COFACE ECONOMIC PUBLICATIONS

JULY 2017

BAROMETER
COUNTRY AND SECTOR RISK BAROMETER Q2 2017

By the Group Economists

A gust of optimism is blowing over the world economy

At the end of the first quarter of 2017, we were wondering whether the timid global economic recovery was a flash in the pan. Three months later, the ongoing recovery seems to be a lasting one, given the economic rally in a considerable number of industrial sectors and in Europe, even if a few rain clouds on the horizon, in the United States and in China, darken the picture.

In this barometer, we observe that in the United States, the slowdown in consumption, the still unclear outlines of the fiscal stimulus and the investment plan announced by the White House, as well as the rise in interest rates are elements to be monitored. In the euro area, good news are accumulating: the easing in credit conditions finally boosts business investment; growth exceeds expectations; business confidence has been at its highest for six years; consumer sentiment is on the rise. With the notable exception of the United Kingdom, we estimate that business insolvencies will decline in Europe and we thus upgrade Spain to A2 from A3 and Portugal to A3 from A4.

In Russia (upgraded to B from C), recovery is turning up, for example in the automotive sector (whose assessment is being revised up). It is also good news for its neighbors in the Commonwealth of Independent States (CIS). Uzbekistan is also seeing its assessment improving from D to C. However, there are still greys areas in some countries of the CIS region: political risk remains high and the banking sector fragility is still worrying in countries such as Kazakhstan and Azerbaijan.

The second quarter marks the end of good news for China. In April and May, all the indicators are flashing orange, or even red, including confidence of some economic players. Under these conditions, the risk of insolvency increases. Let us therefore be cautious and watch closely in the next few months the evolution of the second world economic power.

Other examples of the fragility of this recovery in global growth: several emerging countries are downgraded, particularly in Africa (Namibia, Mauritius) and in the Middle East (Qatar, Bahrain).

> **In the euro area, good news are accumulating: the easing in credit conditions finally boosts business investment.**

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FOR SAFER TRADE

A gust of optimism is blowing over the world economy

1 UNITED STATES: SLOWDOWN IN HOUSEHOLD CONSUMPTION AND A FISCAL STIMULUS PACKAGE STILL UNCLEAR

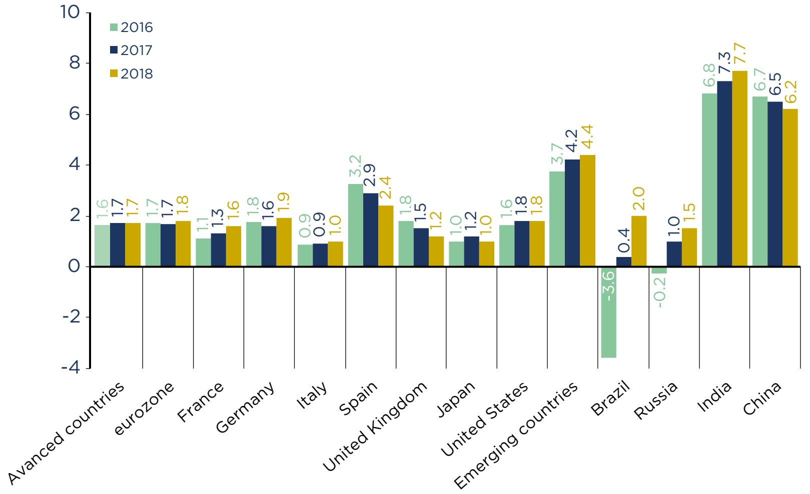
The US economy continues to send mixed signals. On the one hand, business and household optimism remains high, and 175,000 non-farming jobs were created per month on average during the last quarter of 2016. The unemployment rate fell to 4.3% in May 2017, its lowest level in nearly 16 years. On the other hand, household consumption is still waning even with this low unemployment rate.

Despite a revision of US GDP for Q1 2017 from 0.7% to 1.2%, driven especially by final retail sales figures for March, recent data are rather disappointing. Although retail sales gained a further 0.4% in April, they remained below market forecasts (+0.6%). New vehicle sales fell 4.3% in May compared with the previous month and 11.8% year on year, the lowest level since 2011. Payment defaults on auto loans continued to increase according to credit data published in April by the Federal Reserve Bank of New York. Construction spending also decreased 1.4% from the previous month. The rise in inflation and the expected hike in interest rates in the coming months are likely to curb credit growth and reduce consumer purchasing power. Faced with this anticipated increase in credit costs, US households are saving more: the savings rate increased from 5.0% in January to 5.3% in April.

Lastly, on the political front, the implementation of the tax reform proposed by the White House (including lower corporate taxes) remains subject to a vote by Congress. How these tax cuts will be funded will undoubtedly be the main issue of lengthy debates, particularly within the Republican majority, hostile to the mounting public deficit. In addition, the details of the massive investment programme to renovate the country's outdated infrastructure, expected to double the pace of US growth, have still not been revealed.

In this uneven environment, Coface still forecasts US growth to be close to 1.8% in 2017 and 2018 (see chart 1). Despite these forecasts below consensus (2.2% in 2017 and 2.4% in 2018), company insolvencies should continue to decline (-4% this year).

Chart 1
Growth forecasts by country



Source: Coface

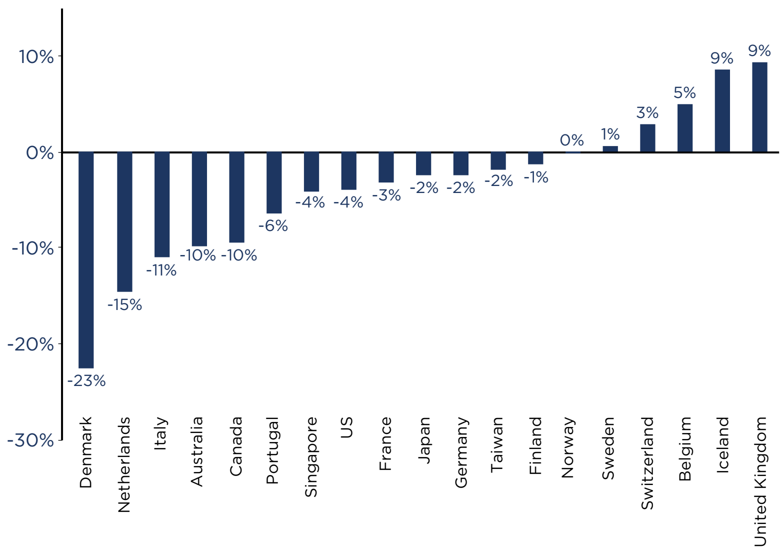
2 EUROZONE: RELAXED LENDING CONDITIONS (FINALLY) CONDUCIVE TO INVESTMENT

Good news continues to mount in the eurozone. In addition to the dissipation of several political clouds (elections in France and the Netherlands), the economic situation remains positive, even offering some favourable surprises. At 0.6% (+1.9% year on year), Q1 2017 growth exceeded expectations particularly thanks to investments. Business confidence, including in Germany, where the IFO Business Climate Index is at its highest level since 2011, and very tempting financing conditions are encouraging businesses to invest more.

According to the European Central Bank's latest quarterly survey on lending conditions in the eurozone published at the end of April, this trend of optimism is expected to continue in the coming months. The ECB notes an increase in loan applications from enterprises for their investments and from households for their consumption and mortgages. According to this survey, demand for loans to enterprises in Q1 2017 increased particularly in Spain and, to a lesser extent, in Germany, decreased in Italy and the Netherlands, and was stable in France. On the supply side, according to the 140 banks surveyed [1], lending conditions have also relaxed across all loan categories, mainly due to competitive pressure.

