Major Country Risk Developments
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By Byron Shoulton

Overview

At the half-way mark for the year, the global economy looks poised to register lower growth than was recorded in 2022. After more than a year of battling inflation, central bankers are slowly realizing that taming inflation is harder than they imagined. While headline inflation has peaked around the world, price pressures are still above targets in most key developed economies. Core inflation remains sticky, even rising in some countries (e.g. U.K., Germany). In the Asia-Pacific region, weakening trade has begun to raise concerns about how solid the post-pandemic recovery will be. Economies in Latin America are positioning to start cutting rates; suggesting the region will likely lead in lowering interest rates.

OPEC's two most influential members Saudi Arabia and Russia announced that they will extend or make additional cuts to oil production next month. Both countries are scrambling to boost the price of crude. Saudi Arabia said it will extend its 1 million barrels a day production cut announced in June into August, while Russia says it will make a "voluntary" supply cut of an additional 500,000 barrels effective in August.

The move by the OPEC+ leaders, made outside of a formal meeting of the organization, comes as the cartel struggles to boost crude prices that have fallen sharply from their peak in 2022 in the immediate aftermath of Russia's invasion of Ukraine. Having briefly risen above $130 a barrel in March 2022, oil is now trading closer to $75 a barrel, despite a series of announced production cuts by OPEC+ that started in October last year, with traders focusing on high inflation and slow growth in most developed economies.

Saudi Arabia has been at the forefront of efforts to raise crude prices as the country attempts to transform its economy through a vast investment program that requires crude revenues to fund it. Russia also desires higher prices to fund its war in Ukraine, having lost a large part of its gas export revenue to Europe after it largely cut off supplies last year. Russia also faces a western-imposed price cap on a significant portion of its oil sales as part of retaliatory measures targeting its funds.

Oil prices have disappointed OPEC+ and many traders that bet on them rising with forecasts of a significant tightening of the market in the second half of 2023 as China's economy recovers from Covid. But economic concerns have consistently weighed on oil prices, while the strength of Russia's own exports- which have mostly held up despite hurdles created by western sanctions-have helped keep global crude supplies relatively strong and consistent. While Saudi Arabia's record of sticking to pledged output targets is good, traders believe Russia is less likely to stick to its latest pledge, given that it already faces numerous challenges in keeping its oil exports flowing. Global demand remains weaker than anticipated at the beginning of the year.

The Federal Reserve has raised interest rates aggressively over the past year, and some of the impact is yet to be felt. As long as the labor market remains tight and inflation stubbornly high, the central bank has little choice but to continue its tightening cycle. U.S. inflation fell to 3% in June, lower than expected, in the latest sign that the Federal Reserve's interest rate rises are having an effect on price pressures.

China

The economy has failed to fully rebound six months after the government unwound severe Covid-19 restrictions that had been in place for three years. A crisis in China's real estate sector (which accounts for more than 25% of economic activity) continues to weigh on economic growth. Furthermore, weaker global trade growth has contributed to the lack of momentum that had been anticipated following the lifting of Covid lockdowns.

Against this background, China cut its benchmark lending rates in June, for the first time in a year as policymakers push ahead with cautious monetary support to spur more robust growth in the struggling economy. One-year loan prime rates were reduced 10 basis points to 3.55% by the central bank, as well as the rates charged on five-year loans were lowered to 4.2% (from 4.3%).

The rates, which are set by major banks and influence the cost of borrowing for businesses and households, indicate the authorities' latest effort to shift the policy framework towards easing – as concern mounts over the trajectory of the world's second-largest economy.

The central bank also cut the country's medium-term lending facility, which affects banking sector liquidity, while Beijing unveiled additional tax breaks for businesses. It is widely anticipated that additional supportive measures will be rolled out in the coming months.

The consensus is that decisive state support is necessary to avoid a confidence trap and keep growth on track. The aim is measured stimulus with a focus on real estate. Other economic indicators point to sustained pressures on confidence. The results of a June survey showed consumer sentiment had weakened further, with only about a third of respondents saying they planned to spend more over the next six months, compared with 40% in April.

