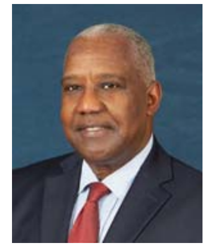
Major Country Developments December 2017



By Byron Shoulton

Global Overview

World trade volumes and business expenditure on jobs and machinery are ending 2017 on an upbeat note. The evidence suggests that global manufacturing activity hit multiyear highs in November as growth continues to gather pace. Factories across the world were at their busiest [since 2007] during November when a global upswing in economic activity and trade boosted manufacturing activity.

Overall **Eurozone** manufacturing expanded at the second highest rate on record. The IHS market purchasing managers' index for the currency block was 60.1. Anything above 50 indicates expansion, a reading beaten only once since April 2000. The **Dutch** manufacturers purchasing managers' index hit a record high; the **Italian** index reported the strongest new orders in 17 years; and Ireland's rate of growth was the strongest in 18 years.

The rise in manufacturing was not limited to the Eurozone. **British** factories were at their busiest in more than four years; the **Japanese** manufacturing PMI pointed to the strongest growth in 44 months, and **South Korea** recorded a 55-month high. In the UK the purchasing managers' index rose to 58.2 from 56.6 in October, its highest reading since August 2013. The survey tallies with official UK manufacturing data that confirms sharp increases across several product lines.

The **U.S.** economic recovery continued at a steady pace with GDP growth of 3.1% over the second and third quarters expected to extend into the fourth quarter. New job creation of 228,000 in November kept the unemployment rate at 4.1%, the lowest in 17 years. A surge in U.S. business confidence, including among small businesses is an especially promising sign for the jobs outlook in 2018. The U.S. expansion is spread across the board including manufacturing, services and the housing sectors. Consumer confidence is also high. The growth momentum is likely to be spurred further by the tax overhaul bill now before congress, which promises to reduce taxes on businesses. The tax initiative is also expected to provide attractive incentives for companies holding an estimated two trillion dollars offshore, to repatriate at least portions of that cash to the U.S. If that happens it would likely provide an additional boost to the economy, acting as a stimulant to investment, hiring and more trade activity.

China's exports and imports were strong in November, underpinned by a recovering global economy and resilient domestic demand. Chinese exports rose by 12.3% from a year earlier, accelerating from 7% growth in October. Meanwhile Chinese commodity imports also picked up modestly. Shipments of copper, iron ore and crude oil imports all rose during November. Even if the Chinese real estate market is beginning to slow, it has not derailed the 2017 commodities rally. However, a recent decline in copper prices may be an indicator that traders are starting to price in slowing demand. The upswing in global demand has meant nine straight months of rising Chinese exports, a significant factor in the country's higher-than expected economic growth – after two years during which weak exports were a drag on growth. Global demand is expected to continue to support steady growth in 2018, giving Beijing more leeway to implement structural reforms including financial deleveraging.

The latest data suggest that the improved global growth still has momentum – but also flashed a warning signal. Rebounding Chinese exports still failed to breach the heavy levels reached earlier. Moreover, the risks associated with **U.S. - China** trade tensions cannot be ignored. The trade gap between both countries exceeded $25 billion consecutively during the last six months. China's trade surplus with the U.S. widened to $27.87 billion in November from $26.62 billion in October. It accounted for almost 70% of China's total trade surplus with all its trading partners. The Trump Administration will take note.

Strong growth across all major economies is obviously a boost to global trade, especially in economies that are heavily integrated in international supply chains. Strong global growth, low macroeconomic volatility and access to cheap credit should ensure that 2017's pick-up in investment, hiring and production extends into 2018-19. The figures point to a shift in the global economy towards self-sustaining growth after a decade of muted investment by businesses, which left advanced economies dependent on extraordinary stimulus measures.

Meanwhile, the world's biggest oil producers agreed to extend a deal to curb oil production throughout 2018 in an effort to shrink swollen stockpiles of crude and keep prices at or above $60 per barrel. Saudi Arabia and Russia whose combined production is equivalent to 20% of global supplies led the effort of 24 countries inside and outside OPEC.

