Major Country Risk Developments
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Overview

Commodity prices are in retreat, signaling a slowdown in the global economy but lending central banks a hand in their fight against inflation. The global commodities index has fallen 11% so far in 2023, as prices for energy, grains and other raw materials have climbed down. Crude oil is close to its lowest levels since just before Russia invaded Ukraine – even after Saudi Arabia's decision on June 5th to cut its crude output further.

Wheat prices are at their cheapest since 2020 and natural gas has tumbled in Europe. Almost every commodity except for weather-affected sugar, cocoa and coffee has seen prices fall. Even copper prices, a bellwether for the global economy because of copper's wide use in construction, cars, electricity, among others, has slipped by 1.5% this year. A major reason for the decline is sluggish global manufacturing activity. Particularly in China, the world's second-largest user of crude oil.

Traders' hopes for a post-pandemic surge in Chinese demand for industrial materials and energy has proven overly optimistic. This is partly because China's recovery has been led by services, rather than the resource-intensive manufacturing and construction that powered previous upswings. As industrial activity in China has remained subdued, imports of semi-refined copper dropped 13% year-over-year in the first four months of 2023. Still, Chinese momentum is improving, and the outlook is becoming more optimistic as the government recently began stressing the need for a strong private sector; while suggesting easing back on recent government criticisms of entrepreneurs, and maybe revising some regulations on the technology and innovative sectors. Its left to be seen how much room for compromise is tolerable to the Chinese leadership.

In the U.S. and Europe too, manufacturing has been lackluster, even as economies grow overall thanks to a stronger services sector. The rise of hybrid working has also tended to make economies less oil dependent. The decline in commodities marks a reversal from a year ago, when Russia's invasion of Ukraine sent prices for energy and grains soaring. That surge stoked inflation in the West, encouraging the Federal Reserve and its peers to raise interest rates, and led to fuel and food shortages in parts of Africa and Asia.

The recent selloffs largely take prices back down to more typical levels, rather than depressed ones indicative of serious oversupply or an economic shock. For example, brent crude is currently trading at $78 per barrel, which would be near the high end of the range in which the benchmark traded between 2015 and 2022. Nonetheless, the price declines point to slowing growth, if not an outright recession in which economic activity contracts.

A silver lining for consumers and businesses is that cheaper energy has started to feed into slower inflation which could eventually help the Federal Reserve, and other leading central banks, to lower rates. For

now, however, other drivers of inflation (e.g. demand for higher wages, labor shortages, etc.,) are sufficiently strong that investors expect further rate increases. And higher rates are likely to curb demand for commodities even more. The energy sector is the worse performer in the S&P 500 so far this year, having been the best in 2022.

Countries that depend on oil and gas sales to sustain their budgets, notably, Russia, Gulf oil producers, Nigeria, Angola, etc., have experienced difficulties. Saudi Arabia announced a cut of a million barrels from its daily oil output to prevent new price declines, after a contentious meeting at which other OPEC+ members refused to follow the Saudis. Instead, the rest of OPEC agreed to maintain existing production curbs. Delegates and advisers from African nations made it clear that they have no intentions of lowering production, as they try to rejuvenate their output after being hard hit during the Covid-19 crash. Russia is broadly seen as pumping what it can given the stresses and strains created by western sanctions and other measures designed to restrict its oil revenue.

Consumers will enjoy the benefits of lower wholesale prices at varying speeds. In the U.S. for instance, lower crude prices quickly feed through to the pump. In Europe, households and businesses will not feel the drop in wholesale gas and power prices so fast, in part because governments put in policies to ease the pain on the way up.

Meanwhile, food prices are still rising, even though wholesale wheat is down 22% this year, aided by bumper harvests in Russia and Australia and exports from Ukraine under the Black Sea grain deal.

Many food producers locked in prices near the peak of the market because they feared losing access to ingredients. Some analysts see commodity prices leveling off rather than falling further. They expect OPEC+ cuts to drain oil supplies in the second half of the year. Metals could get a boost from a splurge in spending on the electricity grid in China, and in the longer term from demand for materials needed for the global energy transition.

For now, still high interest rates and industrial malaise could bring more pressure. Meanwhile, central banks in developed nations continue applying the brakes.

USA

U.S. employers added 339,000 new jobs in May, a surprisingly strong showing. The notable increase from the previous month reaffirmed the job market's vigor despite a swirl of economic headwinds.

For more than a year, warnings that rising interest rates and economic uncertainty would lead to a sharp fall in consumer demand and an increase in unemployment, didn't materialize. However, even as the growth of the U.S. economy slowed a bit, the overall picture has remained better than expected. Still, many forecasters expect a recession to begin by the end of this year. Below the surface, the labor report also offered evidence of softening. The unemployment rate, while still historically low, grew to 3.7%, the highest since last October. As a sign that the pressure to entice workers with pay increases is lifting, wage growth eased.

