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Major Country Risk Developments
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Overview

The goal of delivering Covid-19 vaccines globally is proceeding slowly while additional vaccines are being found to be effective- even as new strains of the virus spreads. The vaccine rollout continues to be slow and cumbersome as distribution challenges stymied the process of getting vaccines speedily to millions. As predicted, it is taking longer for vaccines to reach poorer communities and less developed countries continue to struggle to secure adequate supplies.

The IMF estimates that the GDP of the Group of Seven (G7) most advanced economies, contracted by 5.9% in 2020, compared with an average contraction of 3.3% in emerging and developing economies. However, according to a survey of 30,000 households in nine countries, the steep fall in employment and income in low and middle-income countries exceed economic losses experienced in advanced economies. Poor countries have suffered the most as a result of the virus and they will feel the negative effects longer. The already poor have suffered staggering hardships and if the effects persist, tens of millions of already vulnerable households will be pushed into poverty, the survey concluded. A median average of 70% of those surveyed reported a fall in income in the early months of the virus, 30% reported a loss of employment and 45% missed meals or experienced reduced food intake.

Although measures such as GDP and unemployment suggest the pandemic has had a less severe impact in developing countries than the advanced economies, that's because official data often fail to capture the high levels of informal activity prevalent in poorer countries. Over a quarter of economic activity in Africa, Asia and Latin America are in the informal sector, the study noted. In Kenya for example, the survey found a 38% increase in the rate of adults who had missed meals, and a 69% increase among children, with schools closed, falling household incomes, missed meals and a loss of access to healthcare. The results of the survey are consistent with a World Bank report which warned that the pandemic would push between 88 million and 115 million people into extreme poverty in 2020. This marks the first increase in global poverty since 1998.

Taiwan is viewing a global shortage of auto chips as an opportunity for it to build closer relations with western nations. This follows weeks of lobbying by various governments with Taiwan, (a hub for global semiconductor production) – for more capacity to be allocated to automobile chips. German, Japanese and U.S. officials have been in talks with Taiwanese semiconductor manufacturers and the Taiwanese government for help in the semiconductor shortage issue.

The intense government involvement has triggered political controversy. The backlash has been intense particularly because Germany has traditionally avoided any acknowledgment of Taiwan's existence or close ties for fear of offending China. Beijing claims Taiwan as its territory and demands other countries deny recognition of its de facto independence. The auto chip shortage has highlighted Taiwan's importance and the crucial role it plays in the semiconductor industry.

In the U.S., the chip shortage stoked discussions about the perceived need to bring back more semiconductor manufacturing capacity, which relocated to Asia many years ago. GM will shut three of its U.S. plants and cut production in a South Korean factory owing to the shortage. Ford is cutting production at two plants and predicts that the chip shortage will cut profits in 2021 by $2.5 billion.

German carmakers are considering building up semiconductor stockpiles to prevent a repeat of the crippling chip shortages that brought assembly lines to a standstill and stalled the production of hundreds of thousands of vehicles worldwide. The move could prompt an overhaul of the industry's finely tuned "just in time" supply chain, which has been used for decades and relies on daily deliveries to preserve cash.

Mexico recorded GDP growth of 3.1% quarter-on-quarter during the fourth quarter of 2020. However, according to the National Statistics Institute real GDP fell by 8.5% for all of 2020. This was the steepest annual decline since 1932 but is deemed less precipitous than feared at the onset of the pandemic. The firm fourth-quarter growth suggests that the economic fallout from the accelerated spread of Covid-19 in late 2020 was muted, as manufacturing industries adapted and several industries have been classified as essential, allowing them to operate even under the highest alert level.

A renewed lockdown in Mexico City and its metropolitan area in mid-December was too late to affect the full fourth-quarter figures, although this is likely to dampen first quarter results this year. The underlying assumption is that a recovery in Mexico's domestic demand will be gradual- largely because of a lack of fiscal support measures.

USA

The U.S. economy created a disappointing 49,000 jobs in January, and the reported number of jobs created during the previous two months were revised downwards. This provided the U.S. administration with further justification for the need to enact a big $1.9 trillion stimulus package. While the Federal Reserve Chairman and the Treasury Secretary have warned that the economy remains vulnerable to setbacks because of the trajectory of the virus as well as structural shifts associated with the pandemic, there is unease as to how much more stimulus is enough.

