Major Country Developments
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Overview

The global economy faces the challenge of restoring public trust in economic reform and world trade. While global demand remains subdued, the IMF has warned that reliance on low interest rates to bolster growth cannot continue and it reduced its forecast for 2016 global growth to 3% from 3.1% previously. While modest gains in commodity prices are expected over the coming quarters, the slow pace of improvements suggests this offers only limited relief to fiscal and trade dynamics in highly commodity dependent economies. The modest price rebound is unlikely to be sufficient to allow several commodity dependent countries to begin to substantially rebuild their economic buffers. Moreover, the impact of structurally lower commodity prices compared to the 'boom' years will only be exacerbated by policymakers who may be hesitant to enact much-needed reforms.

The U.S. economy grew at 1.1% during the first half of 2016, and the pace appears to be inching upwards in the second half even though August manufacturing activity and new jobs created for the month were below expectations. Business investment has been generally weak as energy groups cut back on capital spending on oil rigs in light of the decline in crude prices. However, consumer spending has been strong as well as housing construction. The evidence suggests that the economy may have picked up a bit of steam more recently, as growth accelerated to 3.4% in the third quarter. In particular, inventory drawdowns appear to have ended and production to replenish diminished stockpiles looks set to pick up pace as we head into the year-end holiday shopping season. The slightly more upbeat outlook for U.S. economic output, a tightening labor market and signs that inflation is firming have increased expectations that the Federal Reserve may implement an interest rate increase early in 2017. However, a gauge of the service-sector shows that while overall activity remained in growth territory in August, the sector performed at the lowest level in six years. The consensus is that weaker performance in parts of the economy during August may have been a blip and is not enough to conclude that a slowdown is afoot.

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Meanwhile, U.S. bank lending remained strong across the board. Commercial and industrial loans, credit cards and construction loans all posted increases. Residential mortgages rose 4.3% from a year earlier. Together this helped banks increase interest income by 4.8% (even with interest rates stuck at ultralow levels). The key test for banks will come when rates eventually start rising. Loan demand could falter, a sign borrowers were reacting to the change in rates. But if it remains strong when rates go higher, it will provide a boost to bank earnings. Continued evidence of strong lending growth would provide further assurance as to the prospects for both the banks and the broader economy.

In **Germany** a surprise decline in the August Ifo Business Climate index, which covers trade and industry, gave reason for pause. The index fell to 106.2 in August from 108.3 in July, the largest one-month decline since 2012. Companies have been assessing the current business climate and expectations for future business growth have declined. The outlook for Germany's service companies also fell to a two-year low in August. The question being contemplated is whether these are temporary pullbacks or do they represent an evolving pattern. Hard data have pointed to continued yet fragile German economic growth.

China's problems with overcapacity continue to rattle world markets. Pressure mounts on China to monitor and cut its production (e.g. of steel, copper) to remove the current global glut and eventually shore up prices. As China's economy has slowed, its overcapacity and inventory buildup of several commodities are increasingly affecting production and pricing globally. While the Chinese pledged to cut steel capacity by 100-150 million tons over several years, it is still the source of 50% of global steel production so its pledge will remove only a third of its excess production. Without voluntary production cuts, the world will see a boost in sentiment toward protectionism, with individual countries promoting narrow self interests and specific projects. China is verbally opposed to protectionism and says it is committed to an open and integrated global economy. Its trading partners seek concrete actions to support that pledge.

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Meanwhile, China's banking sector have been shedding jobs and cutting salaries. Bank profits were essentially flat in the first half of the year as lenders struggled with shrinking net interest margins and rising bad loans. Staff and pay cuts might herald a more commercial attitude at the banks. Total job losses at seven leading Chinese banks so far this year amounted to 2% of their collective staff. Salaries are going down amid popular discontent over social inequality. This led China's Communist Party to order state-owned enterprises (including banks) to reduce salaries.

The **U.K.** economy has been more resilient than first expected following the June 15th vote to leave the European Union (EU). The August services Purchasing Managers Index (PMI) was at 52.9 up from 47.4 in July, indicating brisk services activity. There has also been a strong rise in manufacturing and a partial recovery in construction which was unforeseen two months ago. While it is still very early and Britain has yet to register its formal withdrawal notice with the EU (after which it will have at least two years to disentangle its previous relationship and negotiate a new pact as an ex-EU member), British politicians and business leaders are breathing a bit easier these days.

