

## Major Country Risk Developments September 2021



By Byron Shoulton

### Overview

The global supply-chain crunch which many first thought would be temporary, now looks likely to last well into 2022. The surge in the Delta variant is slowing global activity and the uncertainty is hurting confidence. Higher costs, raw material supply shortages and worker scarcity continue to disrupt factory production in Asia and the U.S. Furthermore, prolonged shipping bottlenecks, skyrocketing shipping costs and mounting delivery delays have dampened expectations as companies prepare for the upcoming holiday season. The continuation of port and terminal closures has further weakened an already fragile global supply-chain going into the peak holiday season.

In addition, manufacturers struggle to secure sufficient components to complete orders in a timely fashion; containers continue to be in short supply; while the costs of moving a container from Asia to Europe are ten-times higher than in May 2020; and costs from Shanghai to Los Angeles have grown sixfold. Meanwhile, higher raw material and energy costs have led to bidding wars to get space on vessels, pushing freight rates to record highs and prompting some exporters to raise prices or simply cancel shipments. Against this background companies must look ahead and attempt to answer the question: how to mitigate the risk of future impacts to the delivery of goods and materials in the coming year?

It was inevitable that the pace of the global recovery from the pandemic would slow. The sudden surge of growth that follows a resumption of economic activity after a lockdown cannot be repeated, and the easing of restrictions will not always lead to the same sort of boost. But recent softening in some key data is a concern. Not only does it reflect the spread of the more infectious Delta variant and supply chain

worries but also a slowdown in China.

Factory activity faltered across **Asia** in August, with the resurgence in Covid-19 infections adding to global supply-chain disruptions and confirming fears of a slowdown in the region's recovery. Gauges of manufacturing activity fell across major Asian economies, in large part because of virus-related lockdowns, port congestion and higher input costs that hampered production.

There were also signs that global demand for some Asian goods leveled off, as consumers rein in spending in the West. In **Malaysia**, most manufacturers have been told to reduce capacity unless they have vaccinated at least 80% of factory workers. And factories in **Vietnam** have been forced to close or reduce workforces. **China** partly shut the world's third-busiest port last month, though it has since been reopened. These struggles could signal more problems ahead for buyers of those Asian products which remain in high demand, including toys, semiconductors, electronics, etc. While further easing in monetary policy in the region seems unlikely, most Asian central banks are set to maintain accommodative bias. Perhaps India is at risk of hiking in the months ahead, probably closer to the first quarter of next year. By contrast the Chinese central bank has cut its reserve requirement ratio, the amount of cash Chinese banks must hold as reserves.

In **Brazil**, investor sentiment has been hit by rising political tensions together with concerns over the economic recovery and public spending. Latin America's largest economy has seen its currency and stock exchange come under renewed pressure in recent weeks. President Jair Bolsonaro has clashed with the judiciary and the legislature. After a period of relative

calm that led to the real (the currency) appreciating to 4.91:US\$1 in June, the currency has since fallen by 6% to 5.26:US\$1. Meanwhile, the stock market tumbled almost 9% since touching a record high in May. While the spread of the Delta variant globally and certain commodity price pressures may have played a role, domestic issues are the primary drivers for these declines.

As President Bolsonaro's popularity wanes and his approval ratings fall, it has become clear that his government is having difficulty governing. Concerns have surfaced that the populist administration seems inclined to disregard constitutionally mandated spending caps that are meant to prevent budgetary expansion and rein in inflation.

This is of major significance to investors given Brazil's already high level of public debt, now at 84% of GDP. Foreign and local investors see higher risk ahead related to a lack of fiscal discipline. This is also causing pressure on the currency. A rise in government borrowing costs bears this out: the yield on the 10-year local currency bond recently hit its highest point since the 2018 presidential elections. The debt now trades with a yield of 10.3%-11%, well above the 7% at the end of 2020.

The central bank is seeking to fight inflation, which at 8.99% in the year to July – is way above the 2021 target of 3.75%. It has lifted the benchmark Selic rate from an all-time low of 2% to 5.25% and market expectations are that the rate will reach 7.5% by year-end.

