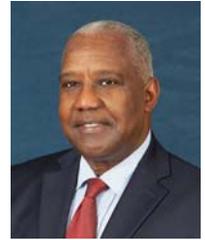


## Major Country Developments August 2017



By Byron Shoulton

### Global Overview

Strengthening European demand and improving outlooks in some emerging countries is helping to boost the pace of global economic growth. The pick-up in demand has led to an acceleration in cross border sales that is outpacing rising costs – making for a sharp pick-up in overseas profits among companies. In the **U.S.**, where the economic recovery is much further along than Europe, rising labor costs are pressuring profit margins. Forecasters are generally expecting faster earnings growth for companies with higher overseas exposure. The dollar's recent weakness, which stems in part from the brighter outlook overseas, also helps.

As the Dow passes the 22,000 mark, led mostly by tech stocks, the environment looks as if it should continue to benefit globally focused companies. U.S. consumer confidence rose in July as Americans expressed faith in current and future economic conditions. According to the Conference Board its index of U.S. consumer confidence rose to 121.1 in July from 117.3 in June, marking the second highest reading since 2000. July's increase was driven to a fresh 16-year high, reflecting falling gasoline prices, the strengthening jobs market and recent record highs in the stock market. An index tracking current household attitudes toward the present economic situation rose to 147.8, while the index tracking expectations about the future increased to 103.3. After a surge in sentiment following the election of President Trump, measures of sentiment have moderated in recent months. An increase in optimism should translate into increased U.S. consumer spending. However, the recent data show consumers have pulled back a bit. Both spending and inflation on consumer purchases softened in July.

Still consumer confidence is being encouraged by an improving labor market. Those saying jobs are plentiful rose to 34.1% in July, compared with 32% in June. Business conditions were described as 'good' in July by 33.3% of respondents, up from 30.6% a month earlier. The U.S. economy created 209,000 new jobs in July, which exceeded expectations of 180,000. In June that figure was 231,000 new jobs added. The unemployment rate is now at 4.3%, a sixteen year low. Job growth has been broad based, with strong hiring in educational and health services as well as leisure and hospitality sectors. Manufacturing provided 16,000 new jobs in July. The pace of hiring rose at its quickest since last February. Average hourly earnings in the U.S. rose 0.3% in July equivalent to 2.5% year-on-year wage growth for the fourth consecutive month.

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Overall, consumers foresee the current economic expansion continuing through 2017. The Federal Reserve underscores this outlook expressing with a reasonable level of confidence that the current expansion can continue and that households are generally in a stronger position with consumer debt not being a threat to stability or being of concern to policymakers. While U.S. factory orders have surged in recent months the U.S. service sector has slowed more than expected. Meanwhile, a string of weak inflation readings has clouded the outlook for the Federal Reserve's interest rate policy. The Fed's July

statement acknowledged that recent weakness in inflation continues to undershoot the central bank's 2% target, but expects it to stabilize at that level over the medium term.

**Euro-zone** inflation remains weak despite a sustained pick-up in economic growth. While producer prices across the currency block are 2.5% higher than a year ago, July prices fell slightly. A sustained drop in manufacturing prices comes despite the pick-up in economic growth that has seen the euro-zone outpace the U.S. over the last 18 months, a sign the currency area's economy is finally emerging from the shadow of the past decade's financial crises. Growth during the first six months of 2017 has fueled expectations that the European Central Bank will start to remove some of the stimulus it has been providing since 2014. The ECB president described the current recovery in the region as robust and cautioned that policymakers would soon decide on the future of its bond-buying program.

The drop in producer prices since the start of 2017 underscores how patient the ECB may have to be. Five months of consistently falling energy prices have been largely responsible for inflation weakness, although prices of intermediate goods- things that are used to make other things- have now fallen for two straight months. Excluding the volatile energy component, producer prices were flat for a second month.

There is now very little prospect of a revival of inflationary pressures in the coming months. A survey of 3,000 manufacturing companies showed the cost of raw materials and other inputs rose at the slowest pace in nine months during July, while they in turn raised their prices at the slowest pace in 2017.

