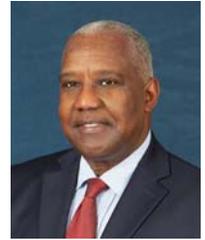


Major Country Developments August 2016



By Byron Shoulton

Overview

Turmoil spread to Turkey which was rocked by a failed coup attempt. The fallout is of immense significance to Turkey's future and its long-held position as an ally of the West. The failed coup caused political relations between Egypt and Turkey to deteriorate further. Egypt's leader accused the Turkish President of not exercising sound judgment in failing to differentiate between a coup and an intervention by the military. This is not being taken kindly by the Turkish President. Turkey assisted Egypt with a five-year \$2 billion central bank loan, with an interest rate of 1%, signed in 2012. The tense relations between the two countries today means Turkey is highly unlikely to renew the terms of the loan once it is repaid in late 2017. Meanwhile, living conditions for most of the electorate in Egypt have deteriorated in the context of a faltering economy. Consequently, President Sisi has been exposed to unaccustomed criticism. Adding to the popular resentment towards the political elite, the newly elected parliament has failed to project a sense of common political purpose.

The failed coup caused political relations between Egypt and Turkey to deteriorate further.

In **Latin America** sovereign risks remain elevated in most of the region even as some stabilization of commodity prices should help in easing economic conditions. A gradual recovery of exchange rates from the lows of first quarter of 2016 will help to limit the run-up in U.S. dollar debt burdens, while slightly stronger oil and metals prices will place a floor under fiscal and export revenues. Fiscal deficits will peak in most of the region's major emerging markets in 2016. Oil-producing economies such as Mexico and Colombia are reflective of this trend.

The **U.S.** economic recovery remains tepid. This was confirmed by GDP growth of 1.8% registered during the 2nd quarter. Consumer spending, including travel has been steady while the real estate and construction sectors continue to provide a boost to job creation. Even small business optimism ticked upwards. Still, the global economic outlook remains uncertain and a psychological shift appears to be inching toward greater pessimism aided by election season chatter supporting increased protectionism at a time of weak global demand. U.S. Interest rates will remain low despite speculation that a rate hike may not be off the table. Currently, there are no economic justifications for a rate increase, given weak inflation trends and the strong dollar which hurts competition in exports but aids an abundant supply of capital inflows compared to the rest of the world.

Germany suffered four high-profile terrorist attacks in July. Three involved refugees from Syria. This has pushed the issue of migration and internal security to the forefront of public debate once again. The Merkel government faces a tough challenge in reassuring voters that it has a handle on public security. Meanwhile, a change to the government's liberal migration policy is being actively sought after by groups opposed to them, especially in light of the recent attacks on German citizens by migrants.

U.K.

After a month pondering the likely economic fallout from the U.K.'s referendum to leave the European Union, the Bank of England confirmed that the economy has weakened markedly. The BOE cut its growth forecast for 2017 to 0.8% from 2.3% previously. It cut

the forecast for U.K. growth in 2018 to 1.8% from 2.3%. With that in mind, the BOE cut interest rates for the first time in seven years to 0.25% and announced a package of stimulus measures designed to support growth amid signs that the economy has slowed since the Brexit vote. The consensus is that a recession is likely in the U.K. and growth will be depressed across the EU over the course of the next two years. The GfK survey, Britain's longest-running gauge of consumer sentiment, has shown consumer confidence falling at the fastest monthly rate since March 1990. However, while all aspects of the July survey fell sharply, the level of confidence is far higher than in previous periods of recession.

The BOE agreed to pump an additional \$79 billion of new money into the economy each month through the purchase of government bonds. The central bank indicated the possibility of further stimulus to be provided over coming months if economic weakness persists as expected. Investment is expected to take a big hit from the increased uncertainty. Business investment is projected to fall 3.75% this year and 2% next year. Investment in housing is also expected to suffer. The injection of extra liquidity demonstrates how seriously the BOE views the potential economic damage from the Brexit vote.

While lower borrowing costs will help households and companies, the cost of loans is not the primary concern right now. Businesses are particularly worried about whether to make investments or hire in Britain without knowing what the country's trade relationship with the EU will be. That could take years to figure out. Meanwhile, the British pound has weakened and is expected to remain weak for the foreseeable future.

The new U.K. government appears somewhat unsure how to proceed now that voters by a 52% majority vote said they want to exit the EU. Warnings from officials in London and Brussels suggest that formal talks over the U.K.'s exit may not begin until the fall of 2017 or later. There is disagreement among the U.K.'s

ruling Conservatives over how quickly to break from the EU, with those who favor leaving fearing that any delay could weaken the government's commitment to a 'hard' deal. Such a delay will mean continued business uncertainty.