Although GDP growth is expected to top 5% in 2021 the outlook is for a steady decline in 2022. With growing doubts about the government's ability or willingness to restore a credible and sustainable economic policy, the short-term outlook remains mixed. Brazilian exports will remain competitive given strong global demand, but domestic job creation and weak investor confidence are likely to be a drag on overall growth momentum.

## USA

The spread of the Delta variant has led to slower U.S. growth, as increasing case numbers have sapped consumers' appetite to spend. Americans have been spending on travel, dining out, attending concerts, museums, and conferences- activities they had postponed during the pandemic. However, there have been recent indications that these activities are slowing. Such spending is taking a hit and affecting businesses, undermined by consumer fears tied to the Delta variant, staffing shortages and persistent bottlenecks in global shipping networks.

Forecasters have lowered U.S. growth projections for 2021 and lifted inflation expectations for 2022. The economy grew at a 6.6% annual rate in the second quarter, a pick-up from the first quarter's 6.3% gain. However, growth is expected to slow in the third-quarter. IHS Markit projects economic growth will slow to 5.4% in July through September, in part because of weaker spending growth. Meanwhile, the personal consumption price index is now expected to rise above 4% in the third and fourth quarters, double the Federal Reserve's 2% goal.

Incomes for American workers are rising as companies compete for workers and the government continues to dole out money from pandemic-relief programs. Such income growth, coming on top of already higher savings that households have accumulated during the pandemic, had primed the economy for strong consumer spending and economic growth later in 2021-2022. However, in recent weeks cancellations of various events, including conferences, several concerts, musical festivals, etc., have dampened consumer attitudes. With the Delta variant raging, some Americans have even cancelled travel/vacation plans. Some colleges have delayed the start of in-person classes; and the Governor of Hawaii urged tourists to stay away from the islands for now.

The perceived worsening of the health situation is weighing on activities that were initially expected to

thrive over the summer months. Oxford Economics predicted at the beginning of summer that consumer spending would rise at an annual rate of 8% in July through September. They recently cut that projection by more than half, to 3.5%. According to the U.S. Department of Commerce, consumers reduced spending on goods, such as cars, furniture and building supplies in August.

New hiring fell below expectations in August as employer and employee confidence took a hit from the spread of the Delta variant. Non-farm payrolls added a modest 235,000 jobs for the month against projections of 728,000. The unemployment rate stands at 5.2% (down from 5.4% in July), but it is 1.7% higher than in February 2020. There are currently 5.7 million more people without jobs than in February 2020.

The Federal Reserve recently sent a clear signal that it will likely begin to reduce its monthly \$20 billion bond-buying program later this year; while interest rates seem likely to remain subdued for some time. The depressed rate of jobs growth in August suggests that the Fed will hold off until the final weeks of 2021 to repeal the wave of monetary stimulus measures it unleashed in response to the Covid crisis.

## China

Across the board, China's government is not prioritizing growth as it once did. Instead, it is trying to rein in unbridled capitalism, whether the power of big technology companies or rising economic inequality. This may be understandable – for example, a slowdown in aluminum production has been blamed on a determination by the government to cut pollution- but it means the country is not the engine of global growth it was after the 2008 financial crisis. This time, it seems the rest of the world will have to find other engines to power the recovery.

China's determination to stamp out Covid has meant even a small number of new infections can cause

major disruptions to trade. In August the Chinese government closed part of the world's third-busiest container port at Ningbo for two weeks after a single dockworker was found to have the Delta variant. Earlier this year, wharves in Shenzhen were idled after a few cases of coronavirus cases surfaced. The narrative has changed as port congestion and a shortage of container shipping capacity is forging a conclusion that, at best, disruptions could last until mid-2022. In short, if new spikes in the pandemic are not effectively contained, port congestion could become the new normal. The global supply chain has become so fragile that a single, small accident could easily have its effects compounded.