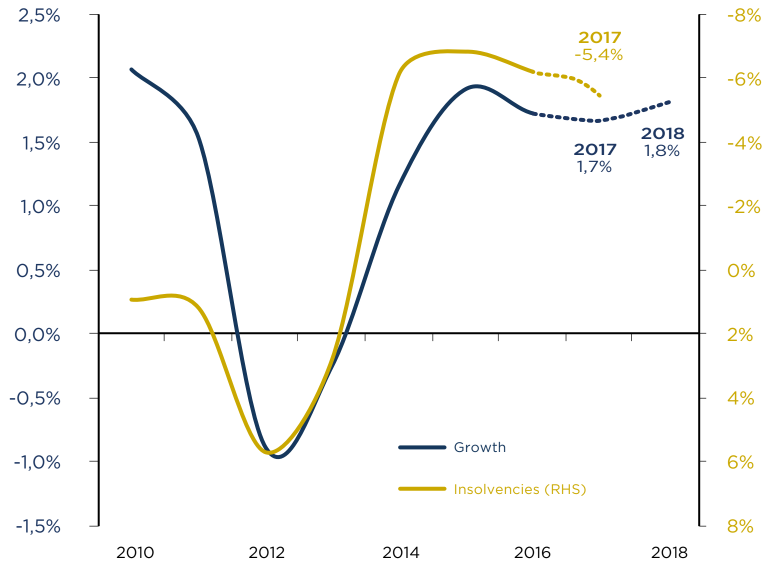
Investment in housing is also benefiting from eased bank lending conditions and better consumer confidence. This is particularly the case in Germany, where investment in construction has also benefited from favourable temporary effects (weather conditions), but also in France or in Spain. In the coming quarters, the gradual tightening of the ECB's monetary policy will certainly need to be watched, but its impact on European businesses is not expected to put the recovery at risk (see inset 1). In this calm macroeconomic environment, microeconomic dynamics are also improving: company insolvencies should continue to decrease in nearly all countries of the Monetary Union this year (see chart 2). However, in the United Kingdom [2], Coface forecasts a 9% increase in company insolvencies on a like-for-like basis [3] in 2017. In this country, the slowdown in household consumption will heighten pressure on sectors such as distribution and textile/clothing and, to a lesser extent, automotive and ICT (these two sectors are also benefiting from the positive effects on exports of the lower pound). A few very open economies dependent on the United Kingdom, such as Belgium (number 4 trading partner, 9% of its exports), will also feel the effects.

Chart 2
Projected growth of company insolvencies in 2017



Source: Coface

Chart 3
Growth in GDP and company insolvencies in the eurozone



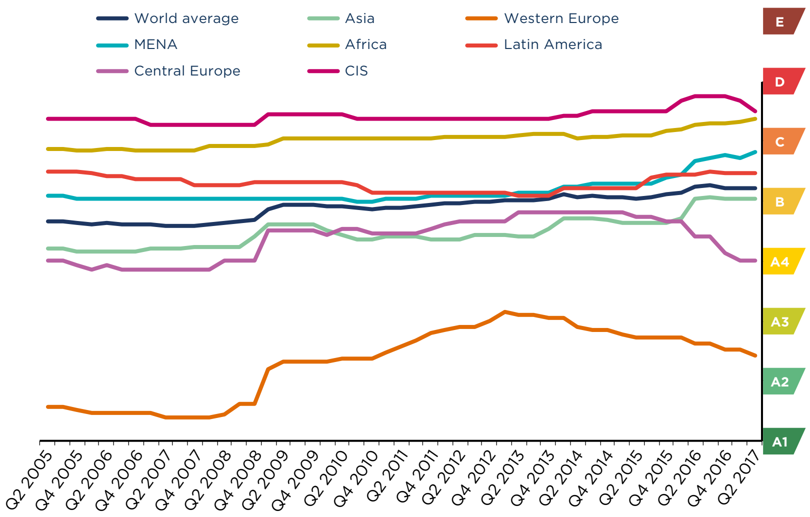
Sources: Coface forecasts

1/ https://www.ecb.europa.eu/stats/pdf/blssurvey_201704.pdf
2/ *"In the face of Brexit, are British businesses left to sink or swim?"*, Coface Panorama, May 2017
3/ Estimates made by removing an exceptional event in the last quarter of 2016: insolvencies of 1,796 individual companies due to a regulatory change. Maintaining the official figures without restatement, company insolvencies should decrease 2.7% in 2017.

Coface thus adjusted its country ratings this quarter for Spain (from A3 to A2), where growth once again surprised on the upside in the first quarter thanks to dynamic foreign trade (+0.8% quarter on quarter, see the section on changes in country and sector ratings), and for Portugal (from A4 to A3), which exited the European Commission's excessive deficit procedure. Chart 4 also shows that Western Europe is the region that benefited most from adjustments to country ratings in recent quarters (with Central and Eastern Europe). Conversely, MENA and Sub-Saharan African countries have seen deterioration in their country ratings in the recent past because of political turmoil (including the Arab Spring outbreak) and, foremost, because of the fall in oil and commodities prices.

Assessments of North America, comprising the United States and Canada, have been fairly stable between 2005 and today. Nevertheless, they both deteriorated in June 2016. The United States assessment was revised downwards to A2 owing to slowing domestic consumption and a lower corporate profitability. Canada was downgraded from A2 to A3 due to household debt, especially housing debt (165% of disposable income), which has been a drag on growth.

Chart 4
Average Coface country rating by region
(A1 = very low risk and E = extremely high risk)



Source: Coface

INSET 1

Bond markets: is the grip really tightening?

The monetary tightening cycle, in progress in the United States and coming up in the eurozone, could be synonymous with a long-term increase in the yields of bonds issued by governments and businesses. However, the consequences of higher bond costs should be considered in the light of the hysteresis effects of the particular economic context that characterised the most recent period. As bond yields moved away from their structural level to reach record lows, the requirements and financing costs of bond issuers fell out of order in an environment of sluggish growth and budgetary austerity.

What explains the recent trends in bond yields?

The recent period was characterised by extraordinarily low bond rates, as evidenced by the erosion of German sovereign yields compared with the eurozone's risk-free rate, the overnight index swap [4] (OIS) (chart 1). This exceptional situation is explained by a relatively inelastic asset supply in the short term faced with temporarily high demand due mainly to the flight to quality and the very expansionary monetary policy. The more or less gradual attenuation of these two factors would thus be the key variable for determining the timing and magnitude of an increase in bond rates. The flight to quality stemmed particularly from high political risk in a multi-faceted electoral cycle period (increased uncertainty, risk of default, risk of redenomination of debt) with a mixed impact on bond markets. Spreads increased to the benefit of assets considered the safest and at the expense of, for example, French government bonds, whose spread with the OIS returned to its 2014 level in Q1 2017 (chart 1), when the Front National's chances of the winning the presidential election were the highest. The monetary environment has also been a determining factor in recent trends in bond yields. Beyond low inflation and the decrease in policy rates, quantitative easing (QE) in the United States and the eurozone [5] affected the yield of all bond categories, given the "preferred habitat" of certain investors in terms of risk and return. On the one hand, bond prices increased (and, mechanically, yields decreased) for the assets directly concerned by the central banks' purchase programmes and for which the most risk-averse investors maintained substantial demand (safety premium channel). On the other hand, QE weighed on asset classes that are not targeted by the purchases and benefited from postponements by investors in search of a higher yield (portfolio-rebalancing channel) and expectations about the conduct of monetary policy (signalling effect channel).

What is the impact of rising bond yields?

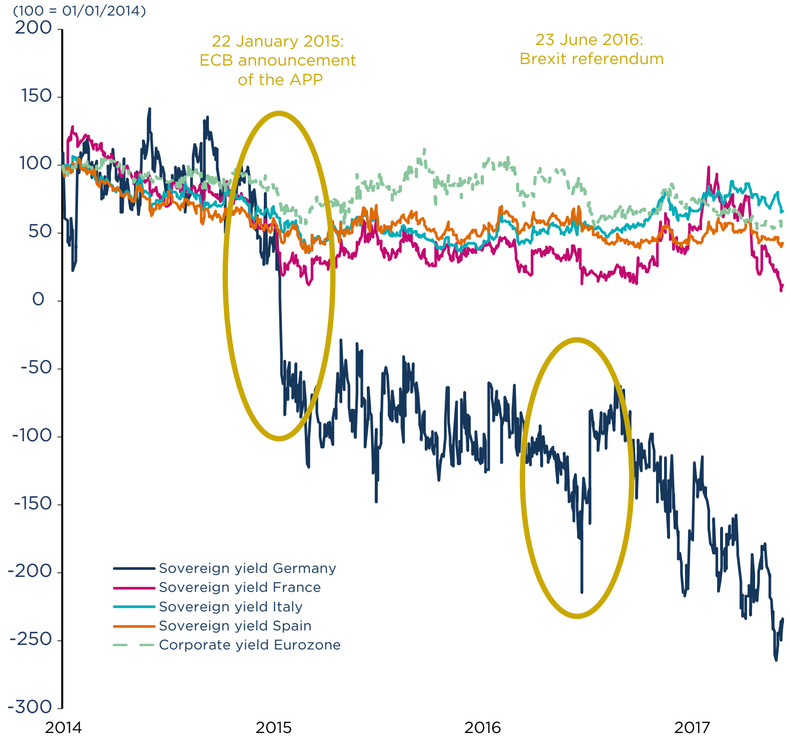
While it is clear that the expected increase in yields will negatively affect the financing conditions of governments and businesses, the distortion between requirements and financing costs allowed issuers to reduce their risk of exposure to rising rates but could weigh on their future financing capacity in the cycle. It should be noted that, despite the decrease in risk-free rates after the financial crisis, the cost of capital (equity and debt) for non-financial business remained at a relatively stable level due to a higher market risk in a period of weak growth and high uncertainty. In a similar movement, the increase in rates should not drastically raise the cost of capital insofar as the increase in the risk-free rate would be offset by the decrease in market risk related to the improved economic conditions.

