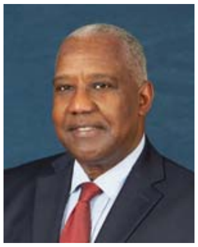
Major Country Developments
March 2018



By Byron Shoulton

Overview

U.S. consumer confidence rose in February, a sign that American households shrugged off renewed volatility in financial markets. The University of Michigan Consumer-sentiment index scored 99.7 in February, up from 95.7 in January. This was the second- highest monthly reading since 2004, below only last October's 100.7 reading. The consensus among experts had forecast the February reading to come in at 99.5. Consumers base their optimism on favorable assessments of jobs, wages and higher after-tax take home pay.

The Conference Board also reported that Americans felt better about the current state of the economy as well as its future prospects. U.S. households have been generally upbeat about the economy in recent months, with growth supported by rising incomes and low unemployment. The recent passage of a package of tax cuts boosted take-home pay for more workers. However, the stock market has moved lower since late January.

Separately, U.S. shale production continues at a record pace and according to the International Energy Agency (IEA) this could overwhelm global demand. U.S. shale production is growing faster than it did even during the boom years of $100 per barrel oil prices from 2011-2014. The difference this time: oil prices are approximately 40% lower. The situation is reminiscent of the first wave of U.S. shale growth, when a flood of U.S. oil caused an oil glut and sent prices crashing. This time around it appears that global demand is strong enough to prevent a major collapse in prices but it suggests that there is not much room for further oil price increases any time soon. U.S. oil output could rise as high as 11 million barrels per day by 2019, rivaling that of Russia, the world's biggest crude producer. The U.S. currently pumps over 10 million barrels a day, the most since 1970.

Meanwhile, President Trump doubled down on his anti-free trade agenda announcing that global tariffs will soon be imposed on imported steel and aluminum. Tariffs of 25% on steel and 10% on aluminum prompted warnings from the European Union, China, Canada and South Korea amid concerns of possible retaliation against U.S. exports. The proposed action is part of a national security investigation and the Administration invoked a rarely used loophole in international trade rules that allows countries to impose trade restrictions in times of war. The initial indications were that new tariffs would apply to steel and aluminum imports from all countries, although many expect there to be a process allowing for exclusions from these tariffs.

The announcement came as senior Chinese economic officials were visiting Washington, D.C. hoping to head off a trade war between the world's two largest economies. Chinese steel groups warned that the impact of the U.S. tariffs would fall disproportionately on other countries, including the U.S. itself. China accounts for one or two percent of U.S. steel imports and about 10% of aluminum imports. Invoking national security in such a case could encourage China to use the same pretext to take action. There are advocates both inside the U.S. Administration and in private industry urging the U.S. to work with its allies to dial up the pressure on China for its unfair trade practices, instead of imposing blanket global tariffs that would be applicable to imports from all countries.

Canada, which is the largest source of U.S. imports of both aluminum and steel, said it would view any restrictions on its exports to the U.S. of either metal as unacceptable and vowed to take responsive measures to defend Canadian trade interests and workers. A Canadian government statement stressed that it was inappropriate to view any trade with Canada as a national security threat to the U.S.

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The EU labeled the U.S. move as a blatant intervention to protect U.S. domestic industry and having nothing to do with national security concerns. The EU noted that it has been a close security ally of the U.S. for decades but would be forced to respond to the tariffs against EU industry that's been hit with what the EU deems as unfair measures, which would likely put thousands of Europeans' jobs at risk. There is broad consensus that tariffs on steel and aluminum (among others) represent a tax hike on American consumers. The tariffs would raise the cost of both metals which are used as inputs in a variety of industries including construction, beverages, autos, airplanes, trains, tractors, food processing, port facilities, mining equipment and household goods. Among the unintended consequences if these tariffs are enacted will be higher costs for manufacturing items that use steel and aluminum inputs. Broadly, the tariffs are seen as being among the first salvos in what could become a prolonged confrontation over trade between the U.S. and its trading partners. Trade experts and many politicians continue to urge negotiation instead of unilateral action by the U.S. to address issues of unfair trade.

Russia agreed to resume direct airline flights to Egypt. This follows a two-year suspension during which Russian tourists were forbidden from visiting Egyptian resorts, previously a favorite holiday destination for Russians. The suspension of Russian air travel to Egypt followed the downing of a Russian airliner over Sinai which killed all 224 people on board. The two countries also signed an agreement for Russian state-owned Rosatom to build a $21 billion nuclear power plant in Northern Egypt. The nuclear deal is another sign of the strengthening relationship between Russia and Egypt since President Sisi came to power in 2014. Ever since the ouster of the Moslem Brotherhood-led government in 2013, President Sisi has sought closer relations with Moscow.