There are growing concerns that the scale of the task of reaching an agreement with the EU is so complex that it may require much more time than the two-years envisioned under EU rules.

There are growing concerns that the scale of the task of reaching an agreement with the EU is so complex that it may require much more time than the two-years envisioned under EU rules. Article 50 outlines a path of mutually assured stability for the exit process. During this period the U.K. would remain an EU member with all the rights and obligations that entails. This is important if European and British corporations and citizens are to make informed decisions about their futures or commit to future spending, investments or residency. Indeed, the article exists precisely because somewhere in the sign-up process the legal authorities advising the state signatories realized that an exit option must not only be included but be properly defined. This is why it is worrying that a case for unilateral action, which would amount to direct revocation of the U.K.'s participation in EU treaties, is attracting support in political circles. If this road were taken it would send a clear message to the world that long-stated British policy of observing international treaties is over. Nonetheless, many have cautioned that two years of negotiations set out in the Lisbon treaty will not be enough. News of delays comes amid the Bank of England's downgrade of its growth forecasts and the outline of actions [including bigger stimulus triggers] it is taking in response.

There is the possibility that a final Brexit plan may yet be achieved via a new treaty rather than via Article 50. This would create new problems. Most notably, it

would probably require a fresh referendum in the U.K. and would also need unanimity by the remaining EU member states. There are also international trade agreements that Brexiters say the U.K. should enter with the rest of the world. There could be difficulties with this as well. The rest of the world will want to see what the U.K.-EU arrangement is before committing to a trade deal. Britain has a weak and needy negotiating position. The negotiation promises to be a hard-headed exercise. Even gaining WTO status for the U.K. is not considered an easy ride. The hurdles to Brexit are accumulating. The new U.K. prime minister has spoken of the need for a U.K.-wide approach, and says she wants to consult with British dependencies. Politicians in Scotland and Northern Ireland (majorities in both of which voted to remain in the EU) are alert and agile and will seek to turn the fallout from Brexit to their benefit. Scotland seems likely to consider its own referendum on whether to remain a part of the EU.

Politicians in Scotland and Northern Ireland (majorities in both of which voted to remain in the EU) are alert and agile and will seek to turn the fallout from Brexit to their benefit.

While Brexit is not impossible, it can only be brought about with sufficient political skill and will power. In its rewriting of domestic law and policy and its reconfiguration of foreign and trade policy, Brexit will be the biggest single exercise by any U.K. government in peace time – and all this on top of governing a country in a period of austerity with limited public spending and a small majority in parliament. The 52% vote to leave the EU in a non-binding referendum will increasingly seem flimsy against the sheer magnitude of the task ahead. Some British politicians have been arguing that Britain can choose to step out of the EU without following a pre-agreed protocol - notably the one defined by Article 50 of the Lisbon treaty. Those supporting this notion are ignoring the sound legal

and practical reasons behind why such actions are frowned upon by the global community. They are ignoring the long-term negative reactions that such a move would trigger among remaining EU members as well as other countries doing business with the U.K.

Meanwhile, British regulators have told at least one leading EU bank that it will not be forced to establish a separately capitalized U.K. subsidiary as a result of the Brexit vote.

Turkey

President Erdogan is seeking to restore his command over the country following the July 15th failed coup attempt involving sections of the Turkish military. Under a three month state of emergency, the Turkish government has taken direct control over the armed forces and all matters pertaining to it. Influential NATO members have expressed unease as President Erdogan continues a full-scale crackdown on tens of thousands across various sectors of society, which he believes may have been supportive of the attempt to remove him from office. Over 50,000 individuals in the military, the judiciary, the police force and academic institutions have been detained, dismissed or placed on administrative leave, pending investigation. Furthermore, the Turkish government has claimed that a Turkish cleric living in the U.S. was behind the coup attempt and is demanding that he be extradited to Turkey for trial. The U.S. is likely to be slow in responding to the request. Turkish officials warn that if the U.S. fails to comply with the extradition request, it would jeopardize the strategic relationship the U.S. shares with Turkey.

Over 50,000 individuals in the military, the judiciary, the police force and academic institutions have been detained, dismissed or placed on administrative leave, pending investigation.