INSET 1
Bond markets: is the grip really tightening?

For both governments and businesses, the decrease in bond rates allowed debt maturities to be extended, thus reducing their short-term exposure to an increase in yields: in the eurozone, the average residual maturity of sovereign debt increased from 6.3 years in 2012 to nearly 7 years in 2016, and the average maturity of corporate bonds in the United States increased from 13 years in 2011 to 16 years in 2016 (chart 2). Despite the decrease in the cost of debt, businesses invested little due to the unfavourable financial and economic factors influencing investment decisions. The distortion between requirements and financing costs can be illustrated by the double gap between the cost of debt and the cost of equity capital and between the cost of debt and the investment opportunities in the face of sluggish demand. Consequently, especially in the United States, corporate debt increased, particularly through an increase in bond issues with annual amounts rising from 1,000 billion dollars in 2011 to more than 1,500 billion in 2016 (chart 6), benefiting dividends and share buybacks rather than investment spending [6]. The decrease in the cost of debt at the bottom of the cycle could thus weigh on the ability to finance investments during the more advanced phases of the cycle, in the same way that maintaining a high level of debt for governments could increase their marginal cost of financing at the bottom of the cycle, precisely when their financing requirements would be at their highest. [7]

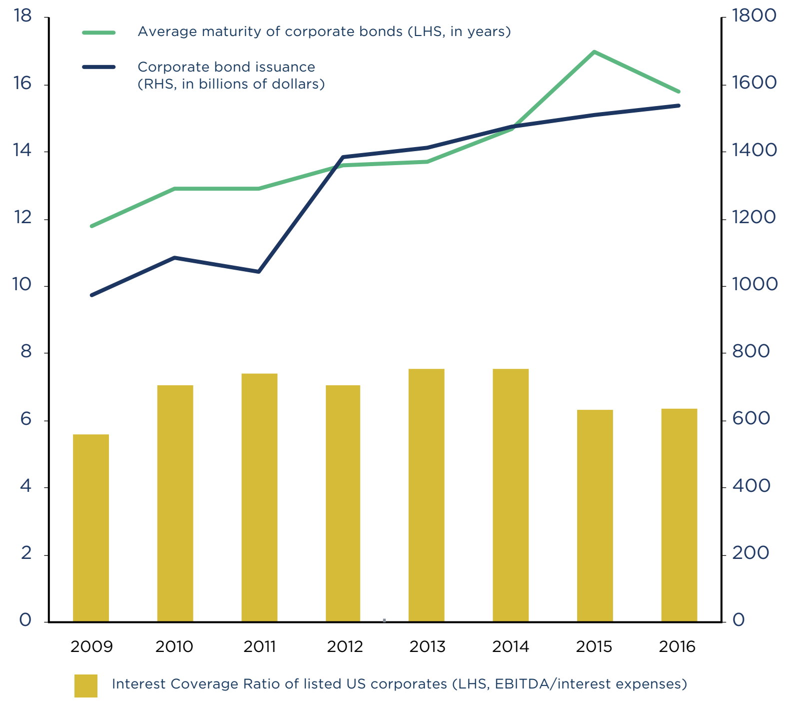
4/ Benoît Coeuré, *"Bond scarcity and the European Central Bank's asset purchase programme"*, speech to the Club de Gestion Financière d'Associés en Finance, Paris, 3 April 2017.
5/ Through the asset purchase programme (APP), which includes a public sector purchase programme component (PSPP) and a corporate sector purchase programme component (CSPP).
6/ Adrian Blundell-Wignall and Caroline Roulet, "Long-term investment, the cost of capital and the buyback puzzle", OECD Journal: Financial Market Trends, 2013.
7/ Benoît Coeuré, *"Sovereign debt in the euro area: too safe or too risky?"*, speech at Harvard, 3 November 2016.

Chart 5
Spread with the Overnight Index Swap (10-yr bonds)



Sources: Datastream, Reuters. Last available data: 16 June 2017.

Chart 6
US corporate bonds



Sources: Securities Industry and Financial Markets Association, Datastream, Coface calculations. Last available data: 2016.

3 THE RECOVERY IN RUSSIA, EVEN TIMID, WILL BENEFIT OTHER CIS COUNTRIES

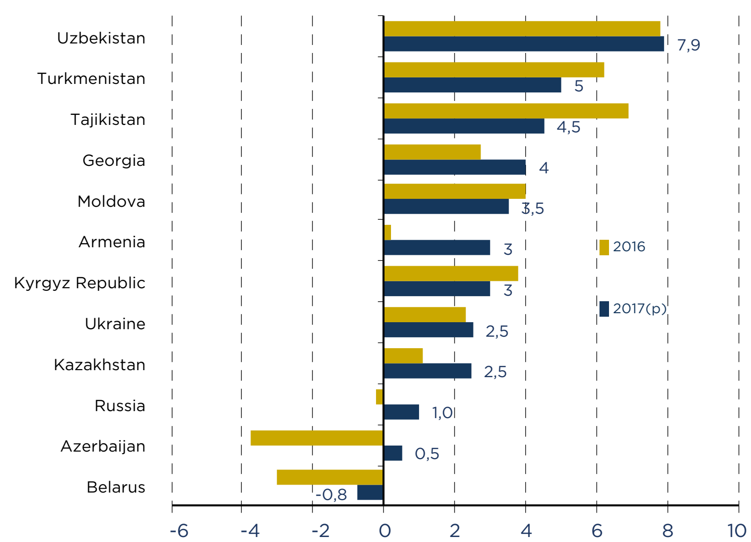
Coface (chart 1) has adjusted the ratings of several countries of the Commonwealth of Independent States (CIS) since the beginning of 2017: Armenia to D in March, Russia to B, and Uzbekistan to C in June. Most of the economies of the countries of this region[8] had suffered in 2015 and 2016 from the combined effect of Russia's recession and the unfavourable trend in commodity prices. Highly dependent on Russia for immigrant workers' remittances and trade, Belarus or Armenia were particularly affected. Kazakhstan, Azerbaijan, Turkmenistan, and, to a lesser extent, Uzbekistan suffered the consequences of lower gas and oil prices. While the Russian economy is showing signs of recovery, admittedly timid but real, and the prices of many commodities are not expected to drop significantly in 2017 (see inset 2 on oil prices), the CIS region's growth prospects appear more positive. Hence, Coface rewarded CIS countries with upgrades (chart 4), including Russia and Uzbekistan this quarter and Armenia in Q1 2017.

Certain countries of the region could benefit from the upturn in activity in Russia through trade and immigrant workers' remittances. The Russian economy's exit from recession should translate into an increase in employment but especially in wages, at least in certain sectors, which would involve higher remittances to their country of origin. These remittances to the CIS already began to grow very modestly (less than 1%) in Q4 2016, but for the first time in more than two years. This increase could have a positive effect on the consumption of countries that have an economy dependent on remittances and a high proportion of immigrant workers in Russia (particularly in construction and retail): especially Armenia and Uzbekistan, the top destination of private transfers from Russia to the CIS.

8/
Including Georgia and Ukraine, which are no longer members of the CIS

9/
See Panorama *"The rise and rise of political risks"* published in March 2017. http://www.coface.com/News-Publications/News/New-Coface-Political-Risk-Index-in-159-countries

Chart 7
Growth forecasts in CIS countries



Source: Coface

In addition, the exports of several economies of the CIS, highly dependent on Russia in terms of trade (Belarus, Armenia, Tajikistan, with 46%, 20%, and 22% of their exports respectively headed to the Russian market) should benefit from more dynamic Russian demand. The expected reduction of inflationary pressures in the majority of the economies (especially in Azerbaijan, Kazakhstan, Belarus, and Moldova) could also drive household consumption. The gradual easing of monetary policies begun in 2016 by several central banks should continue in 2017, fostering investment as well.