The $1.9 trillion injection would follow a $900 billion package passed late last year and an initial $3 trillion program implemented at the start of the pandemic. The size of the pending measure is not supported by Republicans and is the subject of a spirited debate suggesting that if enacted in its present form, it would likely contribute to a spike in inflation.

This additional fiscal push combined with the Federal Reserve's unprecedented monetary policy measures launched during the crisis, should boost U.S. economic growth over the short-term, but carries the potential of fueling a significant rise in inflation. Long-term U.S. bond yields rose to the highest level in a year. The rise in yield reflects a decline in price of U.S. government debt.

Underlying unemployment [including those who are no longer looking for work] remained at about 10%, and real disposable incomes continued to decline. Excluding those who have dropped out of the labor force, unemployment is at 6.3%. Leisure, hospitality and retail sectors continued to shed jobs. Overall, the U.S. economy contracted by 3.5% for all of 2020. However, the economy expanded by 1.46% during October-December last year [quarter-on-quarter], according to the Bureau of Economic Analysis. The outlook is for GDP expansion of 3-4% in 2021.

The U.S. president signed an executive order imposing tighter "Buy American" rules on federal government purchases. This is the latest in a series of initiatives by U.S. presidents to counter criticism that the government is not doing enough to promote domestic industry.

UK-EU

The UK government raised the stakes in a dispute with the EU over post-Brexit rules in Northern Ireland, warning of the possibility of invoking emergency override measures [Article 16 in the Northern Protocol, which forms part of the UK's 2019 Brexit treaty] to ensure free flow of trade between the UK and the region. The British government increased pressure on the European Commission to agree to demands from the UK and Northern Ireland to soften the need for checks on trade across the Irish Sea. The desire is for grace periods that allow the free flow of certain goods across the Irish Sea to be extended until January 2023, pending permanent solutions. The extra time would cover supermarkets and their suppliers, chilled meat products, medicines and parcels.

With some of the grace periods due to expire on April 1, the requested extensions would allow businesses that regularly send goods from the UK to the region much more time to adjust to the new arrangements, which came into effect in January.

The Northern Ireland protocol was a key element of the Brexit deal. To avoid a hard border on the island of Ireland it left Northern Ireland under EU customs rules and part of the single market for goods. Considerable pressure was prompted after the European Commission briefly invoked the Article 16 override mechanism to allow Brussels to block the shipment of vaccines from the EU into Northern Ireland. The threat of border controls on the island of Ireland infuriated communities in Northern Ireland. Both the EU and UK are entitled to invoke Article 16 in the event of the Northern Ireland protocol causing "economic, social or environmental" difficulties.

France

Real GDP contracted by 1.3% quarter-on-quarter in the fourth quarter of 2020. Given that the country was in lockdown from late October until early December, the decline was much milder than the authorities feared (the French economy contracted by 13.7% during the first lockdown in the second quarter of 2020). Full year real GDP contracted by 8.3%.

The contraction was mainly driven by a sharp drop in household consumption, which shrank by 5.4%. Although the second lockdown in October-December was less restrictive than the one in April-June, large numbers of non-essential shops and services were forced to close.

Household consumption of food rose slightly in the fourth quarter, but consumption of manufactured goods, household services and fuel dropped sharply. The other main component to post a quarterly contraction was public consumption, although the decline was marginal (0.4%).

However, other GDP components give reason for optimism. In contrast to the first lockdown, fixed investment was unaffected by the second lockdown, registering a second consecutive quarter of growth in October-December (2.4%). Exports also fared well, posting a continued recovery (4.8% in the fourth quarter), while imports rose moderately (1.3%); the consequence of this was a substantial positive contribution to growth from the external sector. Goods volumes were firmer than services; merchandise trade data indicate that manufacturing was much more dynamic during the second lockdown than the first, reflecting the fact that factories had incorporated new social distancing and other rules and so continued to operate.

Stockpiling in advance of the UK's exit from the EU's customs union and free-trade area also supported French exports.

The GDP results have implications for the government's current dilemma about whether to introduce a third lockdown and, if so, the level of restrictions to introduce. Despite concern about the spread of new Covid-19 variants, the French government is keen to avoid a return to the strict lockdown that was in place in the second quarter of 2020. The GDP results indicate that a lighter lockdown, like the one in place during October-December, has a much milder impact on the economy. The expectation is that a third lockdown is likely, but with relatively moderate restrictions. This will hamper growth in first quarter 2021, which will likely cause GDP growth forecast for all of 2021 to be revised down to 5% (from 5.9% previously).