Italy over the past five years has had three center-left prime ministers who were able to steer the country out of financial crisis and subsequent deep recession. Still, recovery has been sluggish and deemed intangible to many Italians. This has led to widespread dissatisfaction with the political elite and a desire for profound changes in how the country is run. More than 50% of Italian voters now identify with political movements that have criticized the EU.

At the same time, authorities have struggled to deal with an influx of more than 620,000 migrants from Africa and the Middle East – a crisis that has fed anxiety among the Italian populace. Italy's nationalist political movements [e.g. Five Star and Northern League] blame the domestic political establishment- and Italy's loss of sovereignty to the EU- for the ongoing struggles of the middle class. Hence the rise in popularity of these nationalist parties in Italy (and across Europe) and the corresponding loss of appeal for establishment parties. The prospect of Italy entering a bout of deep political uncertainty and instability is unnerving the European Union just as it is trying to launch an integration under French President Macron and the newly minted grand coalition in Germany.

Italy is Europe's fourth largest economy and a founding member of the EU. Italians have traditionally been among the EU's biggest supporters. However, Euroscepticism has been spreading in recent years because of unhappiness with EU budgetary constraints, regulatory policies and the migrant crisis. The next government to be formed in Italy following the current election cycle, will embody all these grievances and represents a strong opposition to the establishment. This does not signal with certainty that Italy is an inevitable candidate for withdrawal from the EU, but it sends a powerful message to the EU bureaucracy in Brussels to take heed and make necessary adjustments that address the growing unease being voiced in Italy and across several member states.

South Africa's ruling African National Congress (ANC) forced embattled President Jacob Zuma to resign in February. Zuma's former deputy Cyril Ramaphosa was sworn in as the new South African president. This brought to an end Zuma's nine-year rule - a period marked by scandal and extraordinary mismanagement that threatened to destroy the legacy and the party of Nelson Mandela.

The new president, who was previously a successful businessman, must now attempt to deliver on the many unfulfilled promises of the Zuma years. For example, better education, housing and job creation. This can only be accomplished in a climate that welcomes investment and encourages entrepreneurism with a strong emphasis on accountability and transparency. South Africa remains one of the world's most unequal countries, with many citizens living in conditions much like those in existence under apartheid. The downward leadership and economic drift under President Zuma resulted in many missed opportunities as investors (local and foreign) lost confidence in the country and held back due to the perception that the Zuma government was synonymous with the use of public office for personal gain.

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The new government recently presented a budget that seeks to repair the economic damage inflicted under the previous regime, while reassuring international investors and the country's poor majority. The budget is a mix of tax increases on high earners and corporations that will help fund education for poor and middle class students along with spending cuts aimed at shoring up the country's credit rating. The budget underscores some of the challenges facing the new government. The tax increases are also targeted to help reduce the fiscal deficit from 4.3% of GDP in 2017 to an estimated 3.6% in 2018-19.

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Economic growth forecasts were nudged higher (GDP growth of 1.5% in 2018, 1.8% in 2019 and 2.1% in 2020 – up from an estimated 1% in 2017). However, even if realized this expansion will not keep pace with population growth and will fall far short of the 3%-5% GDP growth projected by Mr. Ramaphosa when he campaigned for the ANC leadership last year. A change in the government debt forecast from 61% of GDP to 56% by 2022 is meant to help persuade Moody's – the only rating agency that still deems South Africa's bonds as investment grade- to forego a possible downgrade in March. Both S&P and Fitch cut the country's credit rating to below investment grade in 2017. The government is hoping to attract investment to help reduce the 27% unemployment rate before national elections which are due in 2019. The ANC is aware that it risks losing its absolute majority for the first time since the end of white-minority rule in South Africa.

Angola's central bank has allowed the currency the kwanza to weaken to a rate of 187.7: US$1, marking a break from a long-held peg to the U.S. dollar at around 169: US$1. The devaluation is further evidence of the more reform-minded nature of Angola's new administration under President Joao Lourenco.

The hard peg has been a deterrent to investors fearing their ability to access hard currency in Angola, as the country's vastly overvalued exchange rate (the kwanza had been trading in excess of 400:US$1 on the parallel market) has weighed on liquidity in the foreign exchange market. It remains unclear exactly what the new currency regime will look like in practice. While the central bank has specified that it will move to a rate determined by commercial banks at auction within a currency band, it has not revealed where this band will lie, or how it will be determined.

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Furthermore, it is possible that the subsequent impact on inflation (spiking it higher) will allow the central bank to pull back from making more substantial efforts to liberalize the exchange rate. Although a 10% devaluation is a strong start, it is unlikely this will be enough to restore liquidity and sustainability to Angola's foreign exchange markets without further depreciation of the currency.

Investors are likely to view the recent move by the central bank as a positive step towards improving Angola's business climate, particularly if the new currency band is allowed to react to macroeconomic and financial conditions, rather than set at a fixed rate. The government may follow the devaluation by seeking to secure an IMF program, which would help to further improve needed investor and creditor sentiment toward this market.