Eurozone

A key measure of Eurozone inflation has fallen into negative territory for the first time in two and a half years, in a further sign that the surge in prices that has plagued businesses and households may now be in retreat.

The European Union's statistics office, Eurostat, reported that factory gate prices in the region fell 1.5% in the year to May, the first outright decline since December 2020. The measure has fallen significantly since last summer when annual prices hit a peak of 43.3% in August - after energy costs surged in the wake of Russia's full-scale invasion of Ukraine. The decline will raise hopes that a series of rate rises by the European Central Bank (ECB) is finally bearing fruit.

The latest central bank figures show that households increasingly expect inflation to fall over the coming year. However, consumer prices inflation remains well above the ECB's 2% target at 5.5% in the year to June. At 5.4%, core consumer prices are close to record highs.

Higher borrowing costs are also weighing on activity in the region's housing market, Data shows house prices in the eurozone fell for the second quarter in a row. Average mortgage rates across the region now stand at 3.58%, up from 1.78% a year ago. The ECB has raised its benchmark deposit rate by 4 percentage points to 3.5% over the past year.

A breakdown of producer prices showed energy costs were down 13.3% compared to last year. Factory gate prices charged on intermediate goods, such as parts and machinery, also fell. There was also a slowdown in food, alcohol, and tobacco inflation to 12.5% and industrial goods inflation dipped to 5.5%.

Households' expectation for inflation over the next 12 months decreased to 3.9% from 4.1% the previous month. The fall in inflation expectations to the lowest level since March 2022, is a good indicator that the disinflationary process in the eurozone is gaining momentum.

In Germany, the region's largest economy, prices have fallen 6.8%. But these were partly offset by an acceleration in services prices to 5.4%, a record high for the Eurozone. The jump reflected a surge in German transport prices after Berlin increased ticket costs for buses and trains from the heavily subsidized levels of last summer. Higher food prices are dampening household consumption, and the higher cost of raw materials and energy are affecting industrial orders. Recent data shows a bigger-than expected fall of 0.2% in industrial production, though it also revealed a surprise rise of 6.4% in industrial orders.

Germany has signed another long-term deal to import more U.S. liquified natural gas, as it replaces Russian energy supplies. The 20-year duration of the supply contract is an indication that Germany-which began importing LNG only seven months ago-expects gas consumption will endure in its economy despite a goal of cutting 95% of net carbon emissions by 2045. Before the energy crisis Germany was the only big economy in Europe without LNG import capacity, such was its reliance on pipeline gas from Russia.

The eurozone labor market continued to tighten, as jobless numbers in the region fell by 57,000 from the previous month, while the unemployment rate remained at an all time low of 6.5%.

The ECB has warned that it cannot declare victory yet in the fight against inflation. The bank raised its forecasts for price growth to reflect an expected 14% increase in eurozone wages by 2025, which it thinks may push up prices in the labor-intensive services sector.

Meanwhile, the International Monetary Fund (IMF) has cautioned central banks in developed countries that they may have to tolerate a longer period of inflation above their 2% target in order to avert a financial crisis. The IMF warned that policymakers faced a stark choice between solving a future financial crash among heavily indebted countries and raising borrowing costs enough to tame stubborn inflation.

The high debt levels of many European governments leave them vulnerable to another financial crisis. Governments could also help fight inflation by reducing deficit-funded spending to cut demand and lower the amount by which the ECB needs to raise interest rates, the IMF stated. The ECB has created a bond-buying program, called the transmission protection instrument, designed to avoid rising borrowing costs from triggering another Eurozone sovereign debt crisis.

But this program is untested, and the IMF believes more can be done to prepare for potential financial stress. This would include EU governments agreeing to new rules for reducing their budget deficits and debt levels, which have risen above 100% of GDP in many countries including France and Italy. Also, the IMF wants the EU to create a single deposit insurance scheme for all eurozone banks to replace the current patchwork of national systems.