Additionally, the prices of many commodities, without increasing significantly, should not experience any downward trends. They should therefore support the economy of hydrocarbon-exporting countries of the region (Azerbaijan, Turkmenistan, and Kazakhstan, with hydrocarbons representing more than 90%, 75%, and 70% respectively of export revenue and, to a lesser extent, Uzbekistan - 15%) or cotton-exporting countries (approximately 10% of exports of Uzbekistan and Tajikistan), for example.

However, there are still two sources of concern: political risk and the fragility of the banking sectors in certain countries. According to the Coface political risk index[9], the score of CIS countries averaged 47% in 2016, with Georgia having the region's lowest level of risk (28%) and Ukraine having the highest (70.8%). The overall score for the CIS has increased by 5% since 2007. In Uzbekistan, the level of political risk (46%, which represents a moderately high risk), comparable with that of the Democratic Republic of the Congo and Laos, has been relatively stable since 2012. Although still unstable, the political situation could improve with the election of Shavkat Mirziyoyev in December 2016, after the death of Islam Karimov, who had led the country since its independence.

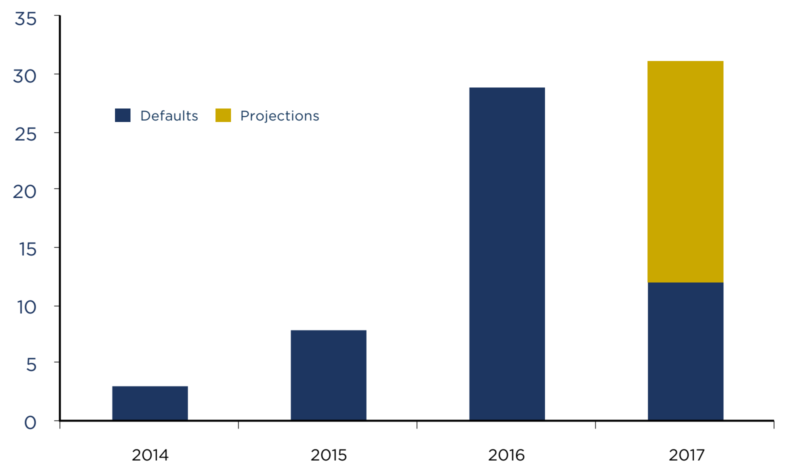
Moreover, the situation of the banking sector needs to be watched, particularly in Kazakhstan and Azerbaijan. The depreciation of the currencies of these two countries in 2014 and 2015 has had a very major impact on their banking institutions, given the strong dollarisation of the sector. Despite various measures taken to stop their situation from deteriorating, these two countries have needed to intervene to prevent the bankruptcy of large institutions: Kazakhstan's government created a hive-off vehicle to transfer the non-performing loans of Kazkommertsbank (the country's number 1 bank, centralising 37% of assets), whose capital was taken over by a private bank (Halyk Bank). The International Bank of Azerbaijan (IBA, concentrating 40% of assets) benefited from public financial support through the sovereign fund SOFAZ. While the risk of a systemic crisis is not the most likely scenario in these two countries, the sector is vulnerable, and the difficulties of these large institutions could weigh on the revival of growth.

4 CHINA: END OF GOOD NEWS

Since the beginning of the 2nd quarter, the signs of a slowdown in China's economic activity have increased. The usual monthly barometers (industrial production, fixed capital investment, and retail sales) were all down in April and May. For the first time since June 2016, the PMI manufacturing business confidence index fell below 50, which is supposed to represent the limit between expansion and recession.

Real estate prices are following the same trend: their growth is at their lowest point since August 2016 (+10.7% year on year in April 2017 for the average home price in 70 major cities versus 11.3% in March). However, since mid-2016, Chinese growth had been largely driven by the construction sector (which directly and indirectly accounts for approximately one third of GDP). In the face of the risk of price overvaluation and speculation in the major cities, the authorities have changed their tune and introduced more stringent measures regarding ownership (minimum holding period for new homes) and lending: the central bank toughened its monetary policy on two occasions in February and March.

Chart 8
Number of Chinese corporate bond market defaults



Source: Bloomberg

In this context of more difficult lending conditions, the risk of company insolvencies is increasing: 12 companies have already defaulted on at least one of their bonds since the beginning of 2017. If this pace continues until December, the record number of bond defaults set in 2016 will be broken (see chart 8). This trend is also in line with the results of Coface's annual corporate payment survey of 1,000 Chinese companies, which shows an increased proportion of payments more than 150 days late at the end of 2016 (15% of the total, compared with less than 10% in 2015 and 5% in 2014)[10].

5 AN UPTURN IN GROWTH BENEFITS INDUSTRY IN GENERAL AND THE AUTOMOTIVE SECTOR IN PARTICULAR

Just as an upturn in global growth after a recession does not benefit all countries, it also does not benefit all business sectors. The Bureau of Economic Research, which serves as the reference in business cycle dating in the United States, defines recession as a *"significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales"*[11]. In addition to the recession period, three other cycle phases are often identified:

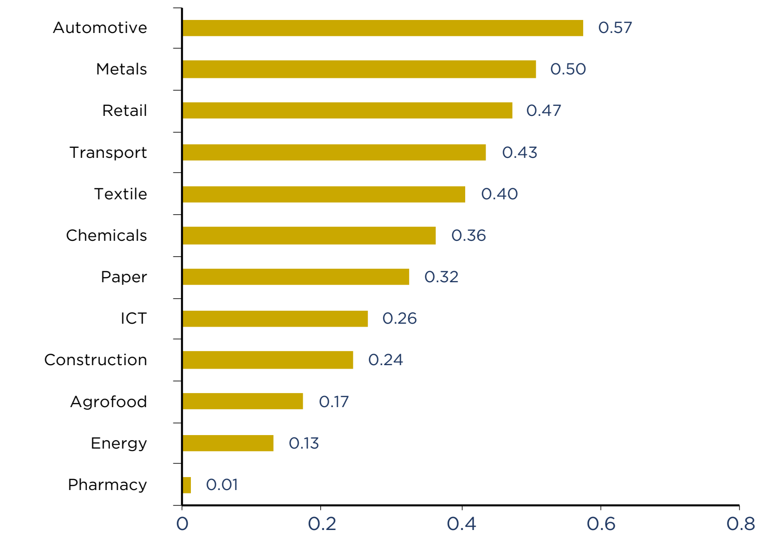
- **Recovery:** the above activity indicators improve, credit growth and corporate profit growth are positive, and interest rates remain low because the monetary policy is still expansionary;
- **Expansion:** growth of activity indicators and credit growth both reach their peak. Interest rates rise because the monetary policy is less expansionary;
- **Slowdown:** growth decreases, lending conditions harden, corporate profits decline, and inventories increase.

In order to identify the business sectors likely to benefit from the current recovery of global activity, we measured the coefficient of correlation between value-added growth in volume of 12 business sectors and GDP growth between 1985 and 2016 in 15 countries[12]. Unsurprisingly, the correlation between activity growth in the pharmaceutical sector and GDP growth of the country is virtually zero on average for our sample of 15 countries.

10/ http://www.coface.com/News-Publications/Publications/China-corporate-payment-survey-the-devil-is-in-the-detail
11/ http://www.nber.org/cycles/jan08bcdc_memo.html
12/ United States, Japan, United Kingdom, Germany, France, Spain, Italy, Portugal, China, Indonesia, India, Brazil, Mexico, Turkey, and South Africa.

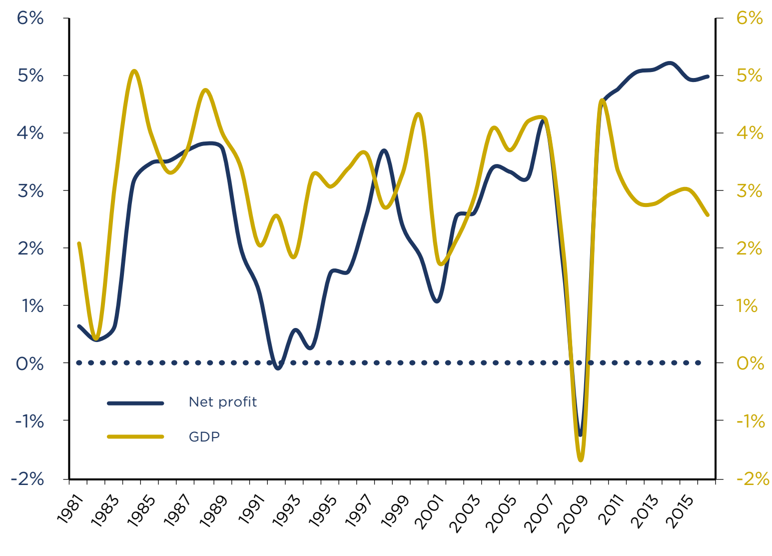
This sample group benefits from increased social spending in a recession period (particularly when the government lets the automatic stabilisers play out and/or implements a countercyclical budgetary policy). The correlation is positive but low for agri-food and energy, with demand in these sectors varying relatively little depending on income and therefore growth. Many goods produced by companies in these sectors, such as food, meet primary needs.