In the **Democratic Republic of Congo (DRC)** President Joseph Kabila's term in office should have ended in 2016 (according to the nation's constitution). However, Mr. Kabila failed to call elections in 2016 as required by the constitution, and via control of the courts and the security forces, he has managed to remain in power and refuses to leave. The president came to power in 2001 after the assassination of his father, President Laurent Kabila.

Presidential and parliamentary elections are now scheduled for December 2018 and preparations are on track, according to the electoral commission's timetable. However, the 46 year-old Mr. Kabila refuses to say if he will retire as stipulated by the constitution or try to run again. Many Congolese are suspicious of Mr. Kabila's silence. Nationwide protests have been brutally suppressed, leaving scores dead. Analysts fear Mr. Kabila is plotting to further prolong his time in office. He could achieve this either by engineering additional delays to elections or, as rulers in neighboring states such as Congo-Brazzaville and Rwanda have done, alter the constitution to allow him additional years as head of state. Alternatively, Kabila could install a puppet and rule from the senate-for-life post that he will assume.

The DRC is the size of Western Europe and boasts rich copper reserves and half the world's supply of cobalt, a crucial component used in electric cars. Investors and civic leaders insist that it is crucial for the DRC that election of a legitimate government is allowed via fresh elections. Without this any perception of normalcy cannot begin to set in. Some observers are doubting that the election scheduled for December will take place.

Mexico

The government of Mexico continues its budget consolidation efforts in 2018, aided by an upward trend in revenues. However, NAFTA renegotiations and the July 2018 presidential elections loom as potential threats to Mexico's budget deficit. Spending reductions of 20% pushed by President Pena Nieto and steady revenue growth of 7.4% narrowed the budget deficit in 2017. The bulk of the spending cuts impacted transport, education and state-owned oil company Pemex. The approved 2018 budget continues the trend from 2017 though it does include modest spending increases to help rebuild from the earthquakes that devastated the country in September 2017. Overall revenue growth is expected to outpace expenditures, supported by a modest uptick in economic activity in 2018.

In addition, a gradual recovery in Mexico's oil and gas sector is expected to fuel steady revenue growth in the years ahead. The sector has suffered through a decade of production declines as well as weak prices in recent years, which have reduced oil's share of government revenues from a peak of 45.7% in 2008 to 16.6% as of November 2017. However, it is forecast that Mexico's oil production will gradually rise over the next few years. Together with projected increases in global oil prices, this will provide a boost to government royalties from the sector. Nearing the end of the primary election season, populist candidate Andres Manual Lopez Obrador (AMLO) remains the frontrunner in Mexico's presidential election race. AMLO has benefitted from anti-establishment sentiment, rising security concerns and corruption scandals, placing him firmly in the lead in most polls. While negative partisanship will likely cap his support, the inclusion of three independent candidates can change the dynamics of the 2018 race. With a large and fractured field, the presidency could potentially be won with 30% of the vote.

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All three coalitions and independent candidates will run on anti-corruption and security policies, with non-establishment candidates likely to have more credibility on these issues. Official platform positions will differ more on economic policies. The PRI and PAN-led coalitions broadly support the status quo, while AMLO has vowed to pursue leftist-nationalist economic policies. AMLO has longed billed himself as the anti-corruption candidate. Amid widespread allegations of wrongdoing among Mexico's established politicians, this will be a cornerstone of his 2018 campaign. Specific policy initiatives include a law aimed at illuminating conflicts of interest, cracking down of fiscal tax havens, and increasing transparency in the public procurement process. Improving security will also be a focus. AMLO's strategy is focused on more effectively identifying and supporting at risk communities. On all of these issues, AMLO will position himself as an outsider and a solution to the status quo policies of the PRI and PAN, Mexico's two most established political parties.

On economic issues, populist AMLO stands in stark contrast to the establishment parties, the PRI and the PAN, favoring a nationalistic economic policy agenda. His policies are aimed at supporting Mexico's rural communities and achieving self-sufficiency in food production. Mexico is currently heavily reliant on food imports from the U.S., which AMLO blames on poor trade policies. His platform also includes policies aimed at achieving energy self-sufficiency, focused primarily on decreasing Mexican gasoline imports and increasing domestic refining capacity. These policies would represent a major shift in view from the current administration and have stoked investor fears that AMLO would disrupt Mexico's trade relationships and the recently liberalized energy sector.

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A victory by AMLO would pose risks to Mexico's current fiscal trajectory. While his official manifesto emphasizes that he would not increase the country's debt-to-GDP ratio if elected, it also includes proposals to double pension pay-outs and provide free higher education to all. These programs along with AMLO's anti-establishment credentials, leads to the assumption that fiscal spending would likely trend higher over the years ahead if he were to win the election.

