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Major Country Developments
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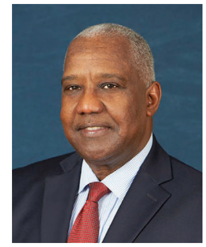

By Byron Shoulton

Overview

Escalating trade tensions between the **U.S.** and **China** were reportedly placed on hold for 90-days; after the leaders of both countries met in Argentina and agreed to continue negotiations. The U.S. is exerting intense pressure on China to change its treatment of investors attempting to enter the Chinese market; and to end its practice of forcing foreigners to give their know-how freely to Chinese partners in order to do business in that country. Meanwhile, reports suggest that China has signaled it is willing to buy more U.S. goods [example soybeans] as well as reduce tariffs on American cars from the current 40%. In exchange for these promises, the U.S. has withheld hiking current tariffs on Chinese goods to 25% from 10%. There is every indication that these negotiations will be contentious and drawn out, and may require additional extensions to the 90-day truce initially announced.

A truce in the ongoing trade war, provides an opportunity for both countries to address the negative impact on business, e.g. loss of U.S. export revenue to the agricultural sector as China retaliated against U.S. tariffs. China wants the U.S. to reduce the tariffs that have hurt trade between both countries and led to the spike in prices of some Chinese goods in the U.S. Few believe a reversal is imminent.

In the past, China has had a tendency of promising a lot in negotiations and then allowing time to pass without implementing little of what it promised. This time around it is doubtful that China will be allowed to successfully apply this tactic. The U.S. Administration placed a strong China sceptic, Robert Lighthizer, to be in charge of the negotiating agenda and strategy between both countries going forward. As a China hawk Mr. Lighthizer is inclined to recommend turning up the heat on China if it is perceived as not moving toward strengthening protection against intellectual property theft; or if it fails to acknowledge that forced technology transfer is a violation of WTO rules and refuses to cease the practice. The U.S. will also be pressing China to remove non-tariff barriers that impede U.S. access to the Chinese market.

Companies initially welcomed the easing of trade tensions between the world's two largest economies, but the lack of a joint statement outlining what was agreed to in Argentina, soon gave way to doubts and more uncertainty. Equity markets tumbled further as a result. Many had hoped that a 90-day postponement of additional tariffs would be a step toward removing uncertainty. However, doubts linger as to what exactly both sides agreed to in Argentina and whether or not there's an established timeframe within which an agreement must be reached. Bottom line: the China-U.S. dust up will be a source of irritation to both sides for some time and will hurt confidence and global growth given the prolonged uncertainty. Until an agreement is forged between both countries a weakening trend in cross-border global trade will likely persist.

Ukraine imposed martial law for 30 days after **Russia** fired on and seized three Ukrainian ships, while detaining its sailors near the Sea of Azov. Since Russia annexed Crimea (a large part of Ukrainian territory), it has continued to undermine the latter's economy and compromise its access to shipping routes. Ukrainian ships have had to sail through a strait controlled by Russia, while a new Russian bridge over the strait has become too low for big ships to sail under. Clearly, the message is to sabotage Ukrainian shipping.

Russia and Saudi Arabia are seeking to lead a cut in global crude production in December aimed at boosting oil prices. However, strong U.S. production as well as no let-up in production among non-OPEC members, serve as a counter balance to Russian-Saudi-OPEC efforts. The outlook is for crude to average $60-$65 per barrel over the coming months.

In **France,** three weeks of protests by motorists against higher fuel taxes, which saw access to major roads blocked, has turned violent [causing damage to property, burnt cars, etc.]. This forced the French government to reverse the taxes. However, this is apparently not enough for protesters who represent a strong and growing force of resentment against the policies of President Macron. The aim is to eventually remove the wildly unpopular Macron from office. Grievances include demands for higher wages and better pension benefits amidst complaints that the Macron government has neglected blue collar workers and pensioners rights in favor of the interests of the rich and powerful.

More troubling is the fact that the demise of Macron would constitute a boost for right-wing populism, which is gaining strength daily in France and across Europe.

The **UK** Treasury has estimated that Britain's GDP will be 3.9% smaller in 15 years' time than it would otherwise have been if the country leaves the European Union under the deal recently agreed with EU leaders. Under a no-deal Brexit, GDP would be 9.3% smaller. Prime Minister Theresa May has begun the hard task of trying to garner support for the recently negotiated deal ahead of a crucial vote in Parliament due on December 11th.