In the **Middle East,** mass arrests among the elite in **Saudi Arabia** and increased tensions with **Iran** over the three-year-old war in **Yemen** are stoking fears of more regional unrest. Iran is accused of orchestrating the resignation of Lebanon's prime minister (since rescinded), which rattled financial markets and drove regional confidence down further.

Saudi Arabia's anti-corruption crackdown has steadily expanded to include Saudi business figures and officials who were previously thought to be securely a part of the hierarchy. Thousands of personal bank accounts have been frozen. The crackdown has sent shockwaves around the region. Princes, prominent businessmen and former ministers face a range of accusations including money laundering, bribery, extortion and channeling government contracts to companies linked to the suspects. The clampdown has alarmed local and international investors, forcing the government to release a series of statements to calm regional markets. The graft probe is said to have been extended beyond the Saudi banking system to include the UAE. Fears of the freezing of bank accounts or the blocking of assets held offshore (e.g. in UAE or Dubai –based banks, exchange houses and finance companies) by the suspects have not been ruled out. The Saudi central bank probe could be extended to other global institutions.

The impact on markets in the Persian Gulf made them among the worst-performing indices in November. Surprisingly, the Saudi equity market was not visibly affected by the multiple tensions. Credit default swaps (CDS) jumped the most for Bahrain and Saudi Arabia, with other sovereigns also rising. There were spikes in currency futures and other market indicators of risks across the region. This trend will likely recur in the coming months as investors and creditors assess renewed concerns of new political developments and the geopolitics of the region.

Regional tensions could intensify in 2018 especially following the decision of the U.S. president to officially recognize Jerusalem as the political capital of Israel. That decision gives those opposed to the continued existence of Israel fodder to mount protests and incite violence. At the most fundamental level the U.S. move suggests removing the political decision over Jerusalem's future status from any revived Israeli-Palestinian peace negotiations; and placing it instead into the global public square. It will be crucial how the rest of the world responds to the U.S. move in the months ahead. In the short-term it could stoke the fires of extremism.

Honduras

Authorities in Honduras have imposed a dusk-to-dawn curfew and given security forces more powers to rein in violent protests in an escalating crisis over late-November elections overshadowed by fraud fears. With no winner declared weeks after the election, supporters of the opposition challenger say the authoritarian president, Juan Orlando Hernandez, is seeking to steal the election. The returns show the results as being a narrow 42.9% versus 41.4% lead for Mr. Hernandez, a U.S. ally in the violent and volatile Central American nation. There is no second round in Honduras' first-past-the-post voting system. Both candidates have claimed victory.

The curfew came after security forces appealed for calm and warned that vandalism will be punished, following days of nationwide disturbances. Protesters have blocked roads, looted shops and damaged property while security forces in riot gear have fired tear gas to quell demonstrations. There were reports of injuries, some with gunshot wounds, including reports of at least one death. The Organization of American States (OAS) had both candidates sign a pledge to honor the choice of the voters. However, the opposition candidate Nasrallah backtracked saying he would only accept the result if it can be corroborated with the physical ballot tallies. As tensions rose protesters hurled rocks in various parts of the country, according to media images. The security forces were captured on camera apparently shooting in the direction of protesters. The government accuses the opposition of inciting violence and seeking to obstruct a hand-count of more than 1,000 disputed ballots. But the opposition claims that more than 5,000 other disputed votes had been included in the official count.

Honduras' stability is important to U.S. interests. The country is the source of large numbers of migrants to the U.S. Mr. Hernandez had been widely expected to easily win re-election, despite serious graft scandals in his government and a reputation as an authoritarian leader. His popularity has been boosted by a dramatic reduction of crime in the gang-plagued country.

Heading into 2018, robust growth in the Honduran economy will help drive rising price pressures. Economic activity averaged 5.4% growth in 2017, fueled by a spike in export growth (particularly in the agricultural sector), as well as remittance-fueled private demand. The expectation is that these dynamics will persist in the quarters ahead. Inflation is forecast at 4.2% in 2018, up from 3.8% in 2017. Rising import prices (e.g. oil) will put upward pressure on inflation during 2018.