Higher freight rates and semiconductor prices seem likely to keep lifting inflation higher. Some companies report that they are storing up critical components for one year of usage because if one component is missing it is impossible to complete production of products.

China's manufacturing activity slowed in August [49.2], based on results of an independent survey of factory activity. The dip below the 50- mark that separates monthly expansion from contraction, was the weakest reading since February 2020. Separately, the measure of the services sector plunged into negative territory with the latest uptick in Covid-19 cases weighing on activity. The services sector was already lagging behind the broader recovery as households remained cautious about spending.

The indices were one of the clearest signs of loss of momentum across China's economy, which outperformed other big economies last year on the back of an industry fueled recovery. But China is now grappling with weaker export demand, high prices of raw materials and a slowing and over-leveraged real estate sector. The real estate sector is a crucial engine of overall economic activity and construction soared last year. But big developers have come under pressure from Beijing to reduce their debt levels. An interest rate cut last year stoked worries of an asset bubble in the real estate sector, while local authorities have

also moved to control prices. In a sign of the policies taking effect, new home prices rose at their slowest pace in six months in July, with average prices across 70 cities adding 0.3% on the previous month.

China's growth forecasts have been reduced and analysts anticipate further government action after the People's Bank of China (central bank) slashed its reserve requirement ratio for banks in July, a decision that injected liquidity into the financial system. To create a buffer against deteriorating macro-economic conditions, it wouldn't be surprising if policymakers moved to ramp up monetary and fiscal stimulus measures. That's because current monetary and fiscal easing measures appear insufficient to reverse the growth downtrend.

Despite the Phase One deal signed last year, The U.S. maintains higher tariffs on two-thirds of all goods imported from China. Still, the U.S. trade deficit with China is now the highest it's ever been. Companies have acknowledged that the high tariffs have forced them to raise prices. Yet for most companies surveyed, China remains a crucial market – only 6% of companies plan to scale back their resource commitments to their China operations over the next year, while 43% plan to invest more. There is lack of evidence that the trade war led to the reshoring of manufactured jobs to the U.S. Official figures show that the number of registered U.S. companies in China has held steady, and only 2% of U.S. companies doing business in China moved segments of their supply-chain to the U.S. in the past year.

Meanwhile, China's purchases of U.S. agricultural goods continue at the fastest pace in recent years. Over the past nine months the U.S. set an all-time record for agricultural exports to China. The momentum began slowly in 2020 and the trend picked up in 2021. For the first six months of this year China bought \$15.2 billion of U.S. ag exports. During the trade war, China's total annual purchases were \$13.2 billion in 2018 and \$16.3 billion in 2019. In addition to soybeans, exports of U.S. corn and beef are up signifi-

cantly in 2021, with pork sales tapering off now that China's pig population has recovered from the swine flu infestation.

## Europe

In August Eurozone business activity expanded close to its fastest pace in 15 years, indicating the region is on course for strong third-quarter growth. Rising vaccination rates boosted business optimism, which was near its highest level since 2012. The region also recorded strong hiring activity and rapid increases in input costs as manufacturing continues to grapple with supply-chain disruptions.

The gap between the output of Eurozone manufacturers and the orders they receive has widened to a fresh 24-year record because of supply-chain disruptions. While Europe's industrial companies reported continued strong growth in activity in the most recent IHS Markit's monthly purchasing managers' index (PMI) survey, they also complain of shortages of materials and delays to deliveries due to disruptions caused by the pandemic. Shortages of material and components weighed on factory production. There was a big increase in suppliers' delivery times – a key barometer of supply delays-although the pace moderated slightly for a third successive month. Businesses' costs and prices grew at some of the fastest rates in two decades, driven by input shortages and booming demand.

The region's manufacturers – in particular large carmakers -have struggled to keep up with rising global demand because of shortages of many materials, including semiconductors, metals, plastics, and wood. Bottlenecks in container shipping have also crimped supplies. Supply issues were the primary cause of shortfalls in manufacturing production relative to orders, on a magnitude not previously recorded by the survey. This is feeding into higher prices for many manufactured goods, which increased by 2.7% in the year to August, contributing

to a recent surge in eurozone inflation to 3%, its highest level in a decade.