Chart 9
Correlation coefficient between GDP growth and added value growth of 12 business sectors between 1985 and 2016 (average of 15 countries)



Source: Coface

Chart 10
Global GDP growth and net margin rates of listed companies in the automotive sector



Sources: Thomson Worldscope, Coface

Construction, paper/wood, ICT, and chemicals hold an intermediate position. On average, the coefficient is relatively high in distribution, transport, and textile/clothing, i.e., goods that meet more secondary needs and are therefore subject to demand that fluctuates according to income. Lastly, two sectors appear to be highly correlated with GDP: metals (whose sectoral rating was raised in China and Brazil in the 1st quarter[13]) and especially automotive. In most cases (9), automotive is the sector whose added value fluctuations are the most correlated with GDP growth. The coefficient is above 0.5 in most countries in the sample.

A rebound in economic activity changes the perceptions of households and businesses, particularly when it is global. The unemployment rate falls, and consumers are more confident and therefore consume more, particularly durable goods such as vehicles. In a recovery period, interest rates remain low, giving households more ability to take on debt to finance vehicle purchases. However, in developed economies, vehicles are increasingly being financed through leases with an option to buy. That is the case in the United Kingdom and the United States, two countries ahead on the vehicle sales cycle compared with the eurozone.

Nevertheless, chart 10 highlights a divergence since 2011 between the rate of GDP growth and the growth in net margin ratio (ratio of net margin to turnover) of the sector's players. The slowdown in global growth has not prevented manufacturers and equipment suppliers from achieving record profitability rates and therefore a downturn in the net debt ratio (20.8% at the end of 2016). Thanks to the countercyclical support of several governments for their automotive industry (through cash-for-scrap programmes in the United States and Western Europe, as well as fiscal measures in China), manufacturers have been able to sell off their vehicles during recession periods. In addition, the inclusion of increasingly stronger technological content in vehicles, especially to meet environmental requirements and consumers' desires for access to driving assistance tools, is driving greater profitability. The same goes for leading equipment suppliers because they are increasingly taking on the role of suppliers of innovations (and no longer just physical goods).

In this context, even though a distinction should be made between growth prospects and credit risks, it is not surprising that automotive is on average the world's lowest-risk sector according to the Coface ratings (see section on changes in country and sector ratings) after the pharmaceutical sector. After Brazil in the 1st quarter, we are now raising the rating of the automotive sector in Russia and Italy (even though the automotive sector in China has been downgraded).

13/ http://www.coface.com/News-Publications/Publications/Recovery-in-global-growth-more-than-a-flash-in-the-pan

INSET 2

Oil: growing scepticism on the market after six months of fruitless efforts

On 30 November 2016, in the aftermath of a historic deal to curtail oil production between members of the Organization of the Petroleum Exporting Countries (OPEC) and its partners (including Russia), a cautious optimism had taken hold of players of the oil market, pushing Brent and West Texas Intermediate (WTI) prices above a symbolic threshold of 50 dollars. Six months after the beginning of the actual implementation of this deal on 1 January 2017, the cautious optimism is now giving way to scepticism.

OPEC goes into extra time

This doubt stems from the admitted failure of OPEC and its partners to achieve, for now, the announced objective of rebalancing the market to put an end to a persistent excess supply that had caused oil prices to drop starting in summer 2014. At a meeting in Vienna on 25 May to assess the effectiveness of voluntarily cutting global output by 1.8 million barrels per day (Mb/d), representatives of OPEC and the countries participating in the deal acknowledged that, despite honouring the commitments made in November, the supply/demand gap was taking some time to close and that global stocks were still higher than before the quotas were put in place.
In addition, OECD reserves at the end of May 2017 exceeded their five-year average by more than 250 Mb/d, undermining the credibility of the cartel agreement. Included in the agreement signed last November, the possibility of an extension became a necessity during this second summit to which both OPEC and non-OPEC ministers were invited. However, they decided that these voluntary cuts would be extended by nine months, until the end of first quarter 2018, instead of the six-month period under the agreement reached in November 2016. Nevertheless, this highly anticipated additional three-month effort disappointed investors. Prices have since fallen under 50 dollars.

US supply on the rise

Although OPEC's influence on global output has long shaped the oil price curve, the cartel, which now accounts for only about one third of global output, has no choice but to admit the ineffectiveness of its efforts to rebalance the market. While OPEC has cut its output, this choice has fuelled the momentum of output in the United States, which picked back up in the second half of 2016. The volume of crude oil produced increased from 8.4 Mb/d in July 2016 to 9.3 Mb/d almost 12 months later, supported in particular by the light crude oil industry (including oil from shale gas). The steady increase of data from Baker Hughes on active drilling platforms suggests that the rise in US production observed in the first half of 2017 should continue. As such, in the wake of US output levels, the June reports of the International Energy Agency (IEA) and OPEC revised their oil supply growth forecasts for 2017 and 2018. However, the increase in output is not exclusively attributable to the United States.

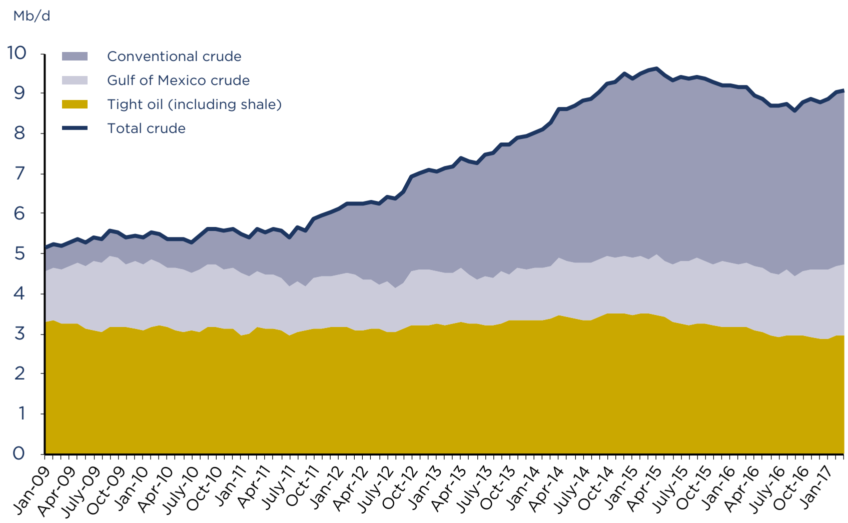
OPEC compromised by two of its members

Libya and Nigeria, OPEC members exempt from output limits due to the significant disturbances that have affected the production sites in these two countries, have also reduce the effectiveness of their fellow cartel members' actions. The recovery of activity at several production sites, confirmed in the last weeks of second quarter 2017, could allow output to reach 1.3 Mb/d in Libya and 2.2 Mb/d in Nigeria by the end of the year, compared with 528,000 barrels per day and 1.6 Mb/d respectively in October 2016 (which had served as the baseline for the OPEC output cuts). Even if they achieved only half of these targets, the increase in output would undermine the efforts by the other OPEC members and their partners by nearly one third already.

Slower increase in demand than expected

The factors for increasing global output are therefore accumulating, and, at the same time, signs that global consumption is growing more slowly than expected have increased. The data for the first half suggest some weakness in Asian demand, India in particular, and European demand. The recovery prospects for 2018 are no more positive. In its latest report, the International Energy Agency (IEA) indicated that output growth will surpass demand growth next year. In the light of the current level of stocks, output, and demand, but also the outlook for these various indicators, investors appear more pessimistic.

Chart 11
US crude oil production



Source: Enery Information Administration

Country risk assessments changes

COUNTRY	Current assessment		New assessment
JAMAICA	C	↗	B
PORTUGAL	A4	↗	A3
RUSSIA	C	↗	B
SPAIN	A3	↗	A2
UZBEKISTAN	D	↗	C

COUNTRY	Current assessment		New assessment
BAHRAIN	B	↘	C
BURUNDI	D	↘	E
EL SALVADOR	B	↘	C
MAURITIUS	A3	↘	A4
NAMIBIA	A4	↘	B
QATAR	A3	↘	A4

BUSINESS DEFAULT RISK

- A1 Very low
- A2 Low
- A3 Satisfactory
- A4 Reasonable
- B Fairly high
- C High
- D Very high
- E Extreme
- ↗ Upgrade
- ↘ Downgrade

Spain ↗
(upgrade from A3 to A2)

The economy could grow faster in 2017 than anticipated, possibly above 2.9 percent. Economy picked up in the first three months of the year thanks in part to strong exports. Spanish merchandise exports soared by 14.1% year on year in the first quarter of 2017 driven by stronger demand in emerging markets and positive European economic momentum. Consumption should remain supported by strong labor market which continues to notice resurgence in job creation and a decline in unemployment.