The hiring numbers suggest that employers remain eager for workers even in the face of high interest rates and economic uncertainty. Many are still bringing on employees to meet consumer demand, especially in services. The only sectors to lose jobs were manufacturing and information. As a surprise, the construction sector, which is sensitive to rising interest rates, grew by 25,000 jobs last month. Big gains were registered in professional and business services, including accounting and bookkeeping, which added 64,000 jobs. Leisure and hospitality businesses- buoyed by restaurants and bars – added 48,000 jobs, as Americans continue to dine out, Government employment, which is still catching up to pre-pandemic levels, also rose significantly, predominantly at the state and local level.

The latest jobs report complicates the work for the Federal Reserve, which had signaled that it could hold interest rates steady at its upcoming meeting This would allow Fed officials more time to assess the impact of previous cuts on economic activity, before proceeding with further rate increases.

Some analysts conclude that fair amounts of economic optimism still exist in the U.S. They argue that if the Federal Reserve slowed its rate hikes, a consensus of small and medium-sized companies believe that the economy could continue to be strong over another year or two. Labor force participation remained strong, with the share of people in their prime working years [25-54 years old] edged up to 83.4%, a level not seen since 2007.

However, consumer confidence is weak. Sectors including banking and manufacturing have shown clear signs of distress. In its most recent region-by-region survey, known as the Beige Book, the Federal Reserve reported that many businesses said they are "fully staffed" while some said they were "pausing hiring or reducing head counts due to weak, actual or prospective demand or to greater uncertainty about the economic outlook."

Meanwhile, lawmakers in Washington averted a potentially damaging U.S. debt default by reaching a last-minute agreement. Big drivers of future deficits – especially Social Security, Medicare, and the military - appear now to be subjects that are off the table in a divided Washington.

Attention is turning back to interest rates. Once again, they are on the rise. In early May the yield on two-year Treasuries, which is especially sensitive to expectations of the Federal Reserve's policy rate, fell to 3.75%. It has since increased to 4.4%.

Separately, U.S.-China relations which are at a 40-year low, is in desperate need of repair. Both sides have become increasingly aware of the growing necessity to sit down with representatives from both countries, to work on areas of disagreement, while seeking to find common ground on other important trade and global issues, including managing artificial intelligence and cyber security threats. As tensions have increased over trade, access to advanced technology, and the safety of the South China Sea lanes, the potential for confrontation has also grown. Moves to get senior diplomats and military leaders from both sides to sit and talk have gained urgency in recent weeks. The signs are now clear that such talks must begin soon. The U.S. side intends to pursue a new strategic industrial policy, while combating climate change and "de-risking" from China. This implies that going forward China will remain one source for critical products, but not the only source. In addition, U.S. allies are being assured by U.S. policymakers that its plans to subsidize the green transition and the drive toward clean energy will be achieved through cooperation with other countries. That would have to include finding ways of working more closely with China. The stakes are high. Both sides are nuclear-armed. Both are involved with unpredictable artificial intelligence (AI).

In theory, the U.S. administration seeks to stabilize relations with an autocratic (and some say) a paranoid China. It wants to combine export controls of sensitive technology with cooperative trade policies, and an arms race with collaboration. Chinese leaders think this strategy is meant to keep it down. The common mistake in advising U.S. policy on China is the idea that the U.S. alone determines the world. The Chinese do not buy that and consider China as an equal to the U.S. in terms of global influence, as a leading trading nation and as a major global creditor.

Eurozone

Inflation has fallen more than expected in the eurozone – to hit its lowest level since Russia's invasion of Ukraine more than a year ago. Yet, the European Central Bank (ECB) has signaled more interest rate rises are needed to tame persistent price pressures.
Annual consumer prices in the 20-country single currency bloc rose 6.1% in the year to May, a decline from 7% in April. The ECB wants to bring inflation down to 2%. The ECB is particularly focused on core inflation, which strips out energy and food prices. This measure fell from 5.6% in April to 5.3% in May, which was more than expected but seemed unlikely to convince policymakers to stop raising rates at their June 15 meeting.

Economists say the fall in core inflation was in large part due to the impact of Germany's launch of a subsidized 49 euros per month public transport ticket in May, which damped growth in transport service prices.

Annual inflation fell in 18 out of the 20 eurozone member countries, rising only in the Netherlands. Price pressures cooled in all product areas for the first time since they started to rise at the fastest pace for a generation more than 18 months ago. While eurozone lending has stalled, the ECB consumer surveys show that tighter monetary policy is not going to affect consumers' vacation plans this year.