Meanwhile, companies operating in the U.K. are stockpiling goods (including food, spare parts, pharmaceuticals, etc.) ahead of Britain's planned exit from the EU. The concern: The U.K. exits the EU without agreements in place to minimize disruptions in trade flows at the border. Businesses and logistics firms are taking contingency steps against a worst case scenario that could result in the possible shortage of essential inputs needed for manufacturing, industry or in the service sector. Recent reports point to a dramatic shortage of warehouse space in the U.K., as a result of hoarding and contingency planning to avoid deep disruptions once Brexit goes into effect in March 2019.

Mexico

Andres Manuel Lopez Obrador [AMLO] who took office on December 1, 2018 as Mexico's new President, will lead a nation with many challenges. While one major hurdle, the revised Nafta trade agreement has been renegotiated [and renamed the US, Mexican and Canadian Agreement or USMCA]; and while Mexico's macro-economic picture is in fairly good shape, many uncertainties remain. These include narco-related violence and intimidation and the associated corruption it facilitates within Mexico's security forces and elsewhere in Mexican society.

The new Mexican President will seek to find common ground with U.S. President Trump in addressing immigration policy [a major focus of the Trump White House], including curbing illegal Mexican migrants as well as those from Central America who attempt to come into the U.S. via Mexico. Economic growth is projected to slow over the coming quarters as investors are expected to sour on AMLO's policies. Investment will likely remain weak in 2019, as uncertainty around policy formulation under AMLO outweighs more clarity seen in U.S. trade relations following the USMCA accord.

President AMLO is as much a nationalist representing Mexico's interests as President Trump is for the U.S., but Mexico needs and relies much more on the U.S. market to maintain economic stability. Diplomacy will need to be utilized by both sides to keep the relationship from tipping over into conflict or becoming adversarial. No doubt, Mexico wants U.S. tariffs lifted on its exports of steel and aluminum; while the U.S. wants Mexico to clamp down on illegal migration across their mutual borders. Mexico will welcome investments by U.S. and other global companies, wishing to take advantage of producing under USMCA for export within USMCA, free of tariffs.

The service sector will remain the key engine of growth, but the pace could slow should weaker investment spending begin to weigh on payrolls and inflation stays elevated. The forecast for GDP growth in 2019 has been lowered to 2.1% from 2.7% previously. AMLO has punctured investor confidence, hurting growth prospects following a public consultation in which 70% of 1.1 million participants voted against a $13 billion airport project in Mexico City that was 30% complete. AMLO has since cancelled the project, striking a blow to the construction sector and hurting overall foreign investor confidence at the beginning of his administration.

The Mexican central bank is expected to hold its benchmark interest rate at 8% after raising it by 25 basis points at its November meeting. The more hawkish stance comes on the back of inflation inching higher after a downturn in confidence sparked a sell-off of Mexican assets. Inflation will likely be within the central bank's 2%-4% target range in 2019. The Mexican peso will likely remain in a lower trading range as market confidence in AMLO has been weakened.

The USMCA will likely be implemented in 2019, leaving preferential trade access intact in North America and modernizing rules for deeper integration. Key changes around autos rules of origin are restrictive in nature, reflecting the policy shift towards protectionism in the U.S. under the Trump Administration.

The alleviation of uncertainty will support investment in the near term, especially in Mexico. Over the long-run, we should expect relatively minimal economic impact on most industries when compared to the status quo. Risks remain around the ratification process. Ratification is expected to move forward relatively easily in Canada and Mexico, though criticism from the left in Mexico is rising. It will face a more difficult path in the U.S. While we ultimately expect the deal will pass, questions remain around timing and the likelihood of some tweaking sought by certain groups in the U.S.

Nigeria

Nigeria's economy is in better shape than a couple of years ago, when it was in the midst of its worst recession in 25 years. The trade balance has improved and foreign exchange reserves have recovered, bolstered by higher oil revenues and portfolio investment inflows. The gap between the official and unofficial exchange rates has narrowed substantially after the central bank took steps toward a market-driven foreign exchange policy.

An anemic economic recovery is hardly cause for celebration however. GDP growth of just below 2% has returned, but this is barely sufficient to keep pace with the rising population. Since President Muhammed Buhari took office in 2015, average per capita income has fallen. Still, thanks to recovering oil production in the third quarter of 2018, Nigeria is expected to avoid the double-dip recession that was projected by the central bank until recently.

