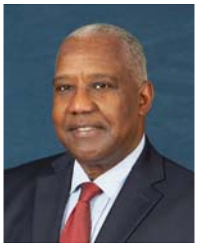
Major Country Developments
September 2018



By Byron Shoulton

Overview

The **U.S.** and **Canada** are engaged in tense negotiations to reach an agreement that would include Canada in a recently revised trade agreement reached between the U.S. and **Mexico**. The U.S. Administration has indicated that it is prepared to move ahead without Canada, but companies and business groups in all three countries, as well as U.S. lawmakers see major problems with that approach. The original Nafta was a tri-lateral agreement which was approved by the U.S. Congress. It follows that a renegotiated Nafta should include all three countries especially as Canada is America's largest trading partner and remains the destination for the largest amounts of U.S. exports.

Companies worry that the new agreement with Mexico could restrict rather than expand trade, while the exclusion of Canada would be bad for consumers in all three countries as prices would likely climb if Canada were to be excluded from the agreement. Furthermore, some 14 million U.S. jobs depend on trade with Canada and Mexico. U.S. business groups have signaled that their support for a new agreement to replace the existing Nafta would be conditioned on Canada being included in the deal. Many U.S. politicians, particularly from states close to the Canadian border, are heavily influenced to support a revised agreement which includes all three countries.

The U.S. economy grew slightly faster than predicted during the second quarter. GDP rose by 4.2% which was the fastest pace since September 2014. Inflation remained steady at 2%. The Federal Reserve says that it remains committed to possible two additional interest rate increases this year; but warned these would be modest increases. Meanwhile the Fed is watching for signs of any negative impact on growth due to the ongoing trade war and high U.S. tariffs imposed on China and other key trading partners which resulted in various counter tariffs. The global outlook is for slower growth in 2019-20 led by weaker demand and higher tariffs kicking in that push up prices and dampen global demand for raw materials and finished goods. Higher oil and input prices are already adding to the cost of such purchases in both the emerging and advanced economies.

Emerging markets are feeling the brunt of changing market sentiment reflected in the continued rout of the value of their currencies versus the dollar. This includes the **Turkish** lira [coupled with a loss of confidence in the country's economic management], as well as the continued weakening of the **Argentine** peso, **South African** rand, et al. The **Indonesian** rupiah fell to its weakest level against the dollar in 20 years.

The textbook recipe for an emerging market crisis includes:

- Currency suffering deep devaluations.
- Country with large dose of debt and a domestic credit bubble.
- Inadequate foreign exchange reserves.
- Current account deficits and/or fiscal deficits.
- Heavy reliance on capital inflows to fund deficits.
- Poor political and/or economic leadership.

Given this criteria, countries that are currently vulnerable extend beyond Turkey, Argentina and South Africa. Total emerging market borrowing increased from $21 trillion or 145% of GDP in 2007 to $63 trillion (210% of GDP) in 2017. Borrowings by non-financial corporations and households in emerging economies have jumped significantly. Since 2017 emerging market foreign-currency debt [issued in dollars, euros and yen] doubled to around $9 trillion according to the Bank of International Settlements. **China, India, Indonesia, Malaysia, South Africa, Mexico, Chile, Brazil and Eastern European countries** have foreign-currency debt equivalent to between 20% and 50% of GDP. In total, EM borrowers will need to repay or refinance around $1.5 trillion in debt in 2019 and again in 2020. Many countries are not earning enough to meet those commitments. With the broad malaise afflicting emerging markets, while U.S. interest rates edge higher and undergirds a stronger dollar, capital is being lured into the U.S. and other advanced economies, often at the expense of emerging markets.

Argentina

The Argentine peso touched a record low in late August, after President Mauricio Macri asked the IMF to speed up disbursement of its $50 billion bailout package agreed to in June. Concerns grew that Argentina may be unable to meet its refinancing needs for the remainder of 2018 and 2019 - when $82 billion of its foreign currency debt matures. After an initial drawdown of $15 billion from the $50 billion IMF facility and promising to use half of the remainder only in case of dire emergency, the country has found itself in an increasingly desperate situation. Argentina needs more foreign financing to roll over existing debt while it competes with increased capital flight from emerging markets [toward better quality developed country debt].

