Has Bank of Nova Scotia (TSX:BNS) Hit a Snag in Latin America?

Description

Unrest in Latin America continues to grow with the civil unrest witnessed in Ecuador and then Chile spreading to the region's third largest economy Colombia. Last week Colombia experienced one of the largest mass anti-government protests witnessed in recent history.

There are very real fears that the ongoing civil unrest in the Andean nations of Chile and Colombia will have a sharp impact on **Scotiabank's** (TSX:BNS)((NYSE:BNS) performance despite CEO Brian Porter dismissing those concerns, claiming that the Latin American countries in which it operates have proven resilient and that the social issues will be resolved.

Rising regional political and economic risk

While Porter could well be right, there are signs that the socioeconomic issues driving the latest round of unrest run far deeper than many analysts and commentators originally believed.

Over the last two decades, the bank has invested heavily in Latin America, where it is now a top 10 ranked bank in the Pacific Alliance nations of Mexico, Chile, Peru and Colombia, with those nations responsible for around a fifth of its net income.

There is every indication that they could have a deep impact on economic growth in the affected nations, which in turn would cause Scotiabank's regional earnings to decline, negatively affecting its bottom line.

The ongoing unrest in Chile has already impacted consumption and business confidence, which in turn will lead to lower demand for credit exacerbated by a weaker economy.

Chile's finance minister has cautioned that the ongoing civil unrest could cause the world's biggest coppers producers 2019 GDP growth to fall from the 2.6% projected to as low as 2% year over year.

That would be a blow for Scotiabank, which after recently acquiring BBVA Chile in a US$2.2 billion 2018 deal, became the Andean nation's third largest privately owned bank.

For the fourth quarter 2019, Chile was responsible for generating almost 5% of Scotiabank's adjusted net income, highlighting that a sharp decline in the Andean nation's economy could have a marked impact on the bank's financial performance.

Colombia, where Scotiabank is the sixth largest bank by market share, was convulsed by protests in its major cities during the last week sparked by growing dissatisfaction with the elected government of President Ivàn Duque.

As in Chile there is no central leadership for the protests but rather a broad range of disparate groups protesting growing socioeconomic inequality, lack of opportunity, rising corruption and the failure of state to meet its social contract.

While Colombia reported better than expected third quarter 2019 GDP growth of 3.6% year over year, there are signs that it could soften because the current unrest along with significant policy failings and an emerging fiscal crisis expected to crimp growth.

The Colombian peso has also fallen to a record low against the U.S. dollar because of weaker oil, Bogota's emerging fiscal crisis and the ongoing protests across the nation.

This isn't good news for Scotiabank, which invested heavily in expanding its presence in Colombia, acquiring Citibank's consumer and small- to medium sized businesses in mid-2018.

Despite Colombia being responsible for 5% of Scotiabank's fourth quarter revenue, it only generated around 1% of its net earnings, indicating that operational issues were already weighing on profitability.

A softer economy and civil unrest in the Andean nation will cause demand for credit to fall, impacting Scotiabank's results. That will be further exacerbated by a weaker Colombian peso.

Foolish takeaway

Scotiabank's presence in the Pacific Alliance nations of Mexico, Colombia, Chile and Peru has become an important growth driver for the bank. Not only has it allowed Scotiabank to offset declining growth opportunities in Canada's saturated lending market, but has also provided an alternate avenue to achieve growth in a region experiencing strong economic growth.

There are signs that the current unrest in Colombia and Chile will impact Scotiabank's earnings over the remainder of 2019 and into 2020 until the political, social and economic issues in those countries are resolved.

This shouldn't cause investors to sell their stocks, however. It remains a top long-term play that's rewarding patient shareholders with a sustainable dividend yielding a juicy 4.8%.

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