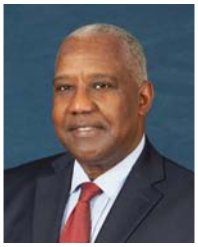
Major Country Developments
February 2018



By Byron Shoulton

Global Overview

Global equity markets slumped even as the global economy continues to display a generally positive growth trajectory. The anticipated market correction may be underway after years of relatively steady advances in stock valuations. The recent slide in equity prices suggest that inflationary trends are advancing and interest rates will rise accordingly in the years ahead.

Meanwhile, trade tensions mount between the U.S. and a number of its trading partners. The IMF predicts global growth of 3.9% in 2018. Optimism about the health of the global economy is boosting confidence and raise expectations for spending across regions and sectors. According to a recent survey by PwC 36% of business leaders expect the global economy to strengthen, up from 17% in 2017. In a disappointing development, global flows of foreign direct investment (FDI) fell by 16% in 2017, according to a new report from UNTAD (United Nations arm for trade, investment and development issues).

The **Canadian** economy rebounded toward the end of 2017 led by manufacturing which recorded its best performance in nearly four years. Canada's GDP advanced by 3.5%. In January the Bank of Canada raised its benchmark interest rate by a quarter percentage point to 1.25%, its third increase in seven months. Unemployment is at a four decade low, and 2017 marked the best year for job creation since 2002. The central bank said its economic outlook is expected to warrant higher interest rates in due time, with 2018 GDP growth forecast at 2.3%.

The **euro** surged after the head of the European Central Bank hinted that the bank's bond purchases might soon be curtailed. Consumer prices in the euro area rose at an annual rate of 1.3% in January, slowing from December's 1.4% pace. The continuation of inflation well under the ECB's 2% target remains a puzzle for policymakers, in the face of robust economic growth and falling unemployment. It follows that the momentum of strengthening consumer demand and higher overall spending will eventually begin to push inflation upwards.

In **Germany**, the 2018 growth outlook was revised upwards to 2% from 1.5%. German unemployment fell to a record low of 5.4%, as the economic expansion has grown so strong that some are raising concerns about overheating as industrial capacity becomes increasingly stretched. The unemployment rate has been setting new records for months, but private sector surveys have reported little sign of a let-up in demand for staff. Germany's Labor Office concurred noting that demand for new employees is at a very high level.

Meanwhile, concern is growing that a coalition agreement to set-up a new German government consisting of Chancellor Merkel's Conservative Democratic Union (CDU) and the Social Democrats (SDP), could pave the way for more cash transfers from German taxpayers to weaker Eurozone countries. While a coalition deal would be a big step towards ending the political deadlock that has gripped Germany since last September's inconclusive elections, many in Mrs. Merkel's CDU are concerned about what teaming up with the SDP will mean for their party's traditionally guarded views on the Eurozone. The head of the SPD recently proposed a United States of Europe, an idea that is loathed within the CDU and elsewhere in Europe as it means national governments would lose control over the European Stability Mechanism (ESM), the Eurozone's crisis rescue fund. Critics have focused on plans to turn the ESM into a permanent European Monetary Fund. Currently, the ESM is controlled by the 19 governments of the Eurozone through an international agreement, and does not come under the scope of EU law. The fear is that any change to this arrangement would compromise the role of domestic parliaments to monitor and question EU decision-making in billion-euro loans to member countries.

In **Italy**, the unemployment rate ticked down from 10.9% to 10.8%, its lowest level since 2012, and better than was predicted.

The **UK** moved closer to the possibility of a 'no deal' outcome in its talks with the European Union over Brexit. The UK government remains unable to agree on a detailed position on its financial services sector, among other uncertainties. The government has been under intense criticism for months from British businesses for failing to spell out what it viewed as its preferred trading relationship for the financial services sector with the EU post-Brexit. The French government has warned that financial services would have full access to the EU single market only if Britain played by all the rules of the trading bloc.

Meanwhile, the International Monetary Fund (IMF) trimmed its 2018 GDP growth outlook for the U.K. to 1.5% from 1.8% previously. The number of UK business leaders who are 'very confident' has dipped to 34% from 41% last year and there are signs that UK businesses are reining in their hiring plans. The number of UK businesses expecting to increase headcount fell slightly to 54% from 63% last year, while 15% expect to reduce headcount, compared to 10% in 2017. Still, most business leaders in Britain say they are upbeat about the growth prospects for their companies in 2018 despite uncertainty about the impact of Brexit.