The Argentine peso slid a further 10% against the dollar in August alone, bringing the weakening of the peso for the year so far to 41%. Investor confidence remains low even after the Argentine central bank boosted interest rates to 60%. Argentina faces the challenge of having to refinance $50 billion of short-term dollar and peso debt that becomes due through the end of 2019. The bulk of these are reportedly peso denominated fixed rate bonds issued by the central bank with interest rates as high as 52%. As the peso has weakened and annual inflation grew to 31.2% (10 percentage points above the IMF's target) the country is once again losing credibility with investors and its ability to arrest inflation in the near-term seems highly unlikely, especially with sky high interest rates and higher energy costs.

The Treasury Ministry is predicting that Argentina will suffer its second recession in three years amid stubbornly high inflation. An early release of funds from the IMF could help stabilize Argentine assets. Otherwise, the country edges closer to a prolonged crisis at a time that seems vulnerable and volatile on many fronts.

President Macri acknowledged that the decision to accelerate access to IMF funding was needed as a guarantee to help fulfill the country's 2019 financing program and to eliminate any uncertainty that has arisen due to the worsening global sentiment toward emerging market debt. Guaranteeing financing for 2019, it is hoped, will help ease the financial crisis enabling the gradual return of confidence that moves the country back toward a path of growth. Argentina's struggle to win back market confidence contrasts with the support the country's reform program enjoys among the international community. The problem stems at least in part over doubts about Mr. Macri's prospects for re-election in 2019. Many investors felt reassured when Argentina negotiated the $50 billion credit line with the IMF and President Macri followed through with mandated reforms to slash the fiscal deficit and tame inflation. While some polls predict that Mr. Macri can win re-election, lingering doubts persists especially because many Argentines remain suspicious of the IMF's demands, which caused hardships among the masses in the past.

In recent years Argentina has had to resort to heavy borrowing on international markets to reduce its bulging fiscal deficit. Now, the financial markets appear more demanding than the IMF. The country will likely struggle to meet the various fiscal targets set by the IMF in exchange for the Fund's $50 billion lifeline. With the current external environment toward emerging markets and uncertainty about where the peso will end up, it is uncertain how soon Argentina will be able to meet the targets set by the IMF and when GDP growth will resume.

South Africa

The economy fell into its first recession since 2009 despite optimism over the replacement of the discredited Jacob Zuma government earlier this year. South Africa is Africa's most industrialized economy, but the economy contracted at a 0.7% annualized rate during the second quarter. This follows a larger contraction of 2.6% annual pace during the first three months of 2018. The currency, the rand, fell by 2.3% against the dollar following recently released economic data to trade at its lowest level since early 2016. The rand has fallen 19% so far this year with more than half of the decline occurring during the final two weeks of August.

After nine years of misrule by former President Zuma, unemployment remains above 27% and the daily struggle for survival for even some who are working remains a major challenge for the sitting government.

Inflation quickened to 5.1% y-o-y in July, up from just 3.8% in March, remaining within the 3-6% target range set by the central bank. The uptick in inflation stems from higher prices for fuel, electricity and water. When combined with a weakened rand and severe drought conditions in Cape Town, the results are thinly stretched resources in households and in the public and private sectors. Despite higher inflation, tax increases and the depreciation of the rand, the central bank could hold benchmark interest rates at 6.5% as inflation remains within the 3-6% target range.

South Africa is still considered among the most advanced economy in Africa and is focused on boosting economic growth and job creation.

The installation of Cyril Ramaphosa as the new president in February, replacing a weakened PresidentZuma, was a boost to confidence and improved the perception of South Africa's political stability. However, there is a lot of work to be done if South Africa is to attract badly needed foreign investment going forward. Policy toward private enterprise and competition remain broadly pro-business. Some favorable moves such as new special economic zones and offering tax incentives are accompanied by tighter competition laws and stricter black economic empowerment rules. Investment incentives in selected industries (such as automotive manufacturing) remain in place. A new mining charter offers some concessions to business but other rules will be tightened. Meanwhile, a new foreign investment law risks limiting access to international arbitration if implemented in full. The government continues to encourage foreign investment and public-private partnerships, but resists the privatization of state assets in most cases.