Jamaica ↗
(upgrade from C to B)

Country concluded the first review of an IMF stand-by arrangement in April, having achieved its primary fiscal surplus target and completed initial reforms. Gross public debt expected to reach 109% of GDP in 2017, down from 115% in 2016 and from 145% in 2012.
Positive real GDP growth has been recorded in 7 consecutive quarters, and economy is projected to grow by 2% in FY2017/18 (driven by agriculture, construction, and tourism.)
Inflation reached an all-time low in 2016 and is expected to end 2017 at 5%. Investor confidence is at an all-time high.

Uzbekistan ↗
(upgrade from D to C)

The economic growth remains dynamic and will be supported by the implementation of infrastructure projects, thanks to access to financing from World Bank and EBRD.
The more favorable commodity prices (cotton; gold) will be a tailwind to Uzbekistan's external sector.
The economic reform move from the government under the new President is likely to be positive for the country's investment and business environment.

Portugal ↗
(upgrade from A4 to A3)

After an increase of 1.4 percent in 2016, the Portuguese gross domestic product is expected to increase by 2 percent in 2017, 1.7 percent in 2018. Export contribution will remain strong as external demand and the effect of the actual depreciation of the euro have more than offset the negative effect of the change in terms of trade associated with the oil price rise. Consumption growth will remain strong but it will increase at a slower pace than 2016 constrain by a higher inflation. Also, European Commission's recommendation to end the disciplinary process for its excessive budget deficit marks a turning point and shows growing confidence in the economy. Portugal reduced its budget deficit in 2016 to 2.0 percent of gross domestic, down from 4.4 percent in 2015. However the country still has a debt burden and its sovereign rating have not been upgraded yet to investment grade.

Russia ↗
(upgrade from C to B)

Russian economy recovers from downturn: investment increased 2.3% yoy in Q1 2017; industrial production +2.3% yoy in April; retail sales do no longer decrease (0% in April), supported by lower inflation, now at the level targeted by CBR (4%).
The corporate profits rose by 5% yoy in Q1 2017, especially in mining and quarrying, electricity gas steam and real estate.
Recover remains slow and limited especially in the manufacturing sector where companies' net income fell.

Bahrain ↘
(downgrade from B to C)

Internal and external fiscal indicators of Bahrain remain weak. Official reserves cove less than one month's current account payments and the budget deficit reached 13.5% of GDP in 2016 and the Public debt stood at around 60% of GDP in 2016, the highest debt-to-GDP ratio in the GCC (and could reach 90% of GDP by 2021). The reduction of the deficit will take time and will depend on oil prices and fiscal consolidation.
Economic growth will slow in 2018 (from 2.3% in 2017 to 2% in 2018), as the slowdown in neighboring Saudi Arabia weighs on trade and tourism. Stronger USD may result in deterioration in international competitiveness (Bahraini dinar is pegged to the U.S. dollar), which is likely to dampen non-oil GDP growth.

Burundi ↘
(downgrade from D to E)

There is no end in sight for the domestic unrest triggered by Pierre Nkurunziza controversial third term election in mid-2015. Burundi's political trouble already weighs heavily on the Burundian economy and is expected to continue to do so in the next months. Hence, EU sanctions are unlikely to be removed since no significant progress has been made. Foreign reserves are perilously low. As a consequence, the country is also experiencing a fuel shortage that will further undermine bleak economic prospects. Plus, with inflation standing around 20%, the risk of large scale riot is increasing.

Mauritius ↘
(downgrade from A3 to A4)

If Mauritius remains among the most friendly business environment in the country, no significant reforms have been implemented. Hence, the country is slipping behind the top performers in the latest World Bank survey for instance.
The resignation in January of Sir Anerood Jugnauth, Prime Minister, because of ill health and the handing over of power to his son, Pravind Jugnauth, raised tensions and increased the risk of political instability in a fairly stable political environment.

Namibia ↘
(downgrade from A4 to B)

The country slipped into technical recession in the final quarters of 2016 and grew 0.2% in the whole year. The outlook for 2017 is lackluster in spite of a recovery in the mining sector. Lower government spending and a tighter monetary policy, which will limit consumption, is expected to weigh on growth. The economic headwinds in South Africa, Namibia's main commercial partner, are also likely to have a negative impact on Namibia. Finally, Hage Geingob support for the New Economic Empowerment Framework could also damage an economy already in the doldrums.

Qatar ↘
(downgrade from A3 to A4)

Measures imposed by Gulf states against Qatar include a blockade of land, sea, and air access and the expulsion of Qatari officials, residents, and visitors from the group of states. This may exacerbate Qatar's external vulnerabilities and could put pressure on its economic growth (reduction of regional trade, corporate profitability damaged) and current and public accounts. If the situation worsens, it may destabilize nonresident deposits (17% of GDP in 2016) and government support may be needed to offset major outflows (using Qatar Investment Authority assets). Lower foreign direct investment and portfolio flows would pressure on Qatar's currency peg.

El Salvador ↘
(downgrade from B to C)

Outlook has deteriorated rapidly on account of the worsening political stand-off. The left-wing government led by Salvador Sánchez Céren faces legislative weakness. Political tension reached a head in April when the opposition-dominated Congress refused to support a budget expansion needed to cover an USD57m principal and interest payment to local pension funds, leading to the country's first default in more than twenty years. The payment was finally made; nevertheless the increasing tension between the two powers has raised government debt payment risks.

Sectors risk assessments changes

SECTOR RISKS ASSESSMENTS OF THE REGIONS

	Latin America	North America	Central and Eastern Europe	Western Europe	Emerging Asia	Middle East + Turkey
Automotive	High	Medium	Low	Low	Medium ↘ High	High
Agrofood	High	Medium	Medium	High ↗ Medium	Medium	High
Chemical	High	Low	Medium	Medium	High	High
Construction	High	Medium	High	Medium	Very high	High
ICT*	High	Medium	Medium	Medium	High	High
Energy	High	Very high ↗ High	High ↗ Medium	High	High	High
Metals	High	High	High ↗ Medium	High	High	Very high
Paper	Medium	High	Medium	High	High	Medium
Wood	High	Medium	Medium	Medium	High	High
Pharmacy	Medium	Low	Medium ↗ Low	Medium	Low	Low ↘ Medium
Retail	High	High	Medium	Medium	Medium ↗ Low	High
Textile	High	High	Medium	High	High	High
Transport	High	Medium	High	Medium	Medium	Medium

* Information and Communication Technologies

Source: Coface

BUSINESS DEFAULT RISK

- Low risk
- Medium risk
- High risk
- Very high risk
- ↗ Upgrade
- ↘ Downgrade

LATIN AMERICA

	Latin America	Mexico	Argentina	Chile	Brazil
Automotive	High	High	High	Low	High
Agrofood	High	High	High	High	High
Chemical	High	High	Medium	Medium	High
Construction	High	High	High	High	High
ICT*	High	Medium	High	High	High
Energy	High	Very high	High	Medium	High
Metals	High	High	High	Medium	High
Paper	Medium	Medium	Medium	Medium	Medium
Wood	High	High	Medium	Medium	High
Pharmacy	Medium	Low	Medium	Low	Medium
Retail	High	Medium	High	Medium	High
Textile	High	High	High	Medium	High
Transport	High	Medium ↘ High	Medium	Medium	High