**A sustained drop in manufacturing prices comes despite the pick-up in economic growth that has seen the euro-zone outpace the U.S. over the last 18 months, a ...**

**China's** capital flow turned positive in the first half of 2017, a reversal from unprecedented outflows during the two previous years that sparked concerns over financial stability. Fresh data indicate that Beijing's support for the renminbi [RMB] and a crackdown on foreign dealmaking and other outflow channels have largely succeeded in curtailing capital flight. China ran a \$16 billion surplus over the first half of this year, excluding central bank intervention, compared with a \$417 billion deficit in 2016. The figures also show that China added to its foreign exchange reserves on a valuation-adjusted basis for the first time since early 2014.

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The RMB has strengthened 3.4% this year, a reversal from its record 6.5% fall in 2016, in part reflecting central bank efforts to squeeze bearish speculators and boost confidence. Meanwhile, foreign exchange reserves rose for a sixth consecutive month in July. This marks the longest run of increases since 2014, when reserves touched a record high of \$3.99 trillion. FX reserves were up \$24 billion over the month and up \$80 billion from January's low. Still 'hot money' movements - viewed as a gauge of investor sentiment toward Chinese assets - continues to flow out of the country, albeit more slowly.

## U.K.

UK economic policy has yet to return to normal after the financial crisis, continuing an exceptionally loose monetary stance and unprecedented fiscal retrenchment. Real GDP growth accelerated in 2014, but momentum slowed in 2015-16. The fallout from the Brexit vote will continue to dominate the policy agenda. As the government focuses its efforts on negotiating the terms of the UK departure from the

EU and on reducing the damaging impact on the economy (of the uncertainty created by the vote), policymakers could be forced to address structural deficiencies, including weak productivity.

Economic growth remained subdued in the second quarter of 2017 as a modest revival in consumer spending offset shrinking industrial production, a sign that a hoped-for shift toward export-led growth remains elusive. Analysts point to the need for businesses- particularly exporters- to take the baton from consumers squeezed by rising prices if the U.K. economy is to avoid stuttering just as Britain's exit talks with the European Union get under way.

The Bank of England has taken a cautious tone on the outlook for the economy, leaving interest rates unchanged at 0.25% but cutting its growth forecast for the next 2 years. Quarterly growth stood at 0.3% in the April-June period, a slight improvement on the 0.2% growth rate of the preceding quarter, but still less than half the pace of growth at the end of last year.

Proponents of Brexit have suggested that the pound's steep depreciation in the wake of last year's referendum could boost overseas demand for British products, strengthening the manufacturing industry and decreasing the economy's reliance on domestic demand. So far, the economy has showed little sign of that shift. The weak performance in the industrial sector suggests that the economy is not rebalancing towards net trade and investments, which the Bank of England wants to happen before raising interest rates.

The sharp fall in pound sterling's value since last-year's Brexit vote propelled inflation to a near-four-year high, triggering a slowdown in consumer spending and inspiring hawkish signals from some Bank of England policymakers. Price growth slowed unexpectedly in June, but remained well above the BOE's inflation target, and above the pace of growth in wages. The best expectation is that inflation will accelerate a little further over the coming months. The depreciation of sterling is

expected to continue feeding through to price pressure, and to push inflation higher in the coming months. The BOE expects inflation to peak at 3% in October.

The forecast is for GDP growth of 1.7% in 2017 (revised down from 1.9%). The expectation is that growth will slow in 2018 to 1.6% (as cost pressures and uncertainty intensify), before rising to 1.8% in 2019. Recent lending growth to UK households has been stable, at 3.8% year-on-year. Mortgage lending rose by an annual 2.9%, and unsecured consumer credit was an unsustainable 10.3% higher than a year earlier.

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Recent growth has been driven largely by consumer services, which rebounded on stronger retail sales, a tentative sign that British shoppers could be returning to stores after sharply paring down spending during the first quarter of 2017. Growth was also supported by a strong performance from the film industry, which has benefited from tax breaks.