China

China pepped up its economy with faster credit growth and new spending goals to spur growth over the next five years. Chinese growth is considered essential for global growth. However, while China's economy rebounded in 2017 with GDP growth of 6.9%, this was the first acceleration in growth in several years. China's transition from an export-led economy to more advanced manufacturing and more technological innovation for domestic application, appears to be underway.

U.S. officials are increasing pressure on China whose policies are viewed by Washington as unfair and being partly responsible for years of high U.S. trade deficits. In addition to the charge that China practices unfair trade, the Trump Administration has placed great emphasis on its launch in 2017 of a 'Section 301' investigation into China's intellectual property practices and the way Beijing forces foreign companies wanting to do business in China, to transfer advanced technologies to local partners. The Administration's stated goal is to address "systemic" issues within China's industrial policies. The Administration is of the view that letting China join the World Trade Organization (WTO) in 2001 was a mistake. This represents a significant departure from previous U.S. policy, which argued that China's integration into the global economic system was good for the world. Indeed, the U.S. Administration believes that the WTO is itself in need of serious reform to deal with emerging problems, particularly the long-term effects of the rise of China on the global economy. Officials insist that when China joined the WTO in 2001 the expectation was that the country would have evolved into a market economy.

Instead, Trump officials say China's economy has grown in the opposite direction, i.e. continued strong state control, state ownership and involvement in important aspects of economic activity, including Chinese state holdings in major assets like energy, cyber security, telecommunications; and ownership stakes in major conglomerates doing business across several sectors, globally and inside China. These players, according to the U.S. Trade Representative, distort the global trading system and place unsustainable strains on resources and markets. China as the world's largest importer of raw materials and minerals have become the largest owner of stockpiles of various commodities including copper, steel, aluminum, et al. This allows China to influence if not set global commodity prices. There is a growing consensus that such distortions need to be confronted and dealt with if the system is to work as intended. The U.S. is seeking support from the EU to join forces to advocate and take on China in a push for reciprocal access to the Chinese market, similar to that enjoyed by Chinese investors, bankers and traders in Western countries.

In January the U.S. imposed high tariffs on imported washing machines and solar panels from South Korea and China, respectively. This could be the first step in the current drive toward enforcing broad U.S. protection to various sectors [from global competition], deemed as casualties of unfair competitive practices and massive state subsidies. Some free trade advocates fear that further moves by the U.S. in this direction could eventually trigger a trade war. China reacted angrily to the imposition of tariffs by the U.S. on imports of solar cells, proclaiming strong dissatisfaction with the move and noted that they would resolutely defend their legitimate interests. In the U.S. the Solar Energy Industries Association said the tariffs would lead to the loss of up to 23,000 U.S. jobs in 2018, and would result in the delay or cancellation of billions of dollars in investment in solar projects.

Meanwhile, Chinese exporters are increasingly concerned about the renminbi's rise against the U.S. dollar. But the lingering threat of capital outflows, as well as the risk of exacerbating trade tensions with the Trump Administration, mean the Chinese government is unlikely to take direct action. The RMB has risen 4% against the dollar this year, building on its 6.7% gain in 2017, to levels seen in mid-2015 when the central bank shocked global markets with a 2.1% one-step devaluation. Chinese state banks have reportedly been buying dollars to manage the RMB's rise, and the central bank could opt for more direct intervention if the currency continues to strengthen.

USA

U.S. job growth exceeded expectations in January and wages climbed at the fastest pace since the great recession, strengthening the case for an interest rate increase in March. Non-farm payrolls rose by 200,000 in January, topping expectations for 180,000 jobs. That compared with revised 160,000 jobs added in December. The report showed strong employment growth in construction, food services and healthcare. The U.S. unemployment rate held steady at 4.1% for the fourth consecutive month. U.S. progress on tax overhaul and deregulation in 2017 may be followed in 2018 with a push toward broad agreement on an infrastructure spending initiative. This would be an added boost to strong momentum already in evidence.

The U.S. economy is forecast to expand in the range of 2.8%-3% in 2018. The slump in oil prices two-years ago was in part a response to weak demand and plentiful supply of crude (including U.S. shale production). Demand recovered quickly. A new driver of oil prices has emerged lately – a weaker U.S. dollar. As the dollar fell by 4% in January, plumbing its lowest level since December 2014, crude oil was trading above $66 per barrel, its highest level since December 2014. Thanks to U.S. shale production which is poised to break records by surpassing 10 million barrels per day in 2018, according to forecasts from the Energy Information Administration. U.S. net imports of crude and petroleum products fell below 2.5 million barrels per day late in 2017, the lowest on record since the early 1970's.