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The more upbeat news lifted the British pound to a two-month high against the dollar and a one-month high against the euro. The pound is trading close to the top of its range since it fell by 12% following the Brexit vote. Going forward, a key barometer to determine the outlook for the U.K. economy will be the political will of the British government to present a credible roadmap and successfully negotiate a mutually beneficial [trade, financial services and economic] pact with the EU. Until that outcome becomes clear, many transactions and new investments between the U.K. and the EU will proceed slowly and with caution. The British government has gone to great lengths to assure global leaders that Britain's decision to leave the EU will not further disrupt global trade.

In many African economies where rising security risks weigh on business sentiment, poor fiscal management will keep borrowing requirements high. In South Africa a downgrade to junk status remains a significant risk. Nigeria seeks a $6 billion loan from China as a way to avoid going to the IMF for assistance. While Nigeria earlier this year took steps toward more investor friendly policies, such as the removal of capital controls and the free-float of the naira, investors are still slow in returning to that market. The prolonged delays in reforms will see GDP contract in 2016.

Similarly, **Angola** announced it would end talks with the IMF over opening a three year lending facility. With the price of crude still subdued, this leaves significant questions over how the country will finance its twin current account and fiscal deficits, and suggests increasing borrowing from China as the best option. In both cases, the embrace of Chinese assistance by those governments rather than an IMF structured program, indicate a reluctance to come to terms with spending outlays (kicking the can down the road) out of fear of a backlash from constituents who would bear the brunt of such reforms.

The consensus outlook is that Sub-Saharan African countries face structurally high fiscal deficits in the years ahead, with the average regional shortfall narrowing only modestly in 2016 from a peak of 6.1% of GDP in 2015. The commodity bust is the most obvious catalyst, and will continue to temper revenue growth over the next few years. Efforts to temper the size of the fiscal deficits will be undermined to a certain extent by high inflation.

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Venezuela

As anti-government protests escalate and calls for the removal of President Maduro hit an all time high, the government has responded with a wide clampdown on the media. Following a march in which hundreds of thousands called on the electoral authorities to activate a constitutional recall referendum to vote Mr. Maduro out of office, the government has responded with hundreds of arrests of ordinary citizens and folks in the media. The situation promises to get even worse.

The current account deficit will remain exceptionally wide [e.g. 7.4% of GDP in 2015 & 7% of GDP in 2016]. By far the most important determinant of current account dynamics is the price of Venezuelan oil and gas products, which account for 95% of total goods exports. In addition, years of underinvestment in the energy sector have resulted in stagnating production levels. One conservative estimate is for production to decline by 5.6% in 2016 to just 2.41 million barrels per day, making it the fifth consecutive year of production declines. The low oil price environment since 2014 has drastically exacerbated the decline in total export values, and the forecast is for a modest pace of price increases over the coming years. These dual anchors of low prices and production levels will keep export revenues extremely low compared to historical trends.

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Over the coming quarters, it is highly unlikely that the current account shortfall will be covered by investment from abroad. Venezuela suffers from one of the world's most hostile business environments, with the government regularly demonizing the private sector and capitalism generally. With the overwhelming majority of oil revenues likely being funneled into debt servicing and imports of essential goods, there are growing strains on social spending. It also suggests that inflation will remain out of control over the coming quarters, as the government continues to expand the money supply in order to finance its domestic expenditures. At the same time the Venezuelan government is expected to allow further devaluation of the bolivar, which will increase the domestic value of oil revenues.

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External debt obligations remain a top priority, due to the dire consequences this import-dependent nation faces if it lost access to hard currency. In the near term, the government will continue to draw down its foreign reserves. Total reserves fell to a 14-year low of $12 billion in July (or 3 months worth of imports). Venezuela is seeking buyers of its stock of gold (which according to the IMF fell to less than 7 million ounces, from nearly 12 million ounces in 2014). Gold accounts for a large share of total reserves.

Despite weak revenues the ruling socialist party is likely to continue raising expenditures in an attempt to shore up President Maduro's declining approval rating which hit 21.2% in August. This is the lowest level of any Venezuelan president since 1998. If a recall referendum were to be held the president would almost certainly lose. With this in mind, Maduro announced a 50% wage increase in August for all public employees, military personnel and pensioners, the third increase in 2016.

Revenues could begin to improve in 2017 if oil prices trend upwards. This could happen if supply cuts are agreed to among major oil producers so as to reduce global market surpluses. However, this is not a certainty as both Russia and Saudi Arabia failed to agree on production cuts at their recent meeting.

Because a default on its foreign obligations would cut the country's access to hard currency and worsen already severe shortages of food, medicine and other basic goods, policymakers may instead be forced to cut transfer payments and wages. In addition to preserving access to needed imports, these cuts would help pull down inflation by removing a key driver of money supply growth.