Vietnam

The country has become a vital link in the global supply chain as geopolitical tensions cause businesses to seek to balance their reliance on supplies from China. As rivalries grow between China and the West over technology and security, more companies fear curbs on what and where they can manufacture. As a result, many companies are supplementing production in China, still the world's largest manufacturing hub, with expansion to locations in other countries such as Vietnam. This includes Korean, Taiwanese and Chinese companies where the strategy appears to be to keep production in China to serve the local market but move production to locations in Vietnam and elsewhere to service their overseas markets.

The trend exposes the risks and uncertainties of shifting resources to countries such as Vietnam, where the bureaucratic and physical infrastructure, including the electricity grid, is straining under the weight of demand as the country faces headwinds from a turbulent global economy.

Vietnam's export-led growth has pulled millions of people out of poverty over the past 30 years, and the country has won a big role in the tech supply chain. Apple already produces millions of AirPods in Vietnam, and the country is home to some of the biggest suppliers to global tech companies. Now the economy is at a crossroads as the authorities are feeling pressure to ease bureaucracy, create a more transparent regulatory framework and to get rid of overbearing red tape. The country has been the recipient of strong investment flows, and these are expected to grow even more over the next few years. The question now: does Vietnam have the infrastructure to accommodate the expected investment inflows for further expansion and growth?

In 2022 Vietnam attracted $22.4 billion in foreign direct investment (FDI) projects, a 13.5% increase over the previous year. The country attracted 962 new FDI projects so far in 2023, up from 578 in the same period last year with the main attraction being cheaper labor costs (compared to China). While the government points to efforts to improve and modernize the country's infrastructure, investors are already noticing a tightening labor market. One Taiwanese manufacturer of electronic equipment anticipates the need for an additional 20,000 workers over the next year and expects to attract such workers from outside the city limits of the industrial complex where its facilities are located. It plans to house these workers in dormitories (not unlike what has been taking place in China).

The labor market is tight and getting more difficult. Highly skilled labor is being demanded by more companies. Vietnam's highly qualified young workers also expect to earn far more than the monthly minimum wage, which for the biggest cities is around $198. The average monthly salary for young Vietnamese professionals in the tech sector is four times that amount.

New investors note the grindingly slow bureaucracy in this consensus-driven and decentralized system in which multiple signatures are required for every

approval. Companies already operating in Vietnam complain that expanding there is tough. A crackdown on corruption has helped to further exacerbate delays. The government has reportedly become paralyzed by procurement anxiety as civil servants and officials fear making mistakes or being imprisoned for corruption or misuse of public resources.

Western businesses cite the absence of a centralized investment agency as one reason why approvals for everything from work permits to solar panels move very slowly. The lengthy procedures and complexity of the system is causing frustration. Furthermore, as Vietnam develops, it remains highly dependent on ties to China for materials needed for manufacturing in Vietnamese factories. If there should be any disruptions to the flow of imports from China, that would mean production shutdowns at factories in Vietnam.

One solution is for big investors to play a role in improving the whole supplier ecosystem. Samsung, which has six factories in Vietnam as well as a research and development center and is the biggest foreign investor, has worked since 2015 with about 400 Vietnamese companies to help them improve product quality.

GDP growth accelerated to 4.1% in the second quarter of 2023, from 3.3% in the first quarter. Manufacturing output will remain flat over the remainder of 2023 amid a downturn in global demand for Vietnam's exports.