The Bank of England projects that spare capacity in the economy will be fully absorbed, partly because it judges that supply in the economy will expand only modestly over the next few years, as Brexit affects decisions about capacity and leads to a period of reallocation in some sectors of the economy. This suggests that even a small pick-up in demand could affect monetary policy by keeping inflation above the 2% target. Still, the BOE expects that any rate increase would occur at only a gradual pace. Subdued wage growth will continue to present a challenge to the outlook.

In 2016 exports of goods totaled \$407 billion and imports amounted to \$588.4 billion, resulting in a trade deficit of \$181.1 billion. The traditional services surplus fell to \$131.1 billion. The overall current-account deficit narrowed to \$115.5 billion from \$122.6 billion in 2015. If the UK economy stays soft in 2017 and the economy loses further momentum in 2018, falling real wages would undermine household spending and discussions on an interest rate rise would likely fade. Efforts toward a more normal monetary policy stance would resurface only when economic conditions have stabilized.

According to the BOE, improving prospects for global growth are supportive of UK business investment and export demand, offsetting projected greater weakness in UK household incomes. This would rebalance the economy from reliance on consumer spending and absorb the small degree of slackening remaining in the economy. The BOE revised down its forecast for future wage growth – even as it continues to predict a sustained pick-up from the recent 2% GDP annual growth rate. Household consumption is expected to grow in line with incomes, leaving the household saving rate stable at around 3%, which would be low by historic standards. The UK Treasury has agreed to underwrite an additional \$20 billion of lending to banks through its term funding scheme to meet any higher than expected demand resulting from stronger than anticipated economic growth. The scheme, which was designed to lend up to \$134 billion to banks at lower interest rates following last year's Brexit vote, was first announced in August 2016. The BOE said it will end the scheme as originally planned in February 2018.

## Colombia

In an attempt to reinvigorate his administration in this his final year in office, Colombia's President Juan Manuel Santos has reshuffled his cabinet and appointed new heads to important government bodies, with effect on August 1, 2017. Despite the

successful signing of a historic peace agreement with the leftist FARC guerrillas last November, public support for the Santos government has been relatively low. Different polls place the president's popularity at between 15% and 25%, reflecting discontent with slow economic growth, corruption scandals and a perception that the government is not sufficiently effective, including its implementation of the peace deal.

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In parallel, the Unidad Nacional para la Paz (UNP), Mr. Santos' coalition in Congress, is showing signs of fracture, partly owing to the president's low approval ratings but mainly due to widening political divisions ahead of the March 2018 congressional elections and the May 2018 presidential poll. The president's decision to shake up his cabinet and other top government positions is designed to recover control over the ruling coalition and to improve policy execution and get faster results in areas of the government's socio-economic agenda. New focus is on improving the transportation, housing, industrial, trade and agriculture sectors. Ongoing challenges, including persistent fiscal constraints, weaker economic growth and bureaucratic resistance to changes, will obstruct progress in implementing the president's social agenda – such as components of the peace accords, investment in rural areas – helping to keep Mr. Santos's popularity low.

Colombia's unemployment rate currently stands at 8.7% (down from 9% a year ago). However, unemployment in Colombia's 13 largest urban centers is substantially higher (10.8%) than the national level. This reflects the continued sluggishness of the overall

economy where there have been contractions posted in manufacturing, retail sales and new building permits. Concerns over poor economic performance prompted the central bank (Banco de la Republica), to once again cut its policy interest rates on July 27th by 25 basis points, taking it to 5.5%, its lowest level in 20 months. This was the seventh cut since the bank began an easing cycle in December 2016 (when the policy rate stood at 7.75%). Although the monetary loosening should help to support economic activity, the labor market is likely to remain relatively weak, which does not bode well for acceleration in private consumption growth. This will likely weigh on overall economic growth prospects.