* Information and Communication Technologies

Source: Coface

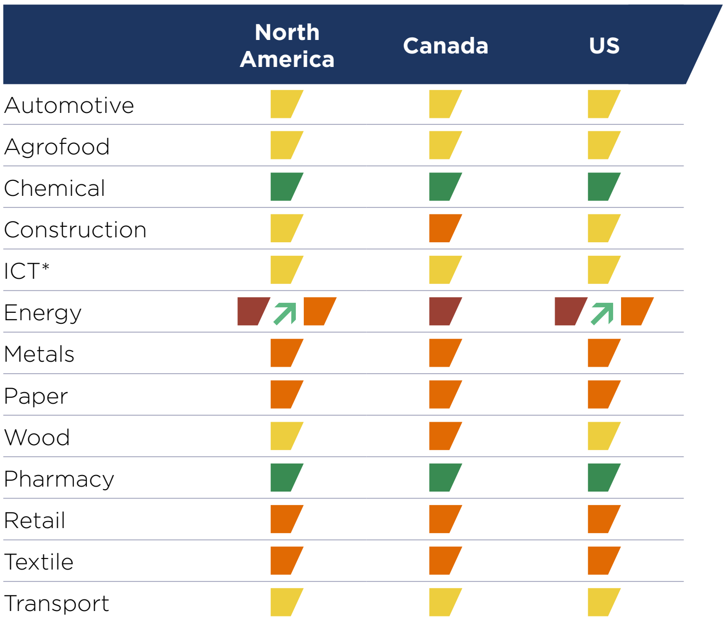
MEXICO

Transport ↘

(Medium Risk to High Risk)

Underdeveloped infrastructure is not expected to big improvements, thanks to shrinking public resources. According to data provided by the Ministry of Communications and Transportation (SCT), 80% of the goods in the country are mobilized by road.
The increase in the price of diesel with the end of subsidies this year will severely affect the transport sector. The fuel expenditure can represent from 35% to 40% of the total costs of the Transporters.

NORTH AMERICA



* Information and Communication Technologies

Source: Coface

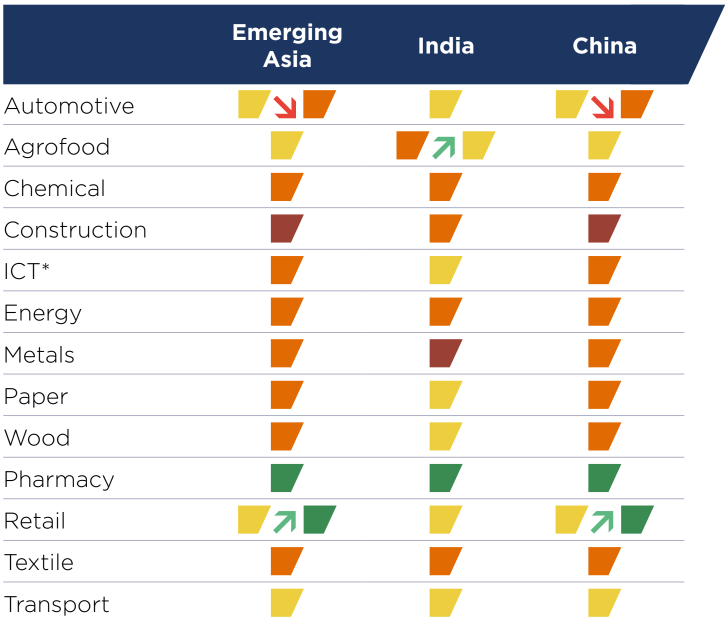
US

Energy ↗

(Very high risk to high risk)

The new US administration will cement the recovery of the US oil & gas sector. The relaxing of regulations will encourage greater upstream activity. Prices below $50 a barrel demonstrate the glut of crude persists with signs of slowing energy demand from main consumers like China, and this despite OPEC countries agreeing to reduce production, with many non-OPEC countries not following suit. The fact that crude output continues to surge in US, with increasing rig counts for the past year, indicate the importance of the US shale. The oilfield services industry concentrated in onshore oil & gas developments in US continues to grow; while offshore is still in recession and many projects on hold.

EMERGING ASIA



* Information and Communication Technologies

Source: Coface

INDIA

Agrofood ↗

(High Risk to Medium Risk)

India will brace a second consecutive year of normal rains in 2017 after two years of drought in 2014 and 2015. In 2016 normal rains led to a record production of food grains (estimated at 272m tons by the government) and a rebound in agricultural growth rate to an estimated 4.6% in fiscal year 2016/17. This compared with a dismal growth rate of 0.8% in 2015/16 and a contraction of 0.3% in 2013/14.

CHINA

Automotive ↘

(Medium risk to high risk)

Government has stepped in to limit auto sales. Including measures to reduce the sale of EVs well as well as subsidies.

Retail ↗

(Medium Risk to Low Risk)

Retail sales in China edged down in April but this can be traced back to a sharp contraction in auto sales. Demand in other categories remains robust.

CENTRAL AND EASTERN EUROPE

	Central and Eastern Europe	Romania	Czech Republic	Poland
Automotive	Low risk	Low risk	Low risk	Low risk
Agrofood	Medium risk	Medium risk	Medium risk	Medium risk
Chemical	Medium risk	Medium risk	Medium risk	Medium risk
Construction	High risk	High risk	High risk	Very high risk ↗ High risk
ICT*	Medium risk	Medium risk	Medium risk	Medium risk
Energy	High risk ↗ Medium risk	Medium risk	Medium risk	High risk ↗ Medium risk
Metals	High risk ↗ Medium risk	High risk	High risk	High risk ↗ Medium risk
Paper	Medium risk	Medium risk	Medium risk	Medium risk
Wood	Medium risk	Medium risk	Medium risk	Medium risk
Pharmacy	Medium risk ↗ Low risk	Low risk	Low risk	Low risk
Retail	Medium risk	Medium risk	Medium risk	Medium risk
Textile	Medium risk	Medium risk	Medium risk	Medium risk
Transport	High risk	Medium risk	Medium risk	High risk

* Information and Communication Technologies

Source: Coface

BUSINESS DEFAULT RISK

- Low risk
- Medium risk
- High risk
- Very high risk
- ↗ Upgrade
- ↘ Downgrade

POLAND

Energy ↗
(High Risk to Medium Risk)
The profitability of the oil refining companies is high and supports the sector.

Metal ↗
(High Risk to Medium Risk)
This sector will be helped by new investments in infrastructures and by the dynamic in the automotive sector.

Construction ↗
(Very High Risk to High Risk)
The new voted UE budget should restore the infrastructure investments cut last year. Nevertheless construction is traditionally risky with many delays in payments registered, what is additionally strengthened by the implementation of reverse VAT for construction services (boosting liquidity pressure on subcontracting companies).

MIDDLE EAST + TURKEY

	Middle East + Turkey	Turkey	UAE	Saudi Arabia
Automotive	High risk	Medium risk	High risk	High risk
Agrofood	High risk	High risk	High risk	High risk
Chemical	High risk	High risk	High risk	High risk
Construction	High risk	Very high risk	High risk	High risk
ICT*	High risk	High risk	High risk	High risk
Energy	High risk	High risk	High risk	High risk
Metals	Very high risk	Very high risk	Very high risk ↗ High risk	Very high risk
Paper	Medium risk	Medium risk	Medium risk	Medium risk
Wood	High risk	Medium risk	High risk	High risk
Pharmacy	Low risk ↘ Medium risk	Low risk	Low risk ↘ Medium risk	Low risk ↘ Medium risk
Retail	High risk	High risk	High risk	High risk
Textile	High risk	High risk	High risk	High risk
Transport	Medium risk	Medium risk	Medium risk	Medium risk

* Information and Communication Technologies

Source: Coface

UAE

Metals ↗

(Very high risk to High Risk)

Challenging conditions in construction across the GCC region may weigh on metals demand. Metal prices are expected to remain volatile in the upcoming period which would narrow profit margins. Especially, expectations of a slower demand from China due to the credit tightening in this country have pushed down iron ore prices by 15.6% between January-May 2017 from a year earlier. This decline in prices have begun hurting the share prices of major mining companies which may also hit producers in the UAE. However, regarding the domestic fundamentals, the UAE will continue to be a key driver of metals demand as the country embarks on an infrastructure spending binge. Hosting of the World Expo 2020 and higher economic growth expected in 2018 would help steel and aluminum consumption growth to reach double digits. Production growth will also rise given plans by Emirates Global Aluminum and Emirates Steel and ensure the country maintains its position as the Gulf's largest metals exporter in the coming decade.

Pharmaceuticals ↘

(Low Risk to Medium Risk)

Delays experienced in Abu Dhabi due to government lower spending on healthcare are causing liquidity issues.