Growth could pick-up in 2019 if oil prices remain stable (or rise). Conversely, it could slow if the price of crude were to soften or electoral uncertainty saps investor confidence. Of greater concern is the suspicion that – barring radical reforms – Nigeria could be stuck with low growth indefinitely. With oil production not expected to lift much beyond 2 million barrels per day, and given the recent weakness in oil prices, the parameters are tight.

According to leading multilateral agencies such as the World Bank and the IMF, for an economy at Nigeria's levels of income, growth of 6%-8% per annum ought to be achievable. However, structural problems, including literacy levels, poor infrastructure such as roads, ports and low electrification rates, continue to stand in the way. To grow faster, Nigeria needs to ramp up expenditure on public goods such as healthcare, education and infrastructure and to pursue a full-blown liberalization program to lure foreign investment.

In the absence of discernable structural reforms, the government sought to increase capital spending, though budgetary pledges have not always translated into reality. Banks, whose balance sheets were damaged by the oil shock of 2014, have not had the incentive to lend to the real economy. Most banks can make money more easily by financing government debt at generous interest rates. While the sitting Buhari government claims a record of "fiscal prudence and sound housekeeping" Nigeria's finances remain as flawed as they have been for decades. The standout figure is the ratio of debt service costs to federal revenue. In 2017 that figure was 65%-70%, the highest of any large African economy. That ratio says more about rock-bottom revenue than the level of debt, which at 20% of GDP should be easily manageable. The problem is Nigeria's tax base, which at about 7% of GDP, is among the lowest on the continent. That is because large portions of the economy are beyond the reach of the tax authorities. Because the federal government – which relies almost exclusively on oil revenue to grease the wheels of the state – does not collect much tax, it does not pretend to provide many services. In 2016, Nigeria spent 3.6% of its output on health according to the World Bank, compared to 5.9% in Ghana and 7.9% in Rwanda.

The Buhari government continues to defend its rationing of foreign exchange as key to ending the recession. Most analysts argue the reverse, saying the rationing of FX- aside from being a boon to black marketers and aiding corruption – has damaged manufacturers by denying them the dollars they need to import essential inputs. Nigeria's economy also continues to be distorted by subsidies. A cap on fuel prices means the Nigerian National Petroleum Corporation loses money on every gallon of gasoline it sells. Those losses appear on NNPC's balance sheet rather than the State's, but fundamentally the government is still paying for this largess. These subsidies are a huge waste of money and mostly a benefit to the more well-off in society as the poor don't own vehicles.

Italy

The growing risk of recession is putting pressure on Italy's new government, which took office in June, to change course and comply with European Union fiscal rules that the government had previously attacked. Italy's leader Matteo Salvini has vowed to find a way to reach an agreement with the EU.

The confidence shock to bond markets, Italian banks and the country's business sector illustrates the constraints facing financially fragile nations in the Eurozone – even if voters choose a government devoted to breaking with EU fiscal orthodoxy. Italy's $2.61 trillion national debt, equivalent to about 131% of GDP, is seen by markets as riskier than most other eurozone nations' - especially if Italy's economic policies don't have the support of Europe's powers-that-be, including the European Central Bank.

Italy's economic recovery has been losing momentum this year, part of the broader growth slowdown in the eurozone amid global trade tensions, higher oil prices and a downturn in the car industry. Most other eurozone economies continue to expand as was confirmed by the region's latest Purchasing Managers' Index. By contrast, Italy's overall PMI measure stood at 49.3% in November for the second month. A PMI score below 50 points to a decline in activity.

The government is searching for ways to avoid a sharp rise in the government's budget deficit, after the spending plans led to a confrontation with the EU. But Italy has compounded its weakening outlook by triggering financial tensions with its fiscal plans, according to the ECB, the IMF and many private-sector economists. The yield on Italy's 10-year bonds rose to nearly 3.7% in October, compared with levels of around 1.7% before the sitting government was formed. Rising yields have particularly hurt Italian banks, which are heavily exposed to the national debt. Yields have eased in the past month, reaching 3.07% in early December, as the government has toned down its rhetoric and signaled that it was seeking a compromise with the EU's Brussels-based executive, the European Commission.

The Commission says Italy's budget plan would increase the structural deficit by around 1.2% of GDP, or about $30 billion, and is demanding a deficit reduction instead. That would imply spending cuts far in excess of the roughly $12 billion of savings that Italy's government is currently trying to find. Failure to bridge the wide fiscal differences between Rome and Brussels is expected to lead to the EU opening disciplinary proceedings against Italy for breaking the fiscal treaty that is meant to keep the eurozone stable. Italy's leaders say they want to avoid that step, which could further unsettle markets, while still delivering their costly fiscal promises to voters. These include allowing retirement as early as age 62 instead of 67 and introducing a "citizenship income" or basic welfare level of approximately $1,000 a month for the poor and unemployed.