The ECB has already raised its deposit rate at an unprecedented pace from minus 0.5% last July to 3.25% in May. Investors are betting it will lift rates by another quarter-percentage point at its next meeting in June and maybe again in July.

The drop in German inflation from 7.6% in April to 6.3% in May reflected a sharp slowdown in energy prices as well as lower inflation for food, other goods, and services.

French inflation fell to 6% in May, down from 6.9%. Slowing price growth in all areas except tobacco took the French rate below the 6.4% level forecast. The cooling of price pressures in the eurozone's two biggest economies – as well as a bigger than expected drop in Spanish inflation to almost a two-year low - lifted expectations that the ECB may stop increasing rates by July.

Europe has weathered well the fallout from the Russian gas shut off, thanks to a strong policy response and mild winter. Tighter financial conditions and the energy price shock are expected to keep economic growth modest over the near term.

Meanwhile, Europe fears a U.S. technology subsidy race and worries that escalating U.S. tensions with China will cause it severe damage. Germany's economy is twice as exposed to China as the U.S.

Mexico

Mining companies are rethinking investments in Mexico, the world's largest silver producer, after the government pushed through sweeping regulatory changes last month. The country's mining body Camimex has warned that new legal mining reforms could potentially jeopardize $9 billion in new investments over the next two years, while interrupting plans for the development of Mexico's vast resources for clean energy technology.

The pending mining code changes, which include making it more challenging for companies to obtain mineral concessions, threaten to trigger a wave of litigation by Canadian miners invested in the country. It is also causing diplomatic tensions with free trade partner Canada, where nearly 70% of foreign-owned mining companies operating in Mexico are based. The new law is clearly affecting investment decisions by many companies in the sector and this could have implications for the sector over the short, medium, and longer terms.

A sampling of foreign mining companies currently operating in Mexico, have opined that they work in remote areas of Mexico, where it is very difficult for the state to create quality jobs. The new law they believe will impact investment and will also negatively impact the workers who the government claims it wants to help the most.

Silver has become an increasingly important metal for use in solar panels, electric vehicles and 5G telecoms networks. Mexico is the world's largest producer of the metal – and is a significant supplier of copper and zinc. Demand for these metals is set to surge with the shift to renewable energy. The sector employs 2.5 million workers in Mexico directly and indirectly.

Since assuming office in 2018, President Andres Manual Lopez Obrador (Amlo) has embarked on a leftwing populist agenda that includes reasserting state control over natural resources and increasingly arbitrary government interventions in the economy, many of which have been challenged in the courts. The Obrador administration has halted awarding new mining concessions and castigated mining magnets for avoiding tax payments, causing environmental damage, and putting pressure on water supplies due to excessive use.

The nationalization of Mexico's lithium reserves last year has hindered projects including the Sonora mine that Chinese producer Ganfeng Lithium bought for $350 million in 2021 and was expected to be in production in 2023.

Under the new mining regulations, which were rushed through Congress during sessions attended only by the ruling party and its allies, explorers will only be able to obtain concessions following a public bidding process conducted by the Mexican economy minister. This is a shift from a previous policy which granted such rights to the first qualified applicant seeking to develop an area. Under the new legislation, all mining exploration activities will be conducted by the Mexican Geological Service which critics say is an underfunded, inefficient state-run agency that could potentially cripple exploration prospects. Neither can the potential for influence peddling be ignored under such conditions.

According to the chair of the Canadian Chamber of Commerce in Mexico, a majority in the Mexican Congress engaged in an unprecedented rubber-stamping exercise by sanctioning a game changing framework for mining operations and

investment. This framework includes reserving mining exploration for the Mexican State. Other modifications to the previous arrangement include shortened concession timeframes with renewals shrinking from 50 to 25 years, tighter restrictions on water use in projects and limiting the rights to only exploit certain minerals rather than any discovered in the area.

Canada's trade minister, its ambassador and mining executives have all expressed concerns to Mexico's economy minister that giving preferential treatment to state-owned entities risks breaching the country's obligations under the free trade U.S.-Mexico-Canada Agreement as well as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership. Mining executives view the proposed changes to concession terms as likely to affect exploration companies' ability to secure financing. Without exploration companies doing the research and development work for the mining sector, there will be a gap in what is mined and when. Once companies deplete their current resources, they need to make new discoveries to replace that supply. The new law, the mining companies say, will limit their ability to develop additional supplies. At least one Canadian mining company announced that they will abandon Mexico as a mining destination due to "political instability." The Canadian mining chamber expects to lodge a legal challenge against the Mexican state but say individual mining companies are reluctant to bring cases forward because of fear of asset seizures by the Mexican government in retaliation.