Indonesia

The central bank (Bank Indonesia) requires export payments and loans obtained overseas to be received in Indonesia through a bank licensed to engage in foreign exchange business in the country. This regulation aims to create a stable source of foreign exchange by making exporters repatriate their earnings and by ensuring loan proceeds are remitted into the country.

The currency law requires the use of Indonesian currency, the rupiah, in domestic transactions. Exemptions include certain transactions related to the state budget, income and grants from/to foreign countries, international commercial transactions, foreign currency savings in banks and international financing transactions. Capital inflows are subject to approval, whereas repatriation is unrestricted. Payments must meet all reporting requirements.

No restrictions apply on profit remittances. Companies operating in Indonesia report no difficulties in remitting profits. Earnings on approved investments are freely transferable.

China's Sinovac Biotech signed a licensing agreement with Indonesia's state-owned pharmaceutical firm PT Bio Farma, allowing the latter to produce its Covid-19 vaccine in Indonesia. Sinovac agreed to make five shipments of the vaccine concentrate between November 2020 and March 2021 to allow Bio Farma to produce 50 million doses of the vaccine locally. Bio Farma will eventually increase production to 250 million doses, which needs to be cleared for distribution by Indonesia's Food and Drug Monitoring Agency.

Enforcement of intellectual-property laws generally remain weak in Indonesia. The agency responsible, Directorate-General of Intellectual Property Rights is underfunded, and the police are ill-trained in IPR related matters. Appealing against IPR rulings in commercial court is a frustrating process, and awards granted in arbitration are often difficult to enforce. A task force charged with strengthening IPR enforcement, coordinating IPR strategies across ministries and conducting public campaigns is responsible for changing the perception of poor accountability in this area.

For 2020 Indonesia remained on the Priority Watchlist of the office of the U.S. Trade Representative (USTR) of countries with the most problematic IPR protection and enforcement regimes. Problem areas include widespread piracy and counterfeiting and strict patentability criteria for incremental innovations, local use requirements, and procedures for issuing compulsory licenses. According to the USTR, Indonesia lacks an effective system for protecting against unfair commercial use, as well as unauthorized disclosure, of undisclosed tests or other data generated to obtain marketing approval for pharmaceutical and agricultural chemical products.

Vietnam

Vietnam has received increasing attention as an alternative manufacturing hub to China amid the U.S.-China trade war. However, its rise as a low-cost manufacturing base in Asian supply chains predates these more recent international tensions. Among many aspects, Vietnam's appeal to investors owes much to the country's internal political stability in recent decades. This is in contrast with many of its regional neighbors, which, while able to offer low-cost labor, have suffered policymaking instability and intermittent breakdowns in relations with major neighbors.

Vietnam's leadership transition, at the Congress of the Communist Party of Vietnam in late January 2021 proceeded smoothly. In place is an administration committed to policy continuity in foreign investment and improving the business environment. Still, obstacles remain including alleged official corruption.

Three areas in Vietnam's business environment that have contributed the most to its competitiveness as a manufacturing hub—labor, investment incentives and trade. The country's low-skilled manufacturing wages will remain competitive for years to come, while scarcity of specialized labor will persist as a disadvantage. It continues to offer generous programs for international firms, even while local supply linkages in more advanced manufacturing is expected to remain limited over the next decade.

Vietnam's proliferating membership in free trade agreements represents an advantage and help to reduce export costs. The main medium-term concern remains a shortage of skilled labor. Advanced manufacturing and services skills will remain scarce. Meanwhile, ample supply of low-skilled labor remains the major strength of Vietnam's business environment. Workers from rural areas have been a key source of labor for industry as the manufacturing sector expands.

Chronic under-employment within agriculture has allowed the transfer of labor to industry without negatively affecting productivity in the former. Output per agricultural worker has continued to rise at pace in recent years amid an outward flow of labor from the sector, despite no major land reforms and only modest application of fixed capital. The continual flow of workers into manufacturing from agriculture has acted as a restraining factor on wage growth among low-skilled and unskilled workers. Estimates by the Economist intelligence Unit (EIU) indicate that the stock of surplus labor in the agricultural sector will not be depleted until the latter half of the 2020s.