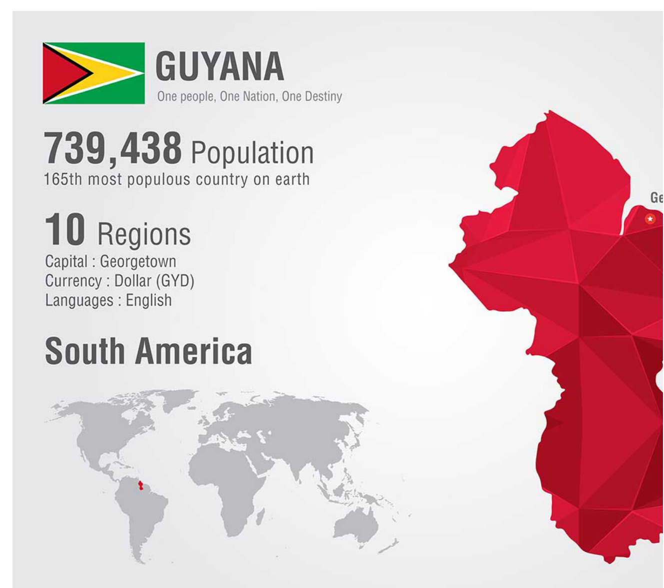
Guyana

OPEC+ has been courting Guyana to become its newest member, in a bid to extend the cartel's influence into this small South American country that has suddenly become the world's fastest-growing oil producer. In recent months, both Saudi Arabia and OPEC's secretary-general have invited Guyana to join the cartel. So far, Guyana has decided not to join. Officials of the Guyanese government stress that the country needs to maximize production and profits in the short-term, given that oil demand is expected to decline over the coming decades. The plan is for Guyana to get as many resources out of the ground as quickly as possible, given the longer-term uncertainty over fossil fuels.

Also, there appears to be concerns that Guyana would become beholden to Saudi Arabia and other OPEC members, and the Guyanese government does not believe that the country's production is large enough to join the cartel at this juncture.

Meanwhile, Guyana is still working to finalize a new legal framework for oil and gas that would apply to future operators in the sector. While Guyana supports efforts to decarbonize the planet and cut fossil-fuel subsidies, the government needs to invest in its economy: build infrastructure, highways, power plants, new hospitals and increase food production.

Oil producing countries outside of OPEC+ are set to expand faster over the next five years, according to the International Energy Agency. Non-OPEC producers are projected to boost output by 5.1 million barrels a day, led by the U.S., Brazil, and Guyana. By



contrast, the 23 OPEC+ members will add new capacity of 800,000 barrels a day, as investments in Saudi Arabia, The United Arab Emirates and Iraq are expected to be largely offset by declines in Russia and among African and Asian producers. A previous attempt by Saudi Arabia and OPEC to bring Brazil into the cartel failed because Brazil was concerned it would have to participate in production cuts.

OPEC has also invited Azerbaijan and Malaysia, which are allies in OPEC+, to join the group as full members, but their production is small and has been stagnating. Guyana's lofty aspirations for its oil discoveries have made it a bigger and more important target than. Exxon-Mobil and its partners have approved more than $40 billion in oil projects in Guyana, with five projects expected to pump more than one million barrels a day combined by the end of the decade. Since 2015, Exxon and its partners have made more than 30 big oil finds in Guyana, with output coming in at 360,000 barrels a day at the end of 2022.

According to estimates, the Stabroek Block off Guyana, has the equivalent of 11 billion barrels of oil. For this reason, it has become the world's most promising oil play. The oil sector growth has triggered a freer flow of high-priced goods and drawn investors to spend on hotels and restaurants in the mostly under developed country. The IMF projects GDP will rise by around 37% this year alone.

As its oil production has grown, so has Guyana's presence on the global stage. The country was elected a non-permanent member of the United Nations Security Council in June. Its economy has expanded rapidly, and foreign investments have begun to flow to infrastructure projects, in support of the country's power grid and port operations.

Angola

GDP growth picked up pace in 2022 registering 3.1%, thanks to higher oil revenues and improved economic management. Angola is one of Africa's largest oil exporters, alongside Nigeria. Still the economy continues to create insufficient jobs, and one-third of the country's 34 million population survives on less than $2.15 per day.

Angola is among several OPEC members that refused to support Saudi Arabia's push for further cuts in crude production to boost global oil prices. Instead, Angola (and Nigeria) received new production targets from OPEC for 2024, that are way higher than each country can realistically pump. Which means neither country will have to cut production.

