% in 2023 and 4.1% in 2024. This can be attributed to the government's plans to reduce spending by 1.6% of GDP over the next four years, as announced by the Treasury Department. Additionally, the tight monetary policies mentioned earlier that aim to limit credit growth and lower overall demand will also contribute to reducing inflationary pressure. The country has the highest GDP per capita in the region of USD 14,772, according to Coface but also high levels of inequality and informality according to OECD (Santander Trade). Wealth disparity is influenced by various factors including the existing tax system which disproportionately affects lower and middle-income classes. However, there are expectations that the second revision of the constitution will address these issues and aim to rectify the imbalances caused by the current tax system.

On a brighter side, Foreign Direct Investment (FDI) increased by 255.7 USD mn in Dec 2022, according to CEIC Data. Partially, the increase in FDI can be attributed to the implementation of the "Let's Invest in Chile" plan by the government that was launched in September 2022. This plan aims to boost investment by five percentage points in 2023 and consists of a comprehensive set of measures (Gov.cl, 2022). These measures, divided into six areas of focus, include providing tax incentives for private investment, especially in the copper sector and projects with a multiplier effect and green initiatives (Gov.cl, 2022). Additionally, the plan aims to enhance access to financing, improve public investment, and promote foreign investment. On top of this, the International Monetary Fund (IMF) has granted Chile a two-

year Flexible Credit Line (FCL) arrangement totaling approximately US\$18.5 billion (IMF, 2022). This arrangement aims to support Chile in bolstering its financial reserves and safeguarding its economy from potential negative situations. Even though IMF lending FCL could be viewed as a sign of economic weakness or dependency on external support, it is important to highlight that the FCL is a specific type of loan provided by the IMF to countries with robust economic policies and strong fundamentals. It serves as a precautionary measure, offering a safety net in the event of future economic shocks. It's important to note that Chile intends to treat this loan as a precautionary measure and does not plan to utilize the funds unless unforeseen economic challenges arise (IMF, 2022).

3. Environmental Factors

The country's geographical location and diverse climate make it susceptible to a range of hazards. Chile faces significant exposure and is vulnerable to earthquakes, volcanic activity, tsunamis, wildfires, floods, landslides, and droughts. These hazards pose ongoing risks to the country's population and infrastructure. Among these hazards, flooding and wildfires have been occurring more frequently in recent years. Additionally, according to the World Bank, earthquakes, although less frequent, represent a substantial proportion of both mortality and economic losses resulting from natural disasters in Chile. Furthermore, the frequency of these hazards and their impacts are already being exacerbated by the effects of climate change introducing additional uncertainties and potential shifts in the occurrence and intensity of wildfires, floods, and landslides.

One of the biggest environmental concerns in Chile is severe water scarcity, and a significant portion of it, around 25%, can be attributed to human-induced climate change (Igini, 2022). Half of Chile's 19 million people already live in the areas suffering from this severe water scarcity. Climate change has contributed to this number as warming temperatures have caused glaciers to retreat. The Andean glaciers which have historically served as a crucial water source for communities in the surrounding areas by supplying rivers and lakes, have experienced a staggering 98% reduction in their size (Igini, 2022). This significant decline in ice poses a serious risk to water availability and agricultural activities in Chile.

The above provided facts, especially the ones regarding water may sound concerning to the investors as the mining industry uses water during multiple stages; however, there are a couple of other factors that must be taken into consideration. First, Chile has one of the world's most privatized systems of water allocation and its constitution specifically says that water rights are treated as private property. Second, the mining sector only uses 4% of the water while the agricultural sector uses 72%, followed by drinking water 12% (International Trade Administration, 2022). While at the same time the mining sector contributed US \$317 billion to the Chilean economy, which equalled about 15% of Chile's GDP, according to the International Trade Administration (International Trade Administration, 2022). On top of this, 73% of the water used by Chilean copper mines comes from reuse (70% from continental water and 30% from sea or desalinated water) (Bnamericas, 2022). It is important to note that mining industries are working tirelessly on building new desalination plants. By 2028, the industry is planning on building 15 new plants, with the projections of seawater usage being almost equal

to the freshwater usage in a decade (gob.cl, 2021). Considering all the above factors, the shortage of water for the copper industry should not be a concern that turns investors away.

IV. Conclusion

We do not advise the EU to invest into copper mining in Cyprus. More mining would lead to higher water demands as copper production requires a lot of water. Cyprus can't handle the water demand as it is and has repeatedly proven to not being able to manage its water related problems. It is therefore doubtful that it would step up to the new demand. Even if it managed to supply the water demand somehow, the copper resources would still not be big enough to cover the EU demand for copper. Meaning that costs and benefits would probably not be in alignment. Further, Cyprus is still in a very unstable political situation with high risk of more instability. Even if there is no conflict with the TRNC right now, Cyprus is always on the verge of a conflict with it. Especially with the unstable political situation in Turkey, it is very hard to predict what is about to happen and if there is a new conflict about to arise. A conflict could have a strong impact on copper mining as a result. Lastly it is still not clear how much of an influence Russia still has over Cyprus. As the EU is currently trying to take a stand against Russia, investing into Cyprus could undermine this intention.

Instead we advise the EU to invest in Chile as it offers a favorable investment climate in the copper industry. Despite initial concerns, recent developments indicate reduced political risks. While protests and proposed reforms raised uncertainties, the rejection of the proposed constitution and tax bill, along with the acquisition of a majority stake in a copper mine by Lundin Mining Corp, signal a more stable environment. Chile's relatively low corruption ranking adds to its appeal.

Economically, Chile is implementing measures to address challenges. The government's "Let's Invest in Chile" plan aims to boost investment, particularly in the copper sector, through tax incentives and green initiatives. The country's high GDP per capita, combined with reduced inflation and increased foreign direct investment, points to growth potential. Environmental challenges, such as water scarcity, are being addressed through the mining industry's efforts to build desalination plants. Overall, Chile's stable democracy, positive economic indicators, and ongoing efforts to mitigate environmental risks make it an attractive destination for copper investment.

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