Vietnam bears many similarities to China in its legacy of central planning, but it has a less restrictive household registration system, removing a potential disincentive to worker relocation. For instance, access to healthcare and government-subsidized schooling are generally better for Vietnamese internal migrants and their dependents, compared with their Chinese counterparts.

In terms of policy restraints on wage growth, the government has committed to modest annual increases in the minimum wage, which have rarely exceeded 4% in real terms in recent years. Meanwhile, industrial action—the formation of unions, striking and participation in collective bargaining—will remain tightly controlled by the authorities.

Organized labor actions mostly take the form of occasional "wild cat" strikes, rather than permanent negotiation and bargaining processes. The challenge continues to be lack of skilled labor. The number of holders of relevant vocational college or degree-level qualifications fall short of employer demand. This is due to a lack of advanced education directly relevant to the needs of foreign-invested manufacturing and services firms. Currently, close to half of higher-qualified labor in the country is concentrated in public sector professions such as education and government administration, partly a result of the legacy of state-dominated central planning.

The loosening of immigration restrictions is meant to counter this trend. Amendments to the Law on Immigration and a new Labor Code (which took effect January 2021), will ease the process of obtaining work permits for foreign staff. However, this will only partially alleviate the problem and will not detract from upward pressure on skilled labor wages.

Government incentives are to be steadily scaled back for lower- value added industries. However, high-tech manufacturers looking to relocate labor-intensive processes will still find generous concessions for years to come. Since it embarked on liberalizing reforms in the 1980s Vietnam has moved towards an export -oriented development strategy that has prioritized foreign investment in fledgling industries. Zones that give priority to foreign investment have played a key role in this strategy since the first Industrial Park opened in Ho Chi Minh City in 1991.

Vietnam has incentivized foreign direct investment (FDI) into specific sectors via a combination of three main types of economic zones: industrial zones, which include industrial parks and export-processing zones; special economic zones; and technology parks. Eligible FDIs can benefit from corporate and personal income tax exemption and rate reduction. Below-market land rents are offered as well. Firms in high-technology sectors, automotive, machinery, and those involved in the production of advanced capital goods are among those eligible. Firms take advantage of incentives offered in export-processing zones while operating outside the zone itself, as an "export processing enterprise", if it maintains customs procedures on site. Moreover, eligibility criteria are flexible, with options for large firms to enter discussion with the government.

Looking ahead, the eligibility for investment incentives will narrow to increasingly focus on higher value-added industries, as the government deprioritizes foreign investment in low-value-added manufacturing industries, including chemicals, plastics and fabricated metals.

This trend will signal the end of the government's long-term strategy to establish major industrial clusters, and to facilitate foreign technology and knowledge transfer to local firms and labor. The expected outcome will be increased domestic availability of intermediate inputs and a deepening pool of skilled labor. Although a range of manufacturing industries exist in the country, only a few have developed into large clusters and some are yet to benefit from increasing economies of scale.

The footwear, textile and garment industries are now well developed with advanced labor specialization and scaled-up manufacturing operations in multiple areas throughout the country. A longer standing but less developed wood-processing cluster that produces intermediate goods exports and feeds into a growing furniture manufacturing industry is located close to the capital Hanoi, with easy access to major forest areas in the north-west. At the other end of the spectrum, the value of electronics exports has surged in recent years. Vietnam is beginning to secure vertical integration in the production of smartphones, with the largest foreign investor in this industry, Samsung, opening a research and development facility and a phone screen manufacturing plant, in addition to its existing assembly operations. However, this manufacturing activity is dominated by foreign intermediate inputs (especially from China) with little domestic contribution.

One concern for businesses is rising property prices, as rents increase rapidly close to major port areas. Vietnam's geography is well-suited to export driven activity. It has a long coastline that supports several deep seaports and navigable rivers that reach into major urban centers. Still, a new and needed railway system is planned within the next ten years. In addition, Vietnam lacks a fully integrated highway system. It is expected that a planned North-South Expressway will be completed in the 2030s.

The only rapid transit option between the two ends of the country is by air. This does not appear to present a major challenge for most export-oriented firms shipping by sea as industrial clusters on both sides of the country have developed to be independent from one another. Firms reliant on domestic markets however are vulnerable to the logistical challenge which is a