The sitting president was re-elected for a second term in 2022, having guided the country toward more foreign investment inflows and focusing on the diversification of the oil-dependent economy. His main aim is accelerating economic diversification, attracting private investments, and creating jobs by encouraging a more favorable business environment. Support from the World Bank in this saw the approval of a $300 million job creation project which is meant to benefit some 12,000 firms. The aim is to help Angola transition from an oil-driven and state-led development model to a more private sector-led model that will be climate resilient.

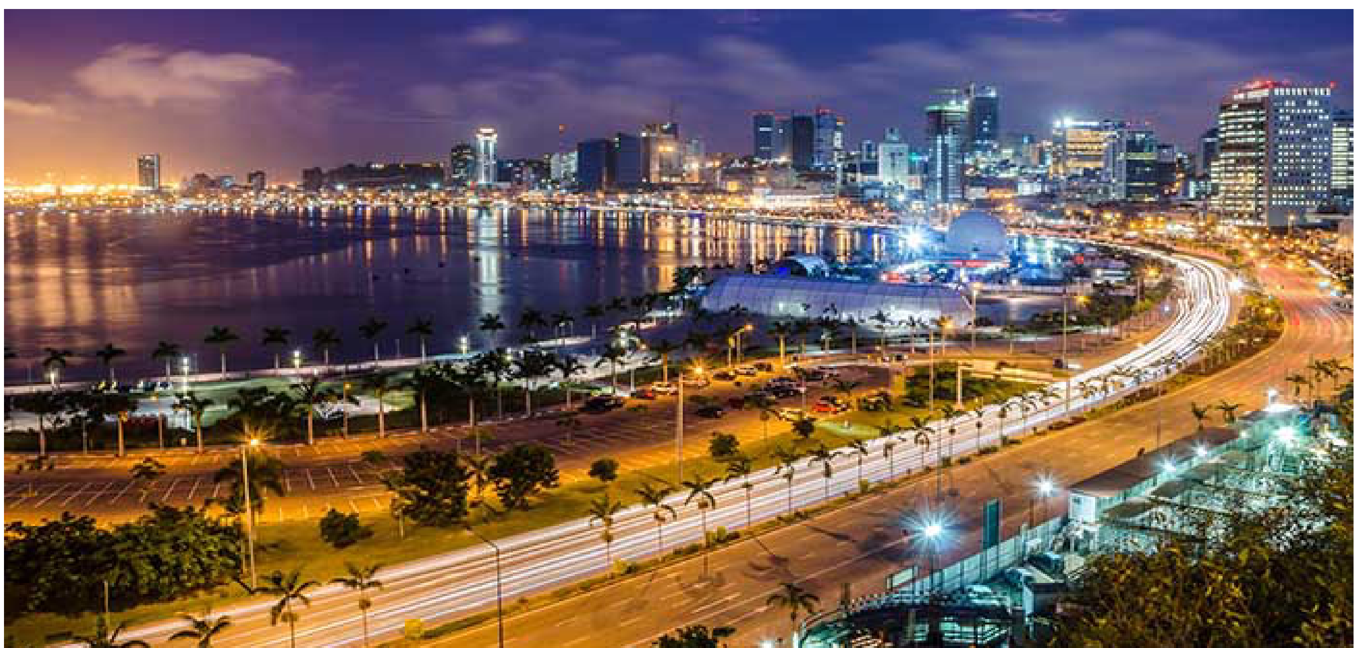
The World Bank initiative will build on the Angolan government's reform agenda to lay a strong foundation for diversified growth that will eventually produce more and better paying jobs, particularly for women and young workers. It is focused on increasing private investment in non-oil value chains, particularly the so-called Lobito corridor which has the potential to link Angola by rail with the Democratic Republic of Congo (DRC) and crosses four provinces in Angola which houses 25% of the population.