Venezuela

As Venezuela's oil industry [and economy] crumbled over the past decade, there was one sector that remained standing: the country's joint ventures with foreign companies, particularly the ones extracting heavy oil from the reserves of the Orinoco Belt. Those deposits of extra-heavy oil makes Venezuela the world's largest proved reserves, and foreign companies including Chevron, Total, Eni and Statoil decided it was worth continuing to work there in spite of the country's mounting problems.

As Venezuela's financial crisis deepens and with a new set of U.S. sanctions adding to the pressure, even the foreign joint ventures are feeling the strain. As conditions deteriorate, European and U.S. companies face tough questions about the future of their Venezuelan operations. Foreign oil companies' continued presence in Venezuela is already the result of their willingness to compromise. In 2006-07 then President Hugo Chavez moved to take control of the oil industry, which had received large-scale investment from companies including ExxonMobil, Chevron, ConocoPhillips and BP.

The sector's "crown jewels" were four projects in the Orinoco Belt extracting extra-heavy oil and upgrading it into a lighter form of crude that can be more easily processed by refineries.

Mr. Chavez issued a decree to give PDVSA, the national oil company, a 60% stake in those projects, and then sent troops to enforce the order by any means necessary. Two U.S. companies, Exxon and Conoco chose to walk away, subsequently suing to recover the value of the assets they had lost. The other companies mostly remained, deciding that retaining minority stakes was a better bet than a long and uncertain legal battle. For years, that seemed the wiser decision. Extra heavy oil in Venezuela has been a long-running success story: production rose from 200,000 barrels per day in 2000 to 900,000 b/d in 2016, according the International Energy Agency, and that success continued even after PDVSA was put in charge. Chevron, for example, was able to hold its production in Venezuela steady over 2010-16. BP which also accepted Mr. Chavez's terms, was able to sell its minority stakes in its Venezuelan joint ventures, along with some assets in Vietnam, to its Russian affiliate TNK-BP for an attractive-looking price of $1.8 billion in 2010.

However, when the price of oil slumped in 2014 PDVSA was plunged into crisis. Desperate for cash to service its debt burden, PDVSA has been starving its operations of funds. Industry sources point to the difficulties in investing in facilities or even properly maintaining those facilities. This explains why production has kept on declining. Estimates of Venezuelan production vary, but figures the government provides OPEC show a decline from an average of 2.6 million barrels per day in 2015 to 1.96 million b/d in October. PDVSA is facing a death spiral of falling output and deeper financial crisis.

Egypt

The IMF announced that it reached a staff-level agreement with the Egyptian government on the second review of the IMF's $12 billion extended fund facility (EFF), which was initially signed in November 2016. A $2 billion disbursement is anticipated from the EFF in December after the IMF Board signs off. This will be in addition to $4 billion that has been provided so far, amounting to half of the total EFF value.

The IMF viewed the ongoing government-led reforms as mostly positive, and did not refer to a number of sensitive issues that were raised in an earlier review. These include energy subsidy reform, which is being paused temporarily for the next year, and further steps to liberalize the exchange rate. The earlier IMF review included a number of waivers for mixed targets. However, there was no reference to waivers in this second review. The next review is likely to entail a more searching examination, as its scope will include the budget for 2019, during which the government has stated that it will phase out fuel subsidies altogether.

Egypt's overall fiscal deficit in 2016/17 was 10.9% of GDP, compared with a revised target of 10.5%. The higher deficit was largely a result of the increase in interest payments, resulting from hikes in interest rates by the central bank as part of a response to a sharp rise in inflation. The government is aiming to achieve an overall deficit of 9% next year on the back of a higher tax take – although these targets may be difficult to achieve in light of the high interest rates on government borrowing and the pause in energy subsidy reforms. GDP growth has picked up to 4.9% in the last two quarters – with growth in exports accounting for some of the gains. However, high inflation is expected to continue to dampen consumer sentiment.