South Africa can avoid further downgrades by the rating agencies by committing to fiscal consolidation and reforms within its state-owned entities. The government says it is prepared to push through such reforms. The local banking sector remains sound and mostly profitable and continue to be a key source of corporate financing.

China in Africa

China's president recently pledged $60 billion toward African development over the next three years, while countering criticism that Beijing is trying to ensnare African governments in a debt trap.

Last year, China-Africa two-way trade hit $170 billion – four times larger than U.S.-Africa trade. However, after more than a decade of vaulting growth in trade, finance and investment, China's weighty engagement appears to be jeopardizing future development prospects in Africa.

China lent African countries about $125 billion between 2006 and 2016. China surpassed the U.S. as

Africa's biggest trading partner in 2009. The $60 billion in new money just pledged includes a $5 billion special fund for African imports. The $5 billion earmarked for African imports is seen as a broad commitment to rebalance trade, including the importation of non-commodity goods. This could be read as a commitment to help kick-start African manufacturing. The pledge follows concerns by some African leaders about China's hefty trade surplus with Africa. Although this has declined in recent years, African leaders have been calling on China to try harder to import more value-added goods from African countries.

The Chinese president indicated that China would increase efforts to import African merchandise and invest in African agriculture to ensure African food security by 2030. Markets are now watching to see whether China is prepared to restructure medium-term loans, particular those owed by Zambia. Zambia is Africa's second-biggest copper producer, which borrowed heavily from China and the capital markets, and has indicated it will need to restructure nearly $10 billion in debt.

The new Chinese funds, which match a $60 billion pledge made three years ago, include $15 billion in aid, interest free loans and concessional loans, a $20 billion line of credit and $10 billion in a special fund for China-Africa development. The Chinese are keen to use Africa to serve as an economic and political model for the developing world. The hope is that China's infrastructure finance and manufacturing investment in Africa will spur industrialization and development. But to be productive and contribute to economic development, infrastructure needs to be high quality and high-performing. The evidence shows that China's infrastructure-driven economic model has been far from efficient and some say it is one to be avoided rather than emulated. Over half of China's infrastructure projects are underperforming, often damaging rather than fueling growth and leaving an enormous debt burden for the domestic economy.

Africans are not blind to the dangers posed by Chinese engagement on the continent. Influential voices, such as a former Nigerian finance minister, have cautioned against China's state-led growth model, arguing that it can feed corruption.

Criticism of China's foreign investment outreach is not restricted to African countries. China's Belt & Road Initiative (BRI), which seeks to rebuild China's old silk-road trading route stretching across Eurasia, is being met with claims of too much debt assumption by several countries (including Malaysia, Bangladesh, Pakistan and Sri Lanka). The governments in Sri Lanka and Pakistan have indicated to China that the debt incurred to be a part of the BRI is too burdensome for their respective countries. These important regional partners in the BRI have struck deals handing Beijing control of key projects in both Pakistan and Sri Lanka, prompting local concerns over the loss of economic sovereignty.

In Malaysia's case the newly elected government has put a halt to ongoing infrastructure projects in that country worth over $20 billion and funded by loans from China. The government in Malaysia says it wants to reassess the country's priorities and the extent of its debt burden to China.

Angola

Angola's president has underscored the financial pressure on Africa's second-biggest oil exporter and his own desire for economic reforms by seeking loans from the IMF for the first time in almost a decade.

In a potential turning point for a country undergoing a delicate political transition, the Fund confirmed that Angola's government has asked to initiate discussions on an economic program backed by bailout loans. The ruling party has already launched ambitious plans to revive the southern African nation's oil-dependent economy since the replacement of its longtime ruler Jose Eduardo dos Santos last year.