Ecuador

In view of the country's ongoing liquidity problems, large financing costs, emerging-market turbulence and a wave of bond maturities from 2020 onwards, it is likely that Ecuador will turn to the IMF for financial assistance sometime in 2019. Although such an agreement would come with strict conditions for fiscal targets and structural reforms, the challenging macro-economic environment and the government's economic program suggest that the political will for such a move exists. In September the government took the unpopular but IMF-like step of reducing fuel subsidies.The primary economic policy challenge will be to reduce the large fiscal deficit, and curb the rising public debt (estimated at $49.6 billion or approximately 44.8% of GDP) without stifling the ongoing economic recovery. An economic program approved in the summer includes bold tax breaks intended to boost private investment and expenditure cuts to balance the primary account by 2021.

Oil production gains will be limited by OPEC in the near term. Ecuador remains committed to OPEC agreements, with the government limiting production at its mature fields in line with cartel-wide negotiated cuts. Ecuador's production is expected to decline by 2.1% in 2018 as a result. Over the longer term however, an improving business environment under President Lenin Moreno should help to boost investment and production in the sector. The government is allowing for production sharing contract arrangements with oilfield service providers. As a result, production gains are expected in 2019.

Ecuador's external position remains precarious. There's limited ability to finance a current account deficit because capital inflows remain weak and are unlikely to pick up over the near term, while access to foreign capital markets is curtailed by the country's dire fiscal situation. International reserves are minimal (equivalent to 1.1 month worth of imports), and the economy's dollarization means it cannot depend on exchange rate depreciation to address imbalances. Therefore a return to a current account deficit would likely further drain reserves or cut into base money supply. If imports outpace exports over the coming months, the Moreno government could reintroduce import duties or other import-limiting measures in an effort to prevent the return of a current account shortfall, which poses a downside risk to economic activity.

The reintroduction of import duties is also possible if a fall in oil prices were to occur, or a sharper rise in imports generates a deficit. Over recent quarters, the lifting of import duties coupled with an uptick in economic activity, caused a surge in imports (up 20.5% for the first seven months of 2018). However, this is not expected to continue, as stark austerity measures introduced by the administration which is facing a fiscal crisis, will weigh heavily on economic activity, wages and demand for imports over the next several quarters. Additionally, a number of customs duties remain in place and will weigh on import demand over the coming months. Inflation is at zero for 2018 but projected to pick up by 1.3% in 2019. High debt owed to China (approximately $30 billion) continue to erode the amount of crude Ecuador can sell on the open market. The country is pledged to repay China with shipments of crude.

Ecuador is likely to deepen commercial and diplomatic ties with the U.S., its primary trade partner. Despite diplomatic and trade disputes clouding the relationship, President Moreno's pro-Western foreign policy realignment augurs closer cooperation. Vice President Pence's visit in June 2018 laid the groundwork for talks for a free trade agreement, which is expected to last beyond 2022.

The outlook is for modest economic growth, curtailed by the need for fiscal adjustment. Weak first-half 2018 data, dampened by a downturn in consumption, are in line with estimates of 1.3% GDP growth in 2018. A series of privatizations and pro-business reforms – aided by political stability and still strong Chinese demand- supported by inventories in 2018, and an expected boost in investment in 2019, underscores sentiment for economic strengthening during 2019. Rising mining exports will help oil revenue (even with lower oil prices), and should help to generate moderate current-account surplus in 2018 and 2019. Dollarization is expected to be maintained, as it supports macro-economic stability. In the past, expansionary fiscal policies raised concerns that dollarization might be abandoned, but this risk was mitigated by high oil prices and access to global financing. The government is now adjusting to lower oil prices by signaling fiscal consolidation efforts, hence de-dollarization remains only a mild risk.

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FCIA's Deals Of the Month

Non-Cancelable Syndicated Key Account Limits Policy issued to an insured in the consumer electronic sector with a Policy Limit of Liability $32,000,000 that provides excess coverage on domestic and export customers.

Bank's Key Account Accounts Receivable Purchase Policy with a $40,000,000 Limit of Liability.

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**   **Non-Cancelable Limits:** Subject to policy terms and conditions, after issuing the policy, the insurer may not unilaterally reduce any country or buyer limits.*