Meanwhile, as renewed tensions mount across the Middle East some 235 people were killed in Sinai on November 24 in an attack on a mosque located in northern Sinai during Friday prayers. The attack is suspected to be the work of Islamic State. The attack took place at a mosque considered the center of worship for members of the Sufi order (with an estimated 15-20% following among Egyptians). ISIS leaders had previously denounced this order's spiritual approach to Islam.

The recurrence of such attacks are expected to continue into the foreseeable future, particularly in the Sinai Peninsula. The region has been neglected by the Egyptian government for decades and suffers from higher rates of poverty and unemployment relative to the rest of the country. This partly explains the difficulty of collecting intelligence on jihadi groups in northern Sinai. Resentment towards the state runs deep and many of the local inhabitants (mostly Bedouins) are reluctant to reveal the movements of militants in the region.

Egypt's policy toward private enterprise and competition over the next few years is being watched carefully. Shares held by state entities in several firms in the downstream oil and gas sector are expected to be sold off during 2018-19 on the stock market. A 2005 competition law is expected to be amended to give the regulatory authority more control over mergers and acquisitions. The government has indicated that it wants to revive a public-private partnership program that would facilitate the state selling off its shares in a number of banks while keeping National Bank of Egypt in full public ownership.

The banking system has challenges but profits at leading banks have been good recently due to an improving business climate. With more economic stability the banks have been presented with more opportunities for investment and lending. Several Egyptian banks have foreign investment partners (e.g. Kuwaiti, Saudi investors) with a positive outlook of the Egyptian economy. Many anticipate expanded financing opportunities in the Egyptian market which should help profitability among the banks over the next four years.

Leading private banking groups operating in Egypt are financially stable; they stress a policy to remain diversified in the market, maintaining balanced sources of income on the one hand, and on the other hand, to provide more flexible financing solutions in addition to offering innovative banking products. Many provide valuable credit operations to the corporate sector, across a wide variety of companies. A few private banks indicate a push toward strengthening their position in the retail sector and providing more consumer lending in the coming year.

An investment law and industrial licensing law were passed in mid-2017, aimed at actively courting foreign investment via a series of roadshows and conferences in 2018-19. Construction and infrastructure development across Egypt is in high gear and are attracting interests from several Middle Eastern investors as well as investors in the west. There are ongoing pressures to reduce bureaucratic obstacles in the investment law following complaints of delays from foreign companies.

In 2018-19 the central bank is expected to relax most of the capital controls that were imposed prior to the flotation of the Egyptian pound in November 2016. Remaining restrictions on imports, including tariff surcharges on goods deemed as luxuries are slated to be lifted by 2020-22. The forecast for the differential between the official and unofficial market exchange rate for the U.S. dollar has been narrowed. This reflects the growth in foreign exchange reserves in recent months and the central bank's improved capacity to meet the local market needs for hard currency.

The unemployment rate is projected to fall to about 12% as economic growth picks up in 2018-19. However there are persistent protests by workers over falling real wages and continued high inflation. The economic reform program (agreed with the IMF) should ensure progress in fiscal consolidation, although business-related structural reforms will proceed slowly owing to opposition from vested interests within state bodies.

The fiscal deficit is projected to narrow, albeit gradually, from an estimated 10.8% of GDP in 2017 to 6.6% of GDP in 2021. The current-account deficit is also expected to narrow (from 3.5% of GDP in 2018 to 2.1% in 2022), as the weak pound gives exports a competitive edge. Despite the reduced need for costly fuel imports as of early 2018 (when crude from the Zohr fields begin to replace imports); other imports to Egypt are likely to rise gradually in U.S. dollar terms. This reflects the steady demand for inflows of capital goods needed for infrastructure projects.

The risk of a government overthrow remains low, but large-scale anti-regime protests cannot be ruled out, given limited room for political expression amid tough economic conditions. We expect continued use of heavy security measures to contain social unrest. President Sisi will run for a second four-year term in 2018 and is expected to win, benefiting primarily from strong support within state institutions. Nevertheless, we expect some anti-government protests and labor strikes to continue next year due to economic hardships inflicted by the government's economic agenda on the public. However, these will not be large enough to threaten the regime.