The problems are weighing on the recent rebound in Europe's export-focused economy. The German central bank has warned that production in industry is being held back longer than initially thought by supply bottlenecks; and stressed that this will likely cause the bank to cut its growth forecast for 2021.

Big companies, including Siemens and Volkswagen, have warned that supply chain problems are likely to continue into next year. Recently, VW's main plant, which employs 60,000 people, restarted after the summer break with only a single shift per day, while Audi, BMW and Daimler have sent thousands of workers home because of production stoppages caused by the chip shortage. Adidas and Puma have been hit by plant closings in Vietnam because of restrictions to combat rising Covid-19 infection levels. The projection is that supply chain disruptions will likely push prices up by approximately 30-34% for the basket of products used to calculate eurozone inflation at least until 2022. The risk is that inflation expectations adjust higher.

Factory gate prices rose steeply again in August, albeit at a slower pace than in recent months. IHS Markit's input prices index remained high, at 87.0, although it was down from July's record 89.2. Analysis suggests that the supply bottlenecks should mostly fade away once the economic rebound flattens out and the supply of key materials increases. With the exception of specialized inputs like chips, there does not appear to be other reasons why supply will not catch up with demand for a majority of products by early next year.

Eurozone manufactures responded to rising demand by adding more workers in August, continuing the positive job creation trend that started in February. The number of unemployed people in the eurozone fell 350,000 to 12.3 million, reducing the bloc's jobless rate to 7.6%. The rate is down from 8.5% last year but

is still above the pre-pandemic low of 7.1% - and millions of furloughed workers are excluded from the figures.

The overall PMI score for eurozone manufacturing fell to a six-month low of 61.4 in August but remained well above the 50- level that indicates a majority of businesses are reporting growth activity from the previous month. Activity increased at a higher rate among Italian and Spanish manufacturers, but slowed at German and French companies, while remaining at a high level of growth. This marks ten successive months of continued economic growth in the region.

Concerns about the impact of the Delta variant and input shortages remain but have not derailed the momentum of the rebound thus far. Employment growth was at a 21-year high for the second month in a row as businesses increased staffing to meet expanding order books. Manufacturing businesses experienced some labor shortages but hiring accelerated in the services sector.

Supply-chain delays continue to wreak havoc, leaving companies frequently unable to meet demand and pushing firms' costs higher. However, there are some signs that these inflationary pressures may have peaked for now. The eurozone's two largest economies, Germany and France, both recorded a slowdown in the pace at which manufacturing activity increased. In contrast, business activity growth accelerated slightly in the rest of the eurozone, hitting its fastest pace in 21 years. Part of the reason is that the southern economies [Italy, Spain, Portugal, Greece] have benefited more from a return of tourists, even if the summer holiday season was nothing like those seen before the pandemic.

The European Central Bank has indicated that it intends to keep financial conditions loose for the foreseeable future as it cushions the eurozone's economic recovery.

## Vietnam

Factories in Vietnam have been forced to shut or reduce their workforces due to the latest spike in the highly-infectious Delta variant. This has challenged Vietnam's status as a manufacturing powerhouse. When Covid first hit Vietnam in January 2020, the government undertook one of the world's most successful containment policies. Officials treated the campaign to quash the virus as being similar to fighting a war.

The introduction of strict quarantines and an efficient contact tracing system, aided by law enforcement, allowed the country to wipe out local infections and suppress new outbreaks by mid-year 2020. That success allowed a restoration to business as usual, thereby bolstering Vietnam's appeal to more foreign investors as a far less toxic geopolitical alternative to China. A year later the Delta variant is bringing new infections to record levels at more than 10,000 per day, raising doubts over the immediate future of one of Asia's premier manufacturing hubs. Recently, Vietnam tied with Thailand in the 120th place on a Covid-19 recovery index, whose criteria includes countries' infection management and vaccine rollout – an area in which Vietnam failed to adequately plan for. There were several waves of the virus and each time Vietnam was able to successfully contain it. However, the Delta variant has proven harder to bring under control. Also, it appears that the authorities failed in pushing harder for more people to be vaccinated.