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Meanwhile, Colombia's export income has continued to rebound this year from the low levels of 2016, mostly owing to a recovery in prices for oil and related exports. In May 2016 total exports revenue was down by 18.9% from a year earlier (and in May 2015 it fell by an even steeper 38.5%). In May 2017 exports from the fuel and extractive industries increased by 28.6% year-on-year (compared with a contraction of 30% a year earlier), and sales of agriculture goods were up by 23.5%. Manufacturing goods grew by 4.4% (compared to -9.6% in May 2016) and other sectors gained by 76.6% (versus 43.8% a year before). For the January – May 2017 period as a whole, exports totaled \$14.7 billion, an increase of 24.9% year-on-year (exports declined by 27.2% in the same period in 2016). Exports of fuels and goods from extractive industries totaled \$7.8 billion (up by 44.4%) in the first five months of the year. Oil and oil derivatives accounted for 33.9% of this and had fallen by 41.6% in the comparable period in 2016.

Recovery in oil prices would help to sustain the

growth in export revenue over 2017: the forecast is for an average global oil price of \$54 per barrel, up from \$44 per barrel in 2016. However, oil prices will no longer provide a boost in 2018, when a slight dip in average oil prices is anticipated. Crude prices remain far below the pre-2015 period, which means that Colombia's trade balance will remain in deficit. Furthermore, benefits from better oil prices are diminished by the fact that annual oil production has been falling.

To boot, two key agriculture activities are posting unfavorable performance. Coffee production plunged by 17% year-on-year in April-June, while problems are troubling the livestock sector. The outlook for a swift recovery is marred by forecasts for prolonged rain, and Fedecafe (the coffee producers association) now expects the national harvest to fall below expectations this year. Colombia's coffee export revenue rose by 20% in January-May, to \$1.1 billion, despite a 1% fall in exported volumes. Meanwhile, short-term prospects for cattle producers are uncertain. On July 10th sector authorities declared a quarantine in 132 municipalities across Colombia after several cases of foot-and-mouth disease were identified. According to the most recent data, cattle slaughtering fell by 10% in the first quarter of 2017. Around 70% of exports go to Russia, Curacao, Lebanon and Jordan. However the first two countries have declared a ban on Colombian meat. (Mexico has also suspended imports of Colombian dairy products and hides). The Colombian Ministry of Agriculture expects the disease to be under full control in 3-4 months.

Ten months ahead of the country's presidential election, due in May 2018, it appears that a relatively large number of candidates will be joining the contest. This makes it unlikely that any single candidate will secure the 50% - plus one vote needed to win in the first round. No matter who wins, it is expected that the sitting president and his successor will deepen ties with Peru, Chile and Mexico under the Pacific Alliance, a trade integration pact, and will strive to reinforce ties with countries with which Colombia has free-trade

agreements, including the USA, Canada, South Korea and the EU.

The escalating political and economic crisis in neighboring Venezuela is threatening to bleed into Colombia. A flood of Venezuelans have already crossed into Colombia in search of food and other basic necessities. Thousands of Venezuelans have found work in Colombia in recent years but as the Colombian economy slows it is becoming increasingly more difficult for displaced Venezuelans to find work there. Diplomats now warn that violence in Venezuela, coupled with that country's severe economic crisis could have a destabilizing effect on Colombia either via increased criminal activity or a steady influx of displaced Venezuelans seeking sanctuary.

## Central America

The U.S announced that it will be cutting aid to the Northern Triangle (which includes El Salvador, Honduras and Guatemala) to \$460 million in 2017 from \$655 million in 2016. **El Salvador** will struggle to make necessary fiscal adjustments and promote growth-friendly policies due to intensifying legislative gridlock ahead of 2018 legislative elections. Also, a potential shift in U.S. policy towards El Salvador, amid escalating tensions over illegal immigration, would threaten critical remittances and aid flows. The U.S. Administration has backed up its threat to cut Central American aid budgets by ramping up deportations of illegals and highlighting criminal gang activity. Recent moves by the El Salvador government, including changes to forfeiture laws used to seize criminals' assets and the rejection of corruption allegations made by U.S. legislators toward a prominent Salvadorian politician, may cause further deterioration in bilateral relations between both countries. The gang MS-13, which is highly active in El Salvador and has been at the forefront of heightened anti-immigration sentiment, will force stricter enforcement of immigration policy and could limit remittance inflows to El Salvador, which reached \$4.6 billion in 2016.