The four provinces are important agricultural areas with value chains in cereals (maize, soybeans, wheat, and rice), beans, vegetables, and fruits. A group of investors led by commodity trader Trafigura plans to invest $555 million in the Lobito railway project and was granted a 30-year concession to operate the Lobito Corridor, with the possibility of it being extended to 50 years. The view is that the railway will eventually provide faster trade routes to Europe and the Americas from the copper and cobalt-rich areas of Zambia and Congo.

The recent dismissal of the Economic Minister came after the government withdrew subsidies on gasoline and allowed prices at the pump to rise. This sparked protests by taxi and motorcycle taxi drivers across the country in June, resulting in five deaths and several injuries. The decision also triggered protests by the country's largest opposition party.

The Angolan government is unable to continue to afford the fuel subsidies. The budget deficit forbids such subsidies and Angola's creditors, including the World Bank, IMF, China, and the Paris Club, are all pressing for policy changes as they provide Angola with debt relief and new lending. Cuts in government spending meant removing the fuel subsidies.

Portugal has agreed to increase its business credit line to Angola to two billion euros. The announcement in June means that the Portuguese government will provide new guarantees worth 592 million euros for investments in three projects in Angola. The guarantees relate to the coverage of credit risks for the export of goods and services from Portugal to Angola. On a visit to Portugal the Angolan president signed 13 bilateral cooperation agreements between both countries.



Outlays for the implementation of a long-term development plan [EPT Angola 2015] are expected to come from foreign direct investment (55%); while the state budget would fund 30% of the project. The private sector, including banks and oil producers are to provide 10% and 11% respectively.

China is believed to have agreed to debt relief for Angola although the details have not been published. In 2016 Angola received a $6.9 billion loan from China Development Bank in exchange for unspecified oil exports from Sonangol, Angola's state-owned oil and natural gas company as collateral. Other loans were by other Chinese entities and, as well as western banks and governments. These loans led to Angola amassing a huge debt load within a relatively short time frame. When oil prices fell the country was unable to pay as agreed. Large portions of crude went to repay China.

Angola sought and received various debt restructuring and debt relief agreements. Over the last three years such arrangements helped in providing the economy with some breathing room by stretching out repayment schedules as well as debt write-offs. The IMF also provided valuable financial support – under which fiscal targets were agreed to (including cuts in government fuel subsidies).

Various foreign interests have increased interest in doing business in Angola. These include German, Spanish, Austrian, British, Portuguese, and Israeli investors. All are focused on Angola's natural resources.

India

The thinking in U.S. policymaking circles is that no other country has the size or potential to act as a counterbalance to China than India. The U.S. and India share the realistic fear of an aggressive China and therefore both countries see a common goal in pulling closer together. Hence the recent red-carpet hosting of Indian Prime Minister Modi in a state visit to the U.S., which included him speaking to a joint session of the U.S. Congress.

Meanwhile, the Indian government is preparing a new multi-billion dollar subsidy scheme for companies making electricity grid batteries. The aim is to accelerate India's transition to clean energy away from the current large reliance of the use of coal. Coal currently accounts for roughly three-quarters of India's power generation and PM Modi has set out an ambitious target to build 500 gigawatts of renewable capacity by the end of the decade. India is among the world's fastest-growing energy consumers- and is committed to transitioning away from coal. Batteries are essential for storing renewable energy because, unlike the regular power supply generated by coal plants, the availability of solar and wind fluctuates throughout the day.

A draft proposal for a production-linked incentive subsidy scheme would offer $2.6 billion from 2023 through 2030 for companies to set up manufacturing capacity for 50-gigawatt hours' worth of battery cells in India. The plan, submitted by India's power ministry, is now under discussion and subject to change.

For Indian authorities, more domestic battery cell manufacturing is essential, not just for energy transition but for reducing dependence on battery imports from its rival China. At least 90% of the value must be generated domestically under the plan, including sourcing components locally rather than via imports (mostly from China). India has resisted pressure to phase out coal usage, but officials view bringing down the costs of battery storage is an essential alternative to building new coal-power plants. The draft plan acknowledges that there is a limit to how much more coal power India can build. Issues including "international opinion" and environmental concerns make expansion of coal-based thermal generation beyond a limit, an infeasible option for India, the draft states.