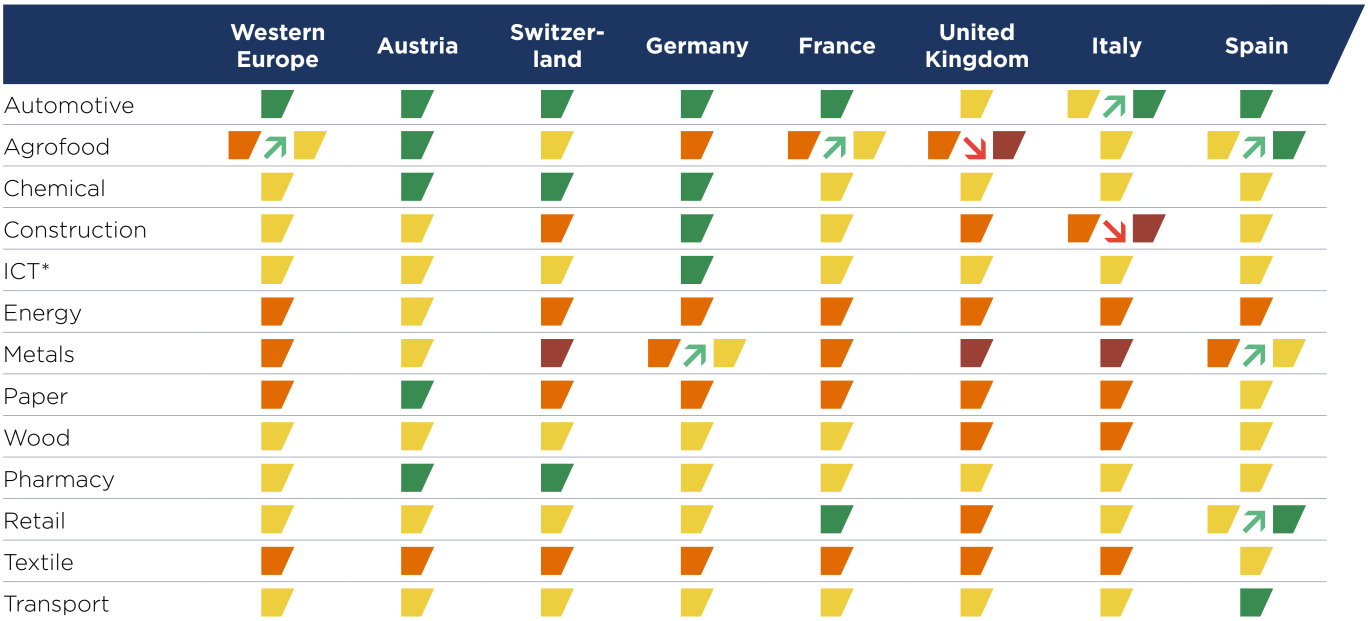
SAUDI ARABIA

Pharmaceuticals ↘

(Low risk to Medium Risk)

Highly dependent on government spending which are lower than previous years.

WESTERN EUROPE



* Information and Communication Technologies

Source: Coface

GERMANY

Metal ↗

(High Risk to Medium Risk)

Positive outlook due to stabilizing metal prices and the good dynamic of customer metal sectors as automotive, construction and engineering.

FRANCE

Agrofood ↗

(High Risk to Medium Risk)

French cereal growers are doing better, after a year 2016 when they suffered bad harvests.

UK

Agrofood ↘

(Medium Risk to Very High Risk)

Higher input costs resulting from sterling pound depreciation start to weigh on companies margins in a highly competitive industry. Food inflation now evident as retailers start to pass supplier price rises to consumers. Besides, agribusiness is among the most likely sector to be affected by Brexit due to lower public funding from Common Agricultural Policy (CAP), weak investment, and higher labor costs.

ITALY

Automotive ↗

(Medium Risk to Low Risk)

Very good trend in 2016 with volumes increased by over 15% in Italy thanks to several factors including growth of customers confidence, fuel prices decline, promotional campaigns by automakers, growth of "car sharing". Further good trend expected for 2017.

Construction ↘

(High Risk to Very High Risk)

Weak performance of the sector during Q4 2016 which should impact the profitability of construction companies in 2017.

SPAIN

Agrofood ↗

(Medium Risk to Low Risk)

The agrofood sector should continue to benefit from both domestic and external demand. The sector grew by 2.1 in the first quarter compared to the previous quarter and by 4% year-on-year. On the external side, agrofood exports accounted for 16.7% of total exports and increased by 15.6% per year according to March 2017 data. The contribution to export growth reached 2.6 percentage points and it was the second contribution after capital goods. The Ministry of Commerce's business surveys also show that the sector exporters are anticipating an increase in their sales over the next two months.

Metal ↗

(High Risk to Medium Risk)

According to industrial production data, metal processing has grown by 4% in December and by 1.8% compared to 2015 and the sector slow recovery has managed to reach almost the level it had in 2011. Capital goods had also increased by 3.3% in December and by 2.3% in the whole year. Metal structures, on the other hand, continue to fall year-on-year although there is already a possibility of improvement.

Retail ↗

(Medium Risk to Low Risk)

Strong domestic demand driven by dynamic household consumption would continue to support the retail sector. Sales rose by 0.6% in April 2017 comparing to the previous month and increased by 2% since the beginning of the year. The department store recorded the largest increase with 1.1% month-on-month in April, as well small chain stores sales, which grew by 0.9%. Excluding services station, retail sales across all channels combined increased by 2.4%.

BUSINESS DEFAULT RISK

- Low risk
- Medium risk
- High risk
- Very high risk
- ↗ Upgrade
- ↘ Downgrade

OTHER COUNTRIES

	South Africa	Russia	Japan
Automotive	High risk	Very high risk ↗ High risk	Medium risk
Agrofood	High risk ↗ Medium risk	Medium risk	Medium risk
Chemical	High risk	Medium risk	Medium risk
Construction	Very high risk	Very high risk	Medium risk
ICT*	Medium risk	High risk ↗ Medium risk	Medium risk
Energy	High risk	Medium risk	High risk
Metals	Very high risk ↗ High risk	High risk	High risk
Paper	High risk	High risk	High risk
Wood	High risk	High risk	Medium risk
Pharmacy	Medium risk	Medium risk	Medium risk ↗ Low risk
Retail	Medium risk ↘ High risk	High risk	High risk ↗ Medium risk
Textile	High risk	High risk	High risk
Transport	High risk	High risk	Medium risk

* Information and Communication Technologies

Source: Coface

RUSSIA

ICT ↗

(High risk to Medium Risk)

Lower inflation, gradually increasing demand throughout the economy and increasing profitability of the corporate sector are expected to boost business confidence and support fixed investment. The modernization of the production capacities will support the ICT sector.

Automotive ↗

(Very high Risk to High Risk)

After 2 consecutive years of decrease, sales of new passenger cars and LCVs increased by 9,4% in March 2017, compensating for losses in January-February and allowing a slight positive result for Q1 2017 (first one in more than 4 years). This trend is expected to continue, slowly, and the automotive market may recover slightly in 2017 (+11% oxford economics forecast), especially for LCV.

Production of new vehicles is expected to increase in 2017, driven by higher domestic demand.

JAPAN

Pharmacy ↗

(Medium Risk to Low Risk)

This sector is less profitable with a deterioration of the day sales outstanding.

Retail ↗

(High Risk to Medium Risk)

Domestic demand hasn't fully recovered to the pre sales tax hike levels, but retail sales have picked up (3.2% in April vs. 2.1% in March) supported by higher wages. Moreover Abe is expected to postpone the next sales hike to 2019. JPY depreciation has also favored tourism revenues. This is a tailwind that could run out of steam in case JPY appreciation returns, but widening interest rates diffs with the US should, at least in theory, continue to exert depreciatory pressure going forward.

SOUTH AFRICA

Retail ↘

(Medium Risk to High Risk)

Internal and external headwinds, including high unemployment (27.7% in Q1 2017), inflation (5.3%), and political uncertainties, are currently weighing on the retail sector and will continue in the next few months. After growing at a sluggish pace in 2016 (+1.9%), retail sales contracted for the first time on a quarterly basis since 2009 (-1.0% in Q1 2017).

Agrofood ↗

(Very High Risk to High Risk)

The general agricultural conditions sub-index improved by 4 index points in the first quarter of this year to 69. This is largely supported by the favourable outlook for the 2016/17 production season. The National Crop Estimate Committee's first production estimates for summer crops reached 16.21 million tonnes, up by 72% from the previous (exceptionally weak) season. This could be the largest crop since the 2013/14 production season on the back of favourable weather conditions.

Metals ↗

(Very High Risk to High Risk)

While 2015 was considered an *annus horribilis* for the global steel industry, with the price of the alloy falling to its lowest level since 2004 and consequently causing several steel producers to cut capacity or simply close shop, there was a slight recovery in 2016 and the industry seems to be on the mend going into 2017. Global mining production is on the rise in Q1 2017 (+7.2%), especially platinum production.

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