The latest outbreak has hit hardest in Ho Chi Minh City, Vietnam's densely populated business center, where authorities have enforced a 12-hour curfew, prohibited most movements and deployed thousands of troops. Production of global brands such as Nike, Adidas among others have had their operations disrupted, highlighting Vietnam's growing role in global supply-chains. Toyota has also announced the suspension of parts made in south-east Asia – mostly Vietnam but also Malaysia, which is also struggling

with surging cases.

The administration of Prime Minister Pham Minh Chinh (who emerged in February – following a five-yearly leadership reshuffle of the communist party), is hastening to secure and administer vaccines to get the economy back on track. In a one-party state whose leaders derive much of their legitimacy from delivering economic growth, this is a crucial task.

With the country's former "zero-Covid" strategy now moot, most of the focus is on containing infections and keeping business going. Some companies are reportedly employing a "three-on-site" model of having factory staff work, eat and sleep at work. This is hard on employees and costly for companies. Some multinationals are putting up managers at hotels. Local companies warn that while big foreign firms can afford to pay for hotels, companies making lower value-added products such as garments, shoes, or furniture are having a hard time maintaining their production. It was noted that Vietnam's exports [of these products] plunged in August and the expectations are that this decline, combined with lower consumption, will likely be a drag on Vietnam's GDP growth in 2021.

Ongoing Covid-induced restrictions are seriously constraining the country's manufacturing capacity. Some factories have been reluctant to take new orders over concerns they wouldn't be able to fill them due to insufficient workers. Some companies believe the current disruptions will likely be short-term since Vietnam is still an attractive option for foreign investors compared to other countries in Asia. In August the Vietnam Textile & Apparel Association (Vitas) warned that just 30-35% of the country's textile and garment factories were operational and underlined that 90% of the industry's supply-chain is broken. The pace of vaccinations in the textile and garment sector remains very low. So far, Vietnam has inoculated 2% of its 98 million population.

The Vietnamese government has set a target of



**FCIA**

**Trade Credit & Political Risk Insurance**

**GREATAMERICAN**  
INSURANCE GROUP

bringing the outbreak in the capital Ho Chi Minh City under control by the end of September. It measures progress toward that goal by a 20% reduction in daily Covid deaths and the number of patients being discharged from hospitals exceeding the numbers being admitted. It remains to be seen if Vietnam can contain the crisis in sufficient time to avoid alienating foreign investors. For the time being, there are few overt signs of divestment; the currency (the dong) has been one of south-east Asia's few currencies to appreciate against the dollar in 2021. In July retail sales fell by 19.8% from last year, the largest drop since April 2020, while the Purchasing Managers' Index also declined significantly.

On the external front, the merchandise trade balance turned into deficit over the past few months while foreign investors demonstrated some caution. Meanwhile, the World Bank has forecast Vietnam's GDP growth in 2021 at 4.8%, two percentage points lower than its previous projection – as a result of the impact of the most recent Covid wave on economic activity.

## Taiwan

Foreign trade remains the engine powering Taiwan's economy. Merchandise exports stood at \$342.3 billion in 2020, up from \$330.7 billion in 2019. The prices of electronic products are set to rise as Taiwan Semiconductor Manufacturing [TSMC], the world's largest chipmaker, plan on increasing prices between 10% and 20%. TSMC's chips are key components of widely used gadgets such as iPhones as well as cars. As the world faces prolonged semiconductor shortages, this latest move could reduce demand in the short-term and also provide higher income which TSMC would use to expand capacity.