Turkey

Turkey's business environment ranking score is expected to deteriorate slightly over the next two years. The Economist Intelligence Unit saw its global ranking for Turkey fall by several places in 2017 to 58th. While there is consensus among policymakers on the need to maintain macroeconomic stability, the failed 2016 coup and the government's response have increased the level of uncertainty about the direction of policy. Shortcomings include a politicized and inefficient judicial system, labor market rigidities and widespread tax evasion.

Annual inflation hit 13% in November, its highest rate in 14 years [up from 11.9% in October], caused by the continued weakness of the currency (the lira) and higher global oil prices. This caused the price of imports to rise and spread quickly to other goods and services. Domestic demand remains fairly buoyant.

The central bank faces a dilemma given intense political pressure to not raise interest rates. Price trends in Turkey will continue to depend on a steadier lira. Since September the currency has depreciated by 11%. Weaker capital inflows owing to global monetary tightening and domestic political concerns could keep the currency under pressure in the months ahead, even though it is already weak by historical standards.

Over 2018-19 privatizations at state controlled companies are likely to be delayed amid the post-coup upheaval in state institutions. Some companies, notably those with media holdings or ties to the outlawed Gulenist movement, remain subject to heavy-handed state intervention.

Networks of patronage remain strong in Turkey and is a constraint on the free market. Competition is still limited in a wide range of sectors, although the opening up of the energy market is expected to make some progress over the next few years. Attracting foreign direct investment remains a government priority, but concerns about security, corruption and political influence on the judicial system will tend to curb inflows.

GDP growth is forecast at 5.1% in 2017 with average annual GDP growth of 4.5% projected over 2018-21. The rate of growth has been supported by government stimulus measures, political pressure on banks to extend credit and the pick-up in global demand. The outlook is predicated on the assumption that Turkey's transition to a presidential system of government in the next few years does not lead to further political instability, which would likely deter foreign capital flows into the economy.

Turkey's financial sector is mostly well capitalized and well supervised. However, a tendency by the government to intervene and influence bank policy politically, remains a concern. As President Erdogan assumes even greater powers to himself, there should be no illusions that he will not use his office to lean on the banks if he deems it necessary to influence interest rate and lending policies. That would not be considered healthy in maintaining independence and profitability of the banking sector. The central bank has indirectly increased the cost of its lending to the financial sector in its latest of a series of moves designed to shore up the lira and help to curb consumer price inflation. The move came in November shortly after President Erdogan issued one of his sharpest criticisms yet of high interest rates and central bank independence.

Grand construction projects have been an essential part of the success of President Erdogan and the ruling AKP. According to the World Bank, to date private-sector investment in public-private partnerships projects reached $102.9 billion. The bulk of this figure - $93.3 billion - has been invested since 2002 when the AKP came to power. Financing future megaprojects is likely to be a challenge, as Turkey's financial sector has limited capacity to finance such large projects. The operating losses that are being reported at recently completed projects are likely to cast doubt on the business case for those still waiting in the pipeline.

Recent hard data and surveys suggest that Turkish firms are planning to increase gross investment expenditure by an average of 33.6% in 2018. Such an expansion in productive capacity would be positive news for the economy that is under pressure from a depreciating lira and firming global commodity prices. However, it is far from certain that the necessary investment will materialize. The lira will remain under pressure owing to the volatile domestic and regional political environment, as well as tightening financial conditions in advanced economies. In such an environment, companies - especially those with significant debt exposure in foreign currencies - are likely to opt to take a more cautious stance and could delay some of their investment decisions.

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Bank Insured: Single Buyer A/R Purchase, Non-Cancelable Limit* Policy: $12,000,000 limit of liability in Food sector, Brazil

Bank Insured: Single Buyer A/R Purchase, Non-Cancelable Limit* Policy: $38,000,000 limit of liability in Packaging sector, USA

Corporate Insured – Syndicated Single Buyer Policy, 50% participation in a $36,000,000 limit of liability in Telecommunications sector, USA

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