In **Guatemala** the fiscal deficit will widen in 2017 and 2018, as the government places fiscal consolidation efforts on hold in order to prioritize social and capital spending projects along with increased spending on security. Little progress on reforms is anticipated (especially tax reform) due to a persistently weak revenue base which constrain the government's consolidation efforts going forward. The forecast is for the budget balance to reach -1.4% and -1.5% of GDP in 2017 and 2018 respectively. Deficits will remain narrow however, which along with low government debt levels will prevent any significant deterioration in Guatemala's sovereign credit worthiness.

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A product of rampant tax evasion and a large informal economy, Guatemala currently has the weakest revenue base as a percentage of GDP in Latin America and one of the weakest globally, at 11% of GDP. The sitting government's ability to push through legislation is hampered by mounting allegations of corruption. As a result low tax compliance will persist and limit the government's ability to increase spending further without taking on large amounts of debt. Given an aversion to increasing the public debt burden, the expectation is that the government will opt to return to fiscal consolidation making it possible to shrink deficits again beginning in 2019.

**Nicaragua's** central bank will continue to devalue the currency (the cordoba) at a steady pace over the next two years, in spite of spiking consumer price inflation. Policymakers have weakened the currency by 5% per year since 2007 in order to increase export competitiveness. The central bank maintained the steady depreciation of the currency even when inflation is expected to be driven by rising energy prices as subsidized fuel from Venezuela dries up. Inflation is forecast to accel-

erate over the next year (4% in 2017 and 5.1% in 2018, from 3.5% in 2016). The spike will be driven primarily by rising fuel costs. This jump will be exacerbated by declining support from Venezuela's PetroCaribe program, which has provided heavily subsidized oil imports over several years. As this support dries up Nicaragua will be forced to import crude at market prices. The impact of this will filter through the broader economy. Nicaraguan consumers have already seen electricity subsidies reduced, which is almost certainly indicative of a coming jump in consumer prices.

Price growth will likely be bolstered by rising demand, on the back of remittance inflows. Concerns about U.S. policy changes have seen remittances into Nicaragua from the U.S. spike, which observers believe will continue over the coming quarters. As disposable income rises in this country, it is expected that higher demand will drive a rise in prices.

**Panama's** economy is projected to continue to be among the strongest in Latin America as surging canal usage boosts trade and related industries such as transport and communications. Panama's location and the presence of the newly enlarged canal make it a hub for logistics and financial services, and increased canal traffic will drive higher revenues from fees, filtering through to the wider economy through increased service sector activity.

Because of the canal's increased capacity, cargo movements have risen 12.6% year-on-year through June, while overall canal tonnage is up 22.2% compared with the same period in 2016. The basic view is that the uptrend in shipping volume will continue, supporting robust real GDP growth of 5.6% in 2017 and 5.7% in 2018 compared with 4.9% in 2016. Strong private consumption and fixed investment will compliment the uptick in canal activity. Panama's elevated growth levels over the last several years have contributed to a significant reduction in poverty, which has declined some 20% since 2017. Panama now boasts

one of the region's highest per capita GDP's, which will support household spending. Private consumption is forecast to average 46% of GDP over the next five years. Additionally, Panama possesses an infrastructure pipeline valued at nearly \$23 billion. Construction projects aimed at improving public facilities and transit networks will continue to be attractive to foreign investment, as business friendly policies apply equal standards to foreign firms and the dollarized economy limits risks of losses from currency volatility.

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## FCIA's Deals Of the Month

**Non-Cancelable Limits Policy:** \$25 MM limit of liability, domestic Multi-Buyer policy obtained for risk management in the Oil & Gas Sector

**Bank A/R Purchase Policy:** \$32 MM limit of liability, multi-buyer A/R purchase policy, buyers in the Packaging Sector in LATAM

### *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.*

**\* Non-Cancelable Limits:** Subject to policy terms and conditions, after issuing the policy, the insurer may not unilaterally reduce any country or buyer limits.