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Major Country Developments
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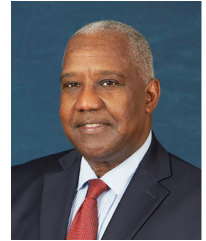

By Byron Shoulton

Overview

We enter 2019 with a number of uncertainties dominating the outlook for global growth. An accumulation of doubts concerning the outcome of major challenges confronting the global economy combined to hit investor confidence hard in December, continuing the turmoil in global equity markets and registering significant losses to investment portfolios for 2018.

The turbulence continues into 2019 without signs of imminent resolutions to several unresolved issues still on the negotiating table. This is contributing to a general lowering of confidence and little expectation that sustained global economic growth will be attained in 2019. Whether it's the partial government shutdown in the U.S. due to a dispute between the Administration and congress over funding a wall on the southern U.S. border; or the ongoing malaise affecting the Chinese economy, tense U.S.-China relations, or the impact of higher tariffs on trade flows; or the lack of a Brexit deal with the EU; rising U.S. interest rates; political strains and weakened economic growth across the EU; a tepid outlook for growth in Asia and Latin America; weak oil and commodity prices or fears that the U.S. economic recovery has peaked: markets appear to have little about which to cheer as we begin 2019.

Critically, the level of global debt has never been higher – at approximately $250 trillion. This figure is three times higher than total global debt two decades ago. The biggest borrowers: the U.S., China, the Eurozone and Japan account for two-thirds of the world's household debt, 75% of corporate debt and close to 80% of all government debt. Large debt loads can be a sign of trouble if borrowers are unable to repay. Large piles of untested borrowing have built-up over the decade since the financial crisis: corporate debt in China, foreign currency borrowing in emerging markets and new popular forms of debt among American households. While debt can spark growth, giving business and governments fuel for industry and infrastructure improvements, excessive debt can be a drag on economic growth and impede the ability of governments to respond to downturns, thereby prolonging recessions.

The consensus is that we have entered a new era and current debt levels should serve as early warning signals, alerting us to overheating in specific countries and sectors. Hopes of a fresh surge in global growth have faded over the past few months and tightening financial conditions and signs of strain in credit markets have begun to feed into fears of a recession or the likelihood of another debt crisis surfacing in the not too distant future. While companies in the developed countries have binged on debt (encouraged by low interest rates), government debt has also grown sharply higher. As the need for debt rollovers and new government debt issues proliferate in the years ahead, there is the possibility of that trend acting to crowd-out private sector needs in the credit markets.

In advanced economies, including the U.S., highly indebted companies represent a growing concern. Businesses in the U.S. spent the post-crisis years taking advantage of ultra low interest rates to borrow cheaply, driving corporate debt to roughly 46% of GDP. While tax cuts have boosted companies' coffers recently, the growth of debt relative to earnings over the past few years also led to large quantities of corporate bonds rated at the bottom level of the investment grade range. This is a worrying trend that would hurt investors and creditors should there be an economic shock that leads to widespread down-

grades. Lenders are pulling back in certain areas, lowering credit limits for sub-prime borrowers and tightening underwriting criteria for new lending.

Companies in emerging markets, for example China, have binged even more – part of a broad surge in borrowing across the developing world. Much of that debt is denominated in foreign currencies. Emerging markets will need to pay down or refinance approximately $2 trillion of debt in 2019. Tightening monetary policy in the U.S. and other advanced economies, along with a recent rise in the U.S. dollar, makes it harder for developing economies to pay off their loans as agreed. Meanwhile, some important measures of debt have also declined in recent years. U.S. household debt, which soared ahead of the financial crisis, fell steeply afterward. Now it is poised to top $4 trillion for the first time. With robust wages and relatively high savings, Americans so far, show few signs of difficulty in managing the debt load.

Borrowing by banks has also declined, leading to a more stable and resilient financial system than the one that stumbled through the global financial crisis. However, in some ways, curtailment of bank debt may have been overdone. Banks, for example, have retreated dramatically from cross-border lending which has and will continue to hurt access to trade financing needs. According the Bank of International Settlements the total amount of cross-border bank debt has dropped from a peak of $35.45 trillion in 2008 to $29.46 trillion in 2018, a fall of approximately 17%.

German, Dutch and Austrian banks have reduced their foreign loan books by more than half since 2008, while Belgian banks cut their international exposures by more than 80%. In Asia the reverse is true. Across the region, banks have increased their cross-border lending, with Japanese banks leading the trend. Cross-border credit extended by Indian, Singaporean, Taiwanese and Malaysian banks has continued to climb. Chinese banks also saw overseas lending rise by more than 40% since 2015.