The request to access IMF loans is meant as a sign that going forward when Angola approaches the capital markets to borrow, having an IMF agreement in place should provide extra confidence to investors. Angola was badly hit by the fall in crude prices since 2014, but observers say that accessing IMF loans as oil prices are now strengthening suggests that the new Angolan president, Joao Lourenco, intends to use IMF cover to deepen reforms. The new president has promised to root out corruption and speed up diversification of the economy beyond oil. The ruling MPLA party has also proposed political reforms, including holding municipal elections for the first time.

Angola's economy, the third largest in sub-Saharan Africa, remains plagued by foreign currency shortages and rising bad loans even after the central bank devalued the currency by over 50% against the U.S. dollar since December 2017. Angola issued a $1.75 billion 10-year bond at a yield of just under 8% in May and could soon return to the market according to emerging market investors. Proceeds would bring much needed dollars to the economy. The request to the IMF comes toward the end of a sensitive transition away from Mr. dos Santos, who ruled Angola with an iron grip for nearly four decades, including through a long post-independence war that ended in 2002. His last years in power were overshadowed by accusations by opposition groups and civil society that his family used state positions for private benefit. Soon after taking power the new president fired Isabel dos Santos, the former president's daughter, as head of the state oil group. He also removed Mr. dos Santos' son as the sovereign wealth fund's chief. The central bank's governor and other key posts were replaced at the same time.

Angola is not seeking a full bailout of public finances. Talks are focused on an IMF facility that would offer longer-than-usual repayment terms in return for structural reforms. It is an indication that Angola wants to use the IMF's seal of approval to help lower the cost of its borrowing elsewhere, particularly as it raises more bonds from private investors. The country is grappling with a decline in crude production from its aging oilfields. Last month's output dropped to its lowest level since 2007.

Sonangol, the state oil group, has pledged to invest in new fields while rebuilding relations with international oil majors who saw Angola as difficult to operate in and a declining producer under Mr. dos Santos' leadership. Total, the French major, recently revived cooperation with Sonangol. However, some energy firms have been considering exit strategies, their concerns heightened by reported delays in Sonangol's project approvals and payments. The international Energy Agency has said that production is forecast to fall to 1.3 million barrels per day by 2023 from a peak of 1.9 million barrels per day in 2008 unless new investment is made in oil exploration.

The fall in crude production increases financing problems for Angola, which has in the past borrowed against oil sales to other countries, including an estimated $22 billion still owed to China, the biggest customer for Angolan crude. Such deals are no longer feasible for Angola given how much of its crude production is already pledged to repay loans. The country can ill-afford to mortgage out any more of the oil industry. Chinese loan repayments are believed to be linked to the price of oil at the time they are negotiated, so Angola has to ship more crude when its value depreciates. Repayment is getting harder as Angolan production has slumped in recent years due to diminishing investment in the country's aging oilfields. Debt owed to China represents 50% of Angola's total outstanding foreign debt.

With the political transition moving ahead and more U.S. dollars finally flowing back into state coffers from higher oil prices, a question-mark remains over the appetite for deep reforms and economic diversification. The country initially approached the IMF in 2017 seeking technical assistance with reforms. It last borrowed from the Fund in a program that lasted from 2009 to 2012.

As Angola seeks to attract foreign investors to help diversify its oil-dependent economy, China looks to take a leading role, but the considerable leverage it wields could leave Angola short-changed. Already heavily indebted to China, Angola could face hard bargaining by the Chinese, as has happened in south Asian countries deeply in debt to China. Yet China faces risk as well. With Angolan debts stacking up, new loans for economic diversification projects could push Angola closer to default. Since oil is used as collateral for Chinese credit, Angola's current production downturn, coupled with pressure of increased repayment requirements, could slow or interrupt shipments to China.

As President Joao Lourenco presses ahead with reforms aimed at creating a more business friendly environment and rolls back the economic influence of his predecessor, it is unclear whether western investors have seen enough to persuade them to engage with a country long plagued by corruption and mismanagement.

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FCIA's Deals Of the Month

Multibuyer Non-Cancelable Limits Policy: $5,000,000 limit of liability supporting the sale of paper products to buyers domciled in North America

Single Buyer, Medium Term Policy: Nonpayment coverage with a $60,000,000 limit of liability, 6 year tenor in telecommunications sector, North America

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.*