Venezuela's external accounts will remain under significant pressure for some time, given the country's heavy reliance on oil and lack of domestic productive capacity. Although imports will continue to decline on the back of currency devaluation, this will fail to keep pace with the decline in exports. Meanwhile, investor concerns about political risk and general business environment weakness will weigh on capital inflows, resulting in continued drawdowns of foreign reserves.

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Pundits in Venezuela expect that even if the referendum proceeds in 2017 and Maduro is ousted, he would be replaced by his vice president. This would leave control of the executive branch in the hands of the socialist party (PSUV) which is unlikely to cut social spending that comprises the vast majority of outlays. The PSUV believes that funneling resources to the country's poor will preserve its hold on power. Still, fiscal adjustment will be unavoidable over the next two years and the bulk of the adjustment will have to come via a rolling back of Venezuela's generous social spending.

Trinidad & Tobago

In 2016, Trinidad & Tobago is likely to post its first goods trade deficit in nearly 20 years. In light of declining oil and gas production, goods exports have declined consistently since 2012. Low energy prices have exacerbated the losses. The country will rely on debt issuance and drawdowns from its sovereign wealth fund to support day to day operations over the coming quarters. With persistently weak revenues, the government remains under acute pressure to cut expenditures in order to close its wide budget gap. A fiscal deficit of 6.1% of GDP is projected for 2016 and is unlikely to change by much in 2017.

Against this background the authorities have been tightly managing foreign exchange reserves and monitoring their allocation. The result has been a series of complaints of payment delays from foreign suppliers over the past two years. Local importers point to delays receiving foreign currency remittances from the banking system. The banks point to foreign currency hoarding by citizens/businesses, creating the need to verify that requests for dollars are legitimate.

The country will continue to face falling revenues over the coming year which will force the administration to issue external debt. It recently demonstrated its ability to issue external debt thereby reducing the need to turn to the IMF. Persistent fiscal deficits and structurally lower growth will keep pressure on the

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government to enact greater budget cuts. Revenues, which are heavily reliant on taxes from the sale of natural gas, continue to fall in light of low energy prices and contracting production. In the current fiscal year revenues fell by 20.3%. Last year they fell by 23%. Although ad-hoc measures, including the sale of state-owned assets will provide a temporary bounce in receipts, structural changes, including tax increases, have yet to take effect and tax collection remain stymied by poor institutional capacity within the government's revenue authorities.

Although spending will continue to contract over the coming months, the pace of contraction will lag that of revenues. In the fiscal year to date spending fell 11.2%. As revenues fall, government debt issuances have soaked up domestic financial market liquidity, precipitating a credit crunch. In recent months, the government has continued planned cuts to social programs, such as its college tuition assistance program, which could be the primary driver of falling expenditures.

Trinidad's wealth fund was worth $5.7 billion at the end of 2015. Withdrawals of approximately $400 million so far this year compare with the government's authorization to withdraw up to a maximum of $675 million per year. Additional debt issuance is expected. The government is increasingly looking to external debt markets to support its budgets. Having nearly exhausted domestic debt markets, a $1 billion foreign offering was made in July as rising investor interest in emerging market assets encouraged the government to proceed. The 10-year bond issuance was overbooked 3.5x, allowing for the reduction of the bond's coupon rate to 4.625% from 5.5%. Trinidad maintains a low external debt stock and favorable maturity profile, suggesting additional debt issuances will likely draw investor interest. Including this latest issuance the country's external debt is forecast to equal just 1.8% of GDP at year-end 2016. That said, Trinidad's deteriorating sovereign credentials in light of persistent fiscal and current account deficits will likely raise interest rates on future issuances and undermine policymakers' willingness to rely on debt over an extended period.

With external financing alleviating the government's cash shortfalls, the need for a turn to the IMF for fiscal support is substantially reduced for at least the next two years. However, there is continued expectation that more budget cuts than are currently planned will be required. That's due to the persistent deficits and limited sources of financing. Should the government repeatedly find itself struggling to secure needed financing, a turn to the IMF remains an option, which would allow it to continue operating while gradually enacting budget cuts.

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Meanwhile, forecasts for global growth in imports of liquefied natural gas (LNG) which is expected to accelerate from 6.3% this year to 12% in 2017-18, is good news for Trinidad. Imports into Asia, which typically accounts for 70% of LNG market, will resume growth. China, the Philippines and Colombia among others are also expected to step up imports over the next two years.

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FCIA's Deals Of the Month

Multibuyer Non-Cancelable Limits Policy:
Supporting $90,000,000 of exports in fertilizer products obtained for risk mitigation purposes, Mexico

Single Buyer, Non-Cancelable Limit Policy:
$36mm limit of liability for corporate client, petrochemicals sector, US

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.