The onset of the pandemic in early 2020 was deemed to pose risks to Taiwan's international trade position. However, global demand for Taiwan-made electronics has been sustained by accelerated digitalization in workplaces and schools in response to the pandemic. The ongoing rollout of fifth-generation telecommuni-

cations networks and the start of mass production of new smartphone models will underpin additional strength in the economy. The crisis will also accelerate global plans for technological upgrades among corporations, governments and institutions over the medium-term, which we believe will preserve demand for Taiwanese technology goods.

In Hong Kong officials have admitted that the city's new stringent travel quarantine restrictions are causing international business executives to warn that the territory's reputation as a global financial hub is under threat. After the government abruptly revised plans to relax travel restrictions, business lobby groups have indicated that the reversal is causing chaos for travelers. Restrictions were set to be relaxed in June but instead the time that travelers must spend in quarantine was increased to three weeks in most cases (from one week).

Business groups claim that the reversal, combined with growing uncertainty about when quarantine rules will be relaxed, have prompted some companies to consider relocating. Concerns have been raised to Hong Kong authorities amid strong requests that the new restrictions be reconsidered. In one case, the head of a large European firm with its regional headquarters located in Hong Kong, warned that it would be shifting a substantial part of its business to Singapore if the restrictions are not eased.

The European Chamber of Commerce (EuroCham), a large business lobby in Hong Kong wrote to the territory's political leader expressing alarm over the strict quarantine rules which they believe put Hong Kong's status as an international finance center at risk. The group emphasized that the tight quarantine regulations could influence many in the international business community to question if they want to remain in Hong Kong indefinitely. The open letter marked an escalation of tensions between the government and businesses, as frequent travel has virtually ground to a halt for more than a year. Businesses are finding it difficult to operate and the government has acknowledged that it is taking the

complaints seriously.

Hong Kong has recorded a modest 12,000 covid-19 cases since the start of the pandemic and just 212 deaths in a population of 7.5 million. However, low vaccine uptake among the elderly and a “zero Covid” strategy that aims to open the border with mainland China – have heightened concerns that a broader reopening would have to be delayed.

Rival Asian financial hub, Singapore, by contrast, has laid out plans to start reopening to foreign travel beginning in September 2021, including a quarantine-free corridor with Germany. Bankers in Hong Kong admit that it will be difficult for Hong Kong if its borders remain closed while rivals are opening up. There has been a net outflow of almost 90,000 people from Hong Kong in the past year, the fastest rate for departures since the Sars outbreak in 2003.

## South Korea

South Korean has become the first big Asian economy to raise interest rates since the start of the pandemic, as record household debt and rising real estate prices outweigh fears over Seoul’s struggle to contain the Delta variant. The Bank of Korea raised its benchmark rate to 0.75%, increasing the seven-day repurchase rate 25 basis points from a record low of 0.50%.

The move was the country’s first rate rise since September 2018, while interest rates have remained unchanged since Bank of Korea (BoK) cut them by 50 basis points in May 2020. The BoK’s move sparked debate over whether other central banks in Asia might soon follow suit earlier than expected.

South Korea is on track for GDP growth of 4% this year. The export-led economy has benefited from robust demand for electronics products including computer chips and smartphones, as well as recovering markets for Korean-made ships and cars. Howev-

er, economic planners in Seoul have grown increasingly concerned that chronic problems in the domestic economy have been masked by the booming export recovery, which helped rescue the country from the depths of a pandemic-induced recession in 2020.

Despite the interest rate hike, financial conditions remain accommodative. The country is seeing side effects from the unusually loose conditions of the past eighteen months and the intent is to normalize interest rates in accordance with the economic recovery. The expectation is that BoK will tighten its monetary policy further to rein in financial risks.

House prices rose by 14.3% year-on-year in July, the most since 2002. Recent data show that household debt increased 10.3% in the second quarter, after posting its largest ever gain in the April to June period.

There are also signs that many self-employed workers in Asia’s fourth-largest economy, which now make up almost one-third of the labor force, are under mounting financial pressure after pandemic restrictions sharply reduced their incomes. Economists warn that despite record government stimulus measures, which have included cash payments, the recovery in consumer spending remains fragile.