The dollar may be weakening partly because economic growth is taking hold in Europe, Japan and much of the rest of the world, enabling central banks to look at ending stimulus efforts and lifting interest rates. These moves should increase the value of local currencies. The broad growth identified by the IMF also has a bullish effect on oil prices as fuel consumption rises. Global oil demand is forecast to reach 99.1 million barrels per day in 2018, up by 1.3 million barrels per day from 2017. For countries whose currencies have strengthened against the dollar, oil prices in local money are not moving up as fast as in dollars, softening the impact on consumers.

The prospect of faster than expected monetary policy tightening abroad has the dollar at its lowest level in more than three years. Expectations of rising interest rates tend to attract yield-seeking investors. The dollar's fall over the last few months reflects a broad shift away from U.S. assets by investors who prefer to allocate more capital to sections of the global economy where growth trends are strengthening, rates are rising and political risks are perceived to be lower.

Separately, President Trump hinted that the U.S. may consider rejoining the **Trans-Pacific Partnership [TPP]** trade and investment agreement, provided there are assurances of reciprocal treatment for U.S. goods and services among member countries. Meanwhile the remaining 11 nations who were part of the original TPP met in January and agreed to proceed without the U.S. The new agreement, renamed the **Comprehensive Progressive Trans Pacific Partnership [or CPTPP]** is scheduled to be signed by all eleven nations in Chile on March 16, 2018. [Please watch for our Special Report on TPP to be published shortly].

Ongoing talks between the **U.S., Canada and Mexico** aimed at renegotiating the North American Trade Agreement [NAFTA] will begin its seventh round in February, with all sides acknowledging some progress without expectations of an imminent breakthrough. Mounting pressure on the U.S. to avoid abandoning NAFTA, is coming from American companies [and other U.S. interests] pointing out the likely negative long-term implications to their businesses of a U.S. withdrawal from the trade pact. U.S. agricultural and auto parts producers, among others, are particularly vulnerable and are very nervous about the fallout should the U.S. choose to withdraw from the trade pact. While rumors of a U.S. withdrawal circulated as a strong possibility in mid-January, by month-end speculation that negotiations toward a "good outcome" on NAFTA had made some progress and the word is that those efforts will continue.

Egypt

President Abdel al-Sisi will run for re-election for a second term in March 2018 and would be running unchallenged except for a last minute announcement by a little known politician who heads a small, centrist party, known as the Ghad party. More astonishing is the fact that the contender, Mousa Mostafa Mousa, while announcing his intention to run, had already declared himself a supporter of President Sisi.

The last-minute announcement came after three other potential contenders, including military men, were forced out of the contest in recent weeks or withdrew. Several opposition figures have called upon Egyptians to boycott the poll saying President Sisi's regime has prevented honest political competition and was opposed to any serious candidate that could challenge him. Young Egyptians are particularly unhappy with insufficient skills to meet the demand of a modernizing, export-oriented economy.

Egypt's large population of 90 million and its prime location as a base to set-up manufacturing for exports to the Middle East region, Asia and Africa, gives it the potential for long-term economic growth. Economic reforms enacted since 2016 in the aftermath of the overthrow of presidents Hosni Mubarak and Mohammed Morsi, provided an opportunity to resolve deep-seated weaknesses and to stimulate economic growth again. That is an ongoing process. Investment in quality education and training remains poor. The security and political stability environment continue to undermine economic growth, including subdued tourist arrivals over the past several years. While 2017 saw a return of some Russian tourists to Egypt, there remains a perception of insecurity which has stalled visitors from around the world from resuming travel to this traditionally historic location. Despite political upheavals, the economy has been slowly liberalized from its socialist origins, with the current government committed to attracting foreign investment and promoting exports.

Economic data shows some improvement, with inflation easing, growth picking up, and the current account deficit falling (to $1.2 billion in 2017 from $5 billion in 2016). Despite the government's efforts to improve the perception of the business climate and attract foreign investment, Egypt's ranking in the World Bank's Doing Business 2018 report fell six places. Nonetheless, in 2017 a new investment law and a law on industrial licenses were enacted. The investment law restores tax incentives, with discounts of 30%-50% available on income tax over seven years. More work towards breaking down bureaucratic obstacles to doing business in this market is being done and is expected to bear fruit in 2018 – especially as President Sisi appears certain to regain power.