India has rolled out a series of subsidy schemes to boost domestic manufacturing in strategic industries such as solar modules and semi-conductors. Most are still in the early stages. Planned production under an existing subsidy scheme for advanced chemistry cell battery storage will primarily supply electric vehicles rather than the electric grid. This means more subsidies will be necessary to encourage the manufacturing of batteries for the electricity grid.

The Indian government is also planning about $500 million in financing to cover the "viability gap" for companies investing in the sector, given that it remains high-risk. While the cost of batteries for the electric grid is at present prohibitive, the market has enormous growth potential. There is a consensus that there has to be growth in demand for batteries. To make that happen there must be various regulations put in place - which are not yet ready.

According to the central bank India's current account deficit shrunk to $1.3 billion during the first quarter of 2023, from $16.8 billion (2% of GDP) in the previous quarter, and $13.4 billion in the same quarter of 2022. The fall in imports reflects slowing consumption demand and is also indicative of the fall in commodity prices from the levels seen in 2022. Export performance has remained resilient despite slower global growth, which has affected exports of other Asian countries. Exports of services rose at a robust pace, driven by earnings from software services (accounting for 50% of total service exports). This trend is expected to continue. Net foreign direct investment (FDI) inflows more than tripled in the first quarter of 2023.

Zambia

Official creditors have reached a deal to restructure a half of Zambia's $13 billion external debt, ending a long impasse following the country's 2020 default. Led by China and France lenders agreed to reschedule $6.3 billion in outstanding loans.
Under the agreement, bilateral lenders led by China provided Zambia with a three-year grace period on interest payments while extending maturities, paving the way for Zambia to resume receiving funding from the International Monetary Fund (IMF). Zambia will now begin negotiations with private creditors on its remaining outstanding debt load.
An unusual feature of this debt rescheduling with official creditors, the agreement also provides for less debt relief if Zambia's economy fares better than expected over the next few years.

Zambia is Africa's second-largest copper producer and has been left in financial limbo and unable to continue accessing a $1.3 billion IMF bailout while China its biggest creditor, and other lenders clashed over a proposal to reduce by half the value of its overall external debts.

While more details are needed on the amount of debt relief the country will receive if its economy improves, the agreement was a diplomatic win for France and China which have been at the forefront of discussions on reforms to the lending system between the advanced economies and poorer countries. The Zambian agreement raise hopes for other countries including Ghana and Ethiopia, which are in similar talks to restructure debts dominated by loans from China, which has become the single largest lender to the developing world in the last decade. China has been reluctant to accept direct debt write-downs of foreign loans by its banks, and in Zambia's case it had proposed that multilateral development lenders such as the World Bank take the unprecedented step of joining the restructuring. Traditionally, development lending institutions provide concessional lending rather than debt write-down's as a way of unlocking an agreement.

Out of concern for domestic financial stability, Zambia has excluded its local currency bonds from the restructuring. Foreign buyers of Zambia's domestic public debt appeared to have reduced their holdings from $3.2 billion to less than $2 billion since the end of 2022, on fears that domestic borrowing could be included in the restructuring. According to the Zambian Finance Ministry, servicing those bond holdings alone would have absorbed almost 80% of the funds available to repay external debt. The debt rescheduling is projected to reduce the country's 2023 budget deficit by 1% of GDP. It will improve the country's fiscal trajectory and credit standing while easing the debt servicing burden. This will provide the fiscal space to help implement the government's development agenda and allow for critical investment in healthcare, education, and infrastructure.
China appears satisfied with the outcome of the negotiations since it limits financial losses to China while spreading more broadly the blame for the distress and untenable situation that Zambia and many highly indebted economies find themselves.
The Zambian central bank projects that this year international reserves will improve to five months' worth of import cover, up from the current 3.8 months.

By Byron Shoulton, FCIA's International Economist
For questions / comments please contact Byron at
bshoulton@fcia.com

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