Brazil

Brazil faces rising risks to fiscal sustainability as interim-President Michel Temer shelved national pension reforms in February, due to the lack of legislative support. While an alternative set of reforms should offer some support to the business environment, policy uncertainty will remain a weight on the willingness to invest. The reform that was shelved had been pushed by the government over the past year and was aimed at lowering the rising costs of the government's pension obligations. The reform was unpopular and President Temer's coalition has weakened as coalition partners position themselves for the general election that will be held in October 2018. The president instead decided to address Brazil's weak security environment by authorizing a military intervention in the state of Rio de Janeiro. Because pension reform requires constitutional changes, which are not allowed during a military intervention, it is now off the table, at least temporarily.

Brazil's near-term fiscal outlook remains unchanged. In 2017, the overall fiscal deficit narrowed to 7.8% of GDP, from 9% previously, outperforming forecasts of 8%. It is expected that over 2018 government revenues will rise in line with the expected rebounding economic activity, while government spending will be constrained in line with the spending cap amendment, which limits expenditure growth to the previous year's rate of inflation. The fiscal deficit is now forecast at 7.5% of GDP in 2018 and 7% in 2019, with debt servicing costs accounting for the vast majority of the shortfall. Brazil's total debt rose to 73.8% of GDP in 2017 and is likely to stabilize at approximately 77% of GDP by 2019, according to private sector consensus forecasts.

Risks are rising to Brazil's fiscal sustainability. Without reforms to lower the government's fiscal obligations, the next government will be forced to either revisit pension reforms or abandon the spending cap amendment. The latter would severely undermine investor confidence in the government, potentially leading to an asset sell-off and a drop in fixed investment that could hurt economic activity – and undermine the expected recovery from the harsh recession of 2015-16. Pension reform will be a huge political challenge for any Brazilian government. Even a reform-supportive president will struggle to put together a large enough legislative coalition to address this sensitive issue. Moreover, opinion polls ahead of the election continue to be dominated by anti-establishment and anti-reform candidates. As a result, uncertainty over policy direction will continue to weigh on fixed investment over the coming quarters.

Brazil's total debt rose to 73.8% of GDP in 2017 and is likely to stabilize at approximately 77% of GDP by 2019, according to private sector consensus forecasts.

In the run-up to the October election, President Temer is expected to focus on an alternative set of reforms that are more likely to be enacted and will offer some support to businesses. The new priorities laid out include changes in procurement laws, efforts to privatize the power company Electrobras and a bill to grant formal independence to the central bank. Taken together these priorities will continue the administration's efforts to reduce the role of the state in the economy and lower the cost of doing business in order to encourage more private investment. Still, these efforts are unlikely to substantially reduce investor concerns over the larger issue of Brazil's fiscal sustainability. The most substantial of the proposals, the privatization of Electrobras will take months to enact as the effort will entail maneuvering several hurdles successfully. That's because there is considerable popular opposition to the company's privatization.

Meanwhile, the consumer outlook is improving as the country's economic recovery strengthens in 2018. Falling unemployment and lower inflation supported a rebound in consumer spending over the final few months of 2017, and that positive growth story continues in 2018, as economic activity picks up. Brazil's labor market showed rapid signs of improvement over the final months of 2017, providing valuable support to the country's consumption-led recovery. The unemployment rate fell to 12% as of November 2017, compared with a record high of 13.7% in March 2017. Job creation was positive in all but three months of 2017. Real average monthly wages rose by 3.5% y-o-y in November-December 2017, the fastest rate of growth since the recession (and follows negative growth during each month between August 2015 and March 2017). The improving trend is expected to continue over 2018, as Brazil's export activity [and overall economic recovery] picks up steam.

Meanwhile, lower interest rates and deleveraging will lower debt burdens. Total household debt as a percentage of earnings was down to 41.4% at the end of 2017, from a peak of 46.1% in September 2015. Brazil's Inflation is at multi-year lows and is likely to remain modest over the coming quarters, further supporting household purchasing power. Inflation levels decelerated rapidly over the course of 2017 on the back of a more favorable exchange rate. The most recent inflation readings registered 2.95%, a dramatic improvement from the 2016 average of 8.8%.

However, much of these improvements are cyclical rather than structural, and come on the back of the severe two-year recession. In this uncertain election year, it will take time for consumer confidence and household spending in Brazil to return to pre-crisis highs.

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FCIA's Deals Of the Month

Bank's Purchase of Receivables Policy: $10 MM limit of liability on a Non-Cancelable* Multi-Buyer policy in the Computer and Peripherals sector, insuring nonpayment risk on receivables purchased on LATAM Debtors.

Non-Cancelable* Multi-Buyer Policy: $11 MM limit of liability supporting sales of Agri Products to Mexico

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.*