Delays in obtaining foreign exchange to pay foreign obligations (once local currency deposits are made) can be as long as three months. However, reports in recent months point to increased availability of foreign exchange in the banking system, resulting in a reduction in payment delays. The central bank appears concerned about the risk of volatility if the Egyptian pound were to appreciate in response to improved foreign exchange availability. The IMF is expected to disburse another $2 billion of its $12 billion extended fund facility for Egypt, having recently completed its second review.

Pakistan

Pakistan is deepening its relationship with Russia and China as the fallout continues from a recent U.S. decision to suspend $2 billion in military aid to Pakistan. The Pakistani government says it is recalibrating its foreign and security policy by looking instead to Russia and China for new military supplies. The Pakistanis announced that they have already purchased Russian helicopters. The new policy could undermine U.S. efforts in the ongoing war in Afghanistan in which Pakistan has provided valuable support to the U.S.

China plans on spending $55 billion in Pakistan on infrastructure projects as part of its plan to build a network of trade routes across the world, causing concerns in the U.S. that Pakistan could eventually become a Chinese client state. Pakistan's growing relationship with China is cause of unease in Washington where officials are strengthening alliances with other countries in the region – including India- as a bulwark against Chinese regional ambitions.

The Pakistanis have been emboldened in their row with the U.S. by the continued backing and support they receive from China. As far as Pakistan is concerned, their actions are simply a reaction to the hardline taken by the U.S. in suspending its military support.

GDP growth is forecast at 5.3% over the 2018-19 fiscal years. Growth will continue to be supported by progress on the China-Pakistan Economic Corridor (CPEC) energy projects and improving domestic business sentiment. Pakistan's large population and strengthening growth rate will likely attract higher levels of foreign direct investment from non-Chinese companies. However, such investment will have a domestic focus and is unlikely to spur a significant increase in employment in export-led industries.

Pakistan's central bank pre-emptively raised its key interest rate at the end of January, to prevent a build-up of inflationary expectations. This was the first rate increase since 2015. Not surprisingly, higher inflation in December and January (5.2%) coincided with the central bank's decision to let the currency devalue by almost 5% in December, amid growing balance-of-payments pressures. The expectation is for inflation to rise in 2018 to the 5.7% range as the currency depreciates further; with a strong possibility that two additional interest rate increases will follow during the year.

The ruling Pakistan Muslim League holds a comfortable majority in the parliament and is expected to remain in power following the July 2018 elections. The outlook for political stability remain poor in Pakistan. For this reason the military will maintain its influence on foreign affairs and national security. Strains between the government, the military and the judiciary are expected to remain, which underlies the risk to political stability.

Ethiopia

Opposition to the ruling Ethiopian People's Revolutionary Democratic Front (EPRDF) grows as anti-government demonstrations (following the release of 5,000 political prisoners) ramp-up the pressure on Ethiopia's autocratic rulers. Analysts regard the mass release as a sign that the ruling coalition is willing to make genuine concessions to those demanding reform for the first time since the ruling coalition seized power in 1991. The release did nothing to ease almost three years of violent anti-government demonstrations. Instead, opposition supporters are looking to expose deepening divisions within the 4-party coalition government to push for change as they sense the regime's increasing vulnerability. Protests continued despite the prisoner releases, with 20 people killed over a two-week period in January.

Ethnic tensions in the south-eastern regions are intensifying and the government is struggling to respond. The regime has traditionally used force to crush all dissent. At the heart of the push for reforms is a large body of unemployed youth.

The EPRDF has presided over one of Africa's fastest growing economies since removing the dictator Mengistu, spending heavily on infrastructure and positioning Ethiopia as a manufacturing hub. However, the economic progress has been accompanied by repression and a conspicuous favoritism towards the ruling elite. The split within the coalition is over whether to allow greater democratic freedoms or maintain its autocratic grip on power while it focuses on development.

Ethiopia export-oriented light manufacturing is a key sector receiving government support in the form of investment incentives. Foreign firms are reportedly positioning to take advantage of the country's long-term growth potential in consumer goods and services. Ethiopia's economic potential is also linked to possible oil, gas and mineral discoveries and room for greater agricultural production. Government investment in transport and power generation will assist greatly; and the development of export-assembly facilities located in industrial parks could expand the country's appeal.

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

FCIA's Deals Of the Month

Accounts Receivable Purchase Policy: $30,000,000 limit of liability covering non payment risk by Domestic obligors in Telecom sector.

Bank Import Finance Policy - $8,000,000 limit of liability covering non payment risk in the construction sector in Argentina, 4 year tenor.

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.*