Recent resurgence of Covid-19 cases has forced South Korea into its toughest social-distancing controls since the start of the pandemic. South Korea’s economy was one of the first among the OECD countries to return to pre-pandemic levels early in 2021. We expect GDP to continue to expand throughout 2022, driven by strong external demand, particularly for electronics and autos.

The currency, the won, is likely to weaken against the U.S. dollar over the next twelve months, owing to monetary tightening in the U.S. However, depreciation will remain moderate, given South Korea’s wide current-account surplus and the BoK’s tightening cycle likely to commence in late 2021.





**FCIA**

**Trade Credit & Political Risk Insurance**

**GREAT AMERICAN**  
INSURANCE GROUP

## Turkey

The Turkish economy is rebounding from the pandemic at a fast clip. The credit-fueled rebound is welcome news for President Erdogan and the ruling AKP party. The growth is the result of a burst in consumption which has helped push inflation to 19%, its highest level in two years. Retail sales in June rose 17%. Meanwhile the currency, the lira, remains weak.

The breakdown of recent economic activity shows that a strong performance in the manufacturing sector more than offset modest declines in mining and utilities output. Manufacturing production was supported by robust increases in output of food and beverage products. Vehicle production output increased by 1.7% month-on-month and is seen as a sign that the worst of the auto sector setbacks in Turkey may have passed. After declining in all of the previous five months, this boost is being celebrated as signaling a turnaround.

The robust performance in the industrial sector and a strong rebound in retail sales since June means that Turkey's economy may have avoided a contraction in GDP in the second and possibly the third-quarter of 2021. Capacity utilization in Q3 continues to rise and confidence across key sectors has improved. Turkey's crude steel production in 2021 will easily reach 2017-18 levels and could exceed 40 million tons (an all-time high) given the strong performance of Turkey's steel industry during the first-half of this year.

There were no surprises when the Turkish central bank kept its key interest rate unchanged at 19% on August 12th. Signs of a recovery, coupled with the further rise in inflation to 19%, means the central bank is unlikely to be in a rush to cut interest rates. The consensus is that an interest rate easing cycle is unlikely to commence before the end of 2021.

Meanwhile, South Korea recently signed a \$2 billion, three-year currency swap agreement with Turkey that will allow both countries to provide liquidity for the

counterparty in a move aimed at strengthening financial stability. Turkey has been on the hunt for such swap agreements in an effort to rebuild its foreign exchange reserves, which were devastated by a failed plan to prevent a further severe devaluation of the Turkish lira.

Under the agreement, the Bank of Korea (central bank) can provide the Korean won to Turkey and the Central Bank of Turkey can provide the lira to financial institutions in South Korea. The central bank of both countries would cooperate further to enable payment from bilateral trades to be settled in the won and lira. The scheme should help undergird the lira and help avoid future lira slumps. It will also support trade between both countries by lowering devaluation concerns and facilitating payment and ease in convertibility in each other's currency. It marks an important step of confidence by South Korea's central bank for Korean businesses and banks doing business with Turkish entities.

Turkey has kicked-off drilling for natural gas as part of a 10-well drilling campaign designed to achieve the first domestic gas supplies by 2023. As Ankara awaits production from its largest hydrocarbon asset, plans are underway to lay a 169 kilometer subsea pipeline that will connect to the country's gas grid. The project is of key strategic importance to Ankara which currently relies on imports for almost 100% of its consumption.

Meanwhile, Russia has allowed its citizens to resume tourist visits to Turkey as of June 2021. Russia had banned such travel to Turkey since April, pointing to soaring Covid-19 cases. With the reopening Russian visitors can now fly to Turkey from 45 airports in Russia. Tourism is vital to Turkey's economy and Russia provided the largest numbers of visitors in 2019. Turkey has fully vaccinated 35.7% of its 83.6 million population.

**By Byron Shoulton, FCIA's International Economist**  
**For questions / comments please contact Byron at**  
**[bshoulton@fcia.com](mailto:bshoulton@fcia.com)**