The Mexican government has argued that the mining legislation changes respect existing trade agreements and "guarantee the practice of sustainable mining." Mexico now has a 180-day period to iron out the final regulation. The Canadian Chamber of Commerce is urging the government to address concerns raised by businesses. The mining code changes come as Latin American governments struggle to capitalize on the opportunity created by soaring global demand for critical minerals vital to strategic industries.

government will be closely monitoring their activities. The Lula government will have to navigate this tricky political environment through continual pork-barreling, which could weaken political stability, as the risk of corruption scandals will rise.

Sluggish economic growth, high interest rates and elevated (albeit declining) inflation will cause growth to weaken in 2023. Deteriorating credit conditions will further aggravate this slowdown as loan costs increase, credit growth weakens, and delinquency rates rise. These factors will likely constrain private consumption and export volume growth, and worsening fiscal dynamics will limit space for public investments. Public external debt is moderate. However, the public debt/GDP ratio is expected to drift upwards (from 75% currently), given that President Lula has vowed to implement large social benefits and increase public expenditure.

There is a fairly liberal attitude towards foreign investment, but taxes were introduced to reduce portfolio inflows (to ease currency-appreciation pressures) during the 2004-12 commodity boom and purchasing of rural land by foreigners is frozen. The transformation of Brazil's external accounts has reduced vulnerability to external shocks, minimizing the risk of controls on capital outflows.

President Obrador also ratcheted up tensions in recent weeks with Mexico's largest mining company

Grupo Mexico by sending troops to seize a stretch of railway that the government wants to use for a priority government transport project.

Meanwhile, separate inflows of non-mining foreign direct investment (FDI) reached $18.6 billion in January-March, the highest quarterly inflow on record. This is a likely reflection of nearshoring trends with foreign companies in the manufacturing space seeking to capitalize on Mexico's proximity to the North American market. That is despite President Obrador's priority for state-led growth and what is seen as his ambivalent attitude to foreign investors. Inflows in the first quarter were up by 48% year-on-year and went mainly to manufacturing and financial services. It bears mentioning that those inflows came from companies that already have operations in Mexico.

Amlo will step down as president after the 2024 elections. The constitution allows the incumbent one (1) six-year term. The consensus among the private sector in Mexico is that the president is carefully putting in place the foundation of his agenda in legislation, so that even while he will leave office in January 2025, his policies will live on.

Ghana

The Board of Directors of IMF signed off on a $3 billion bail-out for Ghana in May and immediately released an urgently needed first tranche of $600 million. This was made possible only on assurances from Ghana's bilateral creditors – in particular China and the Paris Club – that they would be willing to take losses on their loans to Ghana. This is a welcome first step.

For countries in debt distress like Ghana it is necessary that they be accorded some debt relief (post-covid) to set conditions for resuming economic growth-down the road.

Other African countries are in a similar bind and will need help from creditors. The danger is that the mounting debt burden will force some governments to cut back on essential investments in education and health, undermining the progress of recent years.

Western governments have long complained about China's lending in Africa, accusing it of pushing African countries into a debt trap to control their

politics or seize their assets. While some Chinese loans were indeed reckless or burdensome, the criticism is largely unfair. China has financed roads, ports and railways and other needed infrastructure, when private lenders and other countries were often unwilling to do so.

Between 2000 and the end of 2021, China undertook 128 bailout operations in 22 debtor countries worth $240 billion. China's emergence as a highly influential 'lender of last resort" presents critical challenges for western-led institutions such as the IMF, which have sought to safeguard global financial stability since the end of the second world war. Rising global interest rates and the strong appreciation of the dollar have raised concerns about the ability of developing countries to repay creditors. Several countries have run into distress, with a lack of coordination among creditors blamed for prolonging some crises.

Public debt to GDP across Africa has climbed to its highest level in two decades. The average cost of servicing external debt now consumes 17% of government revenues, the most since 1999. Debt and interest payments are crowding out spending on schools, clinics and infrastructure needed for growth. In the 1980's and 1990's, when African countries last had to tighten their belts because of crushing debt, austerity left lasting scars. More young people grew up sicker and less literate, and therefore permanently poor.

In most cases, government revenues are too low as a percentage of GDP; and tax collection needs to be strengthened. Where debts are unsustainable, they must be restructured, which means China must cooperate with the IMF and take losses.

China and the Paris Club appear to have resolved their impasse. In exchange for China agreeing to take losses, the World Bank is expected to provide additional grants and new low-interest concessional loans. Ghana is the first test of this compromise. Ghana owes China about $1.9 billion, or less than a third of the $6 billion owed to China by Zambia, which defaulted more than two years ago. Since then, Zambia has been stuck in limbo while China and its other creditors have wrangled over how to share out the losses. It now hopes to reach a deal in the near future.

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