FCIA

Trade Credit & Political Risk Insurance

GREAT AMERICAN
INSURANCE GROUP

Meanwhile, U.S. security officials have voiced concerns over losing contact with many of their Turkish interlocutors who have been purged or arrested. The coup attempt reportedly involved 1.5% of the armed forces or 8,651 officers. However, the plotters were able to use their resources to devastating effect, reportedly commandeering 35 planes, 37 helicopters, 36 tanks and 246 armored vehicles to launch an assault that left 200 dead and more than 2,000 injured. The ensuing purge, which has led to 3,000 officers being formally dismissed, has implicated a high proportion of leading military figures, with about 40% of Turkey's generals and admirals accused of involvement in the plot. Part of the crackdown by the government includes the closure of Istanbul's Kuleli Military High School which was founded in 1845 and has turned out senior military officers for longer than the Turkish republic has existed. Other military institutions will also be closed.

Part of the crackdown by the government includes the closure of Istanbul's Kuleli Military High School which was founded in 1845 and has turned out senior military officers for longer than the Turkish republic has existed.

The failed coup attempt and Erdogan's response will leave Turkey's military in a state of crisis for the foreseeable future. Changes aimed at tightening Mr. Erdogan's grip over the military and to prevent a repeat of a similar plot in the future will affect the nature, make up and independence of the armed forces going forward. Politics will become front and center. Until now, the Turkish military has had a long history of being above politics and serving the interests and security of the nation above all.

Strains have also emerged in German-Turkish relations since the attempted coup. The Germans have expressed concern about Ankara's crackdown against alleged supporters of the coup. In addition to

the tens of thousands already arrested, the Turkish government is considering reintroducing the death penalty. Since 2005, at the insistence of the EU to which Turkey has sought membership, the death penalty was banned. Turkish authorities have also accused Germany of not condemning the coup attempt forcefully enough.

Of immediate concern to Germany is the future of a landmark deal struck in March between Turkey and the EU to curb the flow of migrants reaching Europe across the Aegean Sea. Under the agreement, Turkey would take back thousands of migrants crossing into Greece in exchange for sweeteners including 3 billion euros in cash and the promise of short-term travel rights to Europe for Turkish citizens. Brussels also agreed to reopen accession talks with Ankara over its membership in the EU. The deal has been highly effective, leading to a sharp drop in the number of migrants arriving in Greece and easing the pressure on the German Chancellor, for whom the influx of asylum-seekers into Germany last year turned into a big political headache.

Turkish government officials now suggest that Turkey may be forced to renounce the March agreement if Europe does not move forward with visa liberalization. The European Commission asserts that Turkey has failed to fulfill all of the 72 conditions required for the lifting of visa restrictions, such as a reform of anti-terror laws. Germans are warning against the possibility of being blackmailed by Turkey. Others are pessimistic and view the changes being implemented in the military as a panic reaction to the coup attempt.

Turkish government officials now suggest that Turkey may be forced to renounce the March agreement if Europe does not move forward with visa liberalization.

They predict that this will lead to confusion about the chain of command. With the military still reeling from



FCIA

Trade Credit & Political Risk Insurance



GREAT AMERICAN
INSURANCE GROUP

the trauma of internal factions turning on each other, some believe the armed forces will now be severely impeded in its ability to confront the multiply security threats facing the country. It is hard to exaggerate the force of the blow that has hit Turkey's armed forces since the failed coup.

With the massive purge of its leadership, the world will be watching with caution as to what happens to Turkey's stabilizing role in this troubled region. Turkey is a crucial actor in the Middle East, and its allies are concerned that as the country grapples with instability and shifts its focus to domestic affairs, the consequences for the region could be unpredictable.

Increased security concerns hit tourism arrivals in July and are expected to continue over many months, more than offsetting the thaw in relations with Russia. The terrorist attack on Istanbul's main airport in June followed by the attempted coup in July have led to new waves of cancellations of flights and reservations, and cast a further shadow over the prospects for the remainder of the summer tourism season.

*By Byron Shoulton, FCIA's International Economist
For questions / comments please contact Byron at
bshoulton@fcia.com*

FCIA's Deals Of the Month

Bank Non-Cancelable Limit Policy: \$7 million limit of liability in bank trade loan with 7 year tenor and 95% coverage, China

Whole Turnover, Non-Cancelable Limits Policy: \$25 million limit of liability supporting sales in the Agri sector obtained for risk mitigation on non-payment by buyers, Global

What is Trade Credit Insurance?

If you are a company selling products or services on credit terms, or a financial institution financing those sales, you are providing trade credit. When you provide trade credit, non-payment by your buyer or borrower is always a possibility. FCIA's Trade Credit Insurance products protect you against loss resulting from that non-payment.