USA

Stock markets stumbled recently (its worst decline since the financial crisis) in part over concerns that American companies and manufacturers are starting to feel the effects from the slowdown in China and the trade war. Deepening fears that the economic slowdown in China and Europe would eventually hurt the U.S. economy, became a reality when Apple revised its 2019 outlook citing slumping sales of its iPhones in China. Other U.S. companies with strong sales in China are paying attention.

Furthermore, recent U.S. manufacturing data show the biggest fall in manufacturing activity since 2008, and business confidence fell to the weakest level in more than two years, according to the Institute for Supply Management. Many manufacturers blamed rising costs related to tariffs. Still, the index reading of 54.1 for December showed an economy in expansion.

The recent weak U.S. manufacturing data represents a shift from last year, when economic figures generally held up even as the stock market sank in the fourth quarter. However, the downbeat economic data and the rout in stock markets were upended by December's jobs report which indicated that 312,000 new positions were filled. The report greatly exceeded projections of 180,000 jobs and was the biggest jump in hiring since February 2018. The official unemployment rate now stands at 3.9% [up from 3.7%] due to additional workers joining the workforce in search of jobs (a sign that companies are luring stragglers back). Job openings have hit record highs, and a growing number of workers are quitting, indicating confidence in their ability to find jobs. Workers average wages increased by 3.2% in December, a solid pick up after months of only small upward movements in pay. The news boosted appetite for stocks again, which may represent a turning point in sentiment. It suggests that the real economy maintained strong momentum at the end of 2018 even as financial markets sank. Widespread employment [if the trend holds] can go a long way toward maintaining growth momentum in an economy where consumer

spending accounts for two-thirds of GDP. Early data suggest retailers had the strongest holiday shopping season in six years, while inflation remains remarkably tame.

U.S. budget and trade deficits have grown higher and are set to continue growing; making it impossible to garner support for any new government-led stimulus measures. There is no need for such stimulus. To the contrary, the consensus is for continued Federal Reserve unwinding of its monthly buying of government securities.

Reversing decades of U.S. reliance on supplies of foreign goods remains illusory, despite U.S. imposition of tariffs on imports from numerous trading partners. Counter-tariffs and boycotts against American goods, especially impacting U.S. farming and agriculture exports is a source of quiet seething, which is only partly compensated for via U.S. government payouts to reimburse farming sector exporters for some of their losses.

Meanwhile, resilient U.S. consumer confidence [which drove spending on autos, new construction, real estate, job creation, etc.], have also weakened recently. Consumer sentiment will be solidly tested in 2019 and will help to determine interest rate policy going forward. Mostly, we expect interest rate increases will be on hold or kept to a minimum in 2019 given low inflation and the number of uncertainties hovering over the global economy. Uncertainty about U.S. growth after interest rates steadily rose last year remains a concern. Some complain that borrowing costs are rising too quickly, yet any weak economic data that could give the Federal Reserve more freedom to cool its pace of rate increases would stoke fears of softer-than-expected growth.

While most of the U.S. economy appears to be humming along, two sectors are vulnerable to recent developments in global markets. One is the oil industry, which boomed for most of 2018 but may have suffered from falling prices toward the end of the year. The other is the slowdown in the housing sector with hints that the auto industry could be next.

China

China's overall economic picture has turned decidedly downbeat. Retail and auto sales continue to decline and the manufacturing sector registered a contraction in December, confirming the ongoing slowdown in demand. So far, the government's attempts to stimulate the economy, including targeted bank lending, have not worked. Officials pledged in December to step up support of the economy as they face new urgency to act. The central bank announced that it will inject $218 billion into the financial system to ease lending. This will be accomplished by reducing the amount of cash that commercial banks hold as reserves by one percentage point.

A significant pullback by Chinese consumers could have a big impact on a world looking for engines of growth; on companies that count on China's continuing expansion and on global investors who have long viewed Chinese consumers as a steady source of profits.

The ninety-day window to hold talks between the U.S. and China to resolve the months-long tariff fight that has dented investor confidence, are due to wrap up on March 1, 2019. China has offered some concessions which could influence the removal of U.S. threats to impose additional tariffs. But more needs to be done; especially addressing charges of intellectual property theft and forced technology transfer, which the Chinese are accused of. Negotiators from both countries are scheduled to meet shortly for the first time since the 90-day cooling off period was decided on.

Trade tensions have weighed on global economic growth prospects, with knock-on effects for oil demand. There are strong incentives to ratchet down the intensity of the dispute between the world's two largest economies. It is not in the U.S. or China's interest to continue along a path of confrontation over

trade and related issues - while global economic sentiment and stability are at their lowest levels in a decade.

U.K.

The UK economy continue to falter due to the many unknowns of Brexit. A recent survey of purchasing managers indicated no growth in the s ervices sector. Uncertainty over the fate of Prime Minister Theresa May's Brexit plans is taking a toll on the British economy. While some businesses have been stockpiling goods ahead of the UK's planned departure from the European Union, growth in services businesses has stopped. Meanwhile, British businesses and consumers largely held off making purchases in the final quarter of 2018 according to recent data. The year-end figures show that the economy is heading to near stagnation ahead of the Brexit deadline.

Meanwhile, the UK government is on a charm offensive in Southeast Asia meant to be a marker of the country's post-Brexit ambitions. A sort of indicator of what a new British foreign policy would look like as the EU exit door fast approaches. The UK's foreign secretary visited Singapore and Malaysia to underscore British interest and its strength in areas such as security and London's wide-ranging commercial, diplomatic and governance expertise. The aim appears to be to beef up Britain's security and ambassadorial presence in Southeast Asia while expanding and strengthening commerce between the UK and the region. Other countries will be added to the list.

Eurozone manufacturing data hit its lowest level since February 2016, the latest sign of cooling growth in Europe.

Argentina

The Argentine economy faces some challenges in 2019. The country struggles to come out of recession, having suffered a severe drought in 2018 followed by a much deeper currency crisis beginning in August 2018. The main driver behind the of peso's value and high inflation (48%) were expansionary fiscal policies. The government is keenly aware of this, and by the start of 2018 had introduced fiscal adjustments, cutting back on printing money, etc. New fiscal targets which form part of the $57 billion lending arrangement with the IMF have been tightened. The government must eliminate the primary fiscal deficit in 2019 [from a deficit of 2.7% in 2018]. It has also agreed to reduce a variety of government subsidies [e.g. energy, power]; and will consider reducing spending on select social programs.

The IMF supports these adjustments but they will only succeed if Argentinians accept that they are in the country's best interest over the medium term. That would help to restore domestic confidence. Still, protection of important aspects of the social safety net will be key if the sitting Macri government is to be reelected in the upcoming 2019 presidential elections. Recent data suggest that Argentine exports picked up pace in the final quarter of 2018, causing the trade deficit in goods to swing to its biggest quarterly surplus in many years.

Brazil

In January President Jair Bolsonaro of the right-wing Partido Social Liberal (PSL) begins a four-year term after securing a reasonably firm mandate to pursue free-market, anti-corruption and socially conservative reforms in the historic 2018 elections. Winning support for his agenda in Congress will be a key test, starting with a much-delayed, unpopular pension reform. This will be challenging given a fragmented legislature, with 30 parties in the lower house and 21 in the Senate. At stake is whether Brazil's cyclical recovery peters out amid renewed concerns over debt sustainability (and inflation), or whether greater progress on economic reforms can lift Brazil's GDP

growth rate to 3% and above over the medium term. Investors and creditors will be watching keenly for signs of tangible progress.

Turkey

Despite recent gains the Turkish lira still lost almost 30% of its value against the U.S. dollar in 2018, putting a strain on Turkish companies with foreign currency debt. Some 846 firms applied for bankruptcy protection in 2018, according to government statistics. Independent analysts say the number may be in the thousands. Some of Turkey's largest conglomerates have had to renegotiate debts worth billions of dollars.

It is not surprising therefore that Turkish citizens are leaving the country by the thousands, taking their talent and capital – and confirming an alarming loss of confidence in President Erdogan and his vision for economic recovery. Following his 2018 re-election which gave Erdogan greater powers under a new constitution, the Turkish economy grew at half the rate of the previous year while the lira plunged.

Amidst growing evidence of cronyism and enhanced authoritarian rule, more than 250,000 Turks emigrated in 2017 (up from 178,000 in 2016), a trend that continued briskly in 2018. In previous waves of immigration students and teachers led the march, but this time the exodus is a virtual brain and capital drain.

The flight of talent and capital is being driven by a combination of forces. They include fear of political persecution, terrorism, a deepening distrust of the judiciary and the arbitrariness of the rule of law, a deteriorating business climate, accelerated by concerns that President Erdogan is manipulating management of the economy to benefit himself and his inner circle.

The result is that, for the first time over several decades, the well-off and secular elite who have dominated Turkey's culture and business life, are moving away and the "new rich" close to Erdogan and his governing party are taking their place. Some of those leaving were participants in protests against the government who Erdogan denounced as delinquents. They have endured arrests and harassments and now feel they need a fresh start away from state violence practiced against citizens.

Thousands of academics, designers, the technically trained and entrepreneurs have applied for business visas in Britain or for golden visa programs in Greece, Portugal and Spain, which grant immigrants residency if they buy property at a certain value level. Estimates are that 10,000 Turkish citizens moved to the UK under the business visa plan, with a sharp jump in applications. Applications for asylum in Europe by Turkish citizens have also multiplied over the past three years.

Worldwide the number seeking asylum has moved from 10,000 in 2017 to more than 33,000 in 2018. Most of those now leaving say they do not want to return to their homeland, citing the polarized political climate in the country. Families are reportedly setting up businesses abroad for the next generation to inherit. At least 12,000 Turkish millionaires – representing around 12% of the country's wealthy class – moved their assets out of Turkey between 2016 and 2017. The 2018 figure is not yet available. Most moved to Europe or the United Arab Emirates. Istanbul, Turkey's largest business center, has been listed among the seven top cities worldwide experiencing an exodus of wealthy (and skilled) individuals.

President Erdogan has sought to make Turkey more conservative and religious, with a growing middle class and a tight circle of elites who are especially beholden to him for their economic success. With the help of subsidies and favorable contracts, the government has helped new businesses to emerge, and they are rapidly replacing many of the old ones. A transfer

of capital is underway – a form of political and social engineering. Some departing citizens point to life in Turkey as becoming very tense in recent years and cite fears of civil strife or the possibility of even civil war developing between Erdogan supporters and their opponents.

Many of those who have moved their assets abroad have been labeled traitors by the president as reports grow that some of Turkey's largest companies are divesting in Turkey. Several such companies have made significant transfers of capital abroad, amid fears they would be targeted in the post-coup crack-down or as the economy began to contract. By one estimate several billions of dollars have fled Turkey in the last couple of years, especially after the coup attempt when people started to feel threatened.

The trend may lose some momentum in 2019 as the lira has rebounded to its highest level since August last year. Inflation which is at 25% year-on- year has dipped by five points over the past two months, thanks to a series of interest rate hikes. While the outlook for the economy remains subdued, the finance minister [the president's son in law] has received recent cautious praise from bankers and analysts.

The impact of last year's currency crisis, exacerbated by years of runaway borrowing and central bank inaction, is continuing to negatively impact the economy. Growth in the third and final quarters of 2018 dwindled to 1.6%, down from 5.3% in the second quarter. Moody's predicts that the economy will shrink by 2% in 2019 while the IMF expects it to expand by a mere 0.4%. Most observers side with the Moody's prediction.

Saudi Arabia

King Salman announced sweeping changes to the Saudi cabinet in December representing the first shake-up of the kingdom's power structures since the killing of journalist Jamal Khashoggi in October. Crown Prince Mohammed bin Salman retains his wide-ranging powers, but the reshuffle is viewed as the king attempting to send a signal that he has responded to the crisis that followed the journalist death. Former trusted advisers to the king have been brought back to head sensitive posts, a sign of attempts to regain a sense of stability.

Some regard the cabinet reshuffle as the monarch wanting to bring more experience to a government that has been increasingly staffed with figures from the private sector and younger confidants of the crown prince. There has been lots of speculation that King Salman needed to establish checks and balances to rein in some of the crown prince's rasher impulses. Significant changes included the appointment of a national security adviser and, the naming of a former finance minister as foreign minister. The ministers of the National Guard, media and education were also replaced.

Meanwhile, the kingdom has pledged to lift spending by 7.4% in an effort to boost the economy. The 2019 budget was released. The deficit is officially forecast at $35 billion or 4.2% of GDP, similar in size to the 2018 budget.

Global crude prices moved higher, buoyed by a supply cut from major suppliers led by Saudi Arabia. Assuming demand holds up this is the result which the Saudis have been seeking to help lift revenues.

Jobs are Saudi Arabia's most immediate headache. It needs to create 1.2 million new jobs by 2022 to meet its target of 9% unemployment for Saudi citizens [from 12.9% currently]. To free up work for them, the government is discouraging the hiring of foreigners. Since January 2018 firms have been charged the equivalent of $107 per month for each foreign worker they employ with a discount if they employ more Saudi workers than expatriates.

The levy will double by 2020. Migrants pay another fee for each of their dependents. These charges appear to be working. Almost one million foreign workers have left Saudi Arabia since the start of 2017. However, Saudis are not replacing many of these positions. The construction sector has been disproportionately affected. It employs 45% of foreigners but suffered a 60% exodus of these workers. The number of Saudis working in construction has also fallen. Young Saudis are said to be reluctant to work with their hands – and anyway firms cannot afford them. A low-skilled foreign worker takes home 1,500 rials each month. The de facto minimum monthly wage for Saudi citizens is 3,000 rials.

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Bank A/R Purchase Policy - Non-Cancelable Limits: $50,000,000 Limit of Liability on purchased international and domestic receivables in Technology sector.

Medium Term Single Buyer Policy: $7,500,000 Limit of Liability on import finance from Central American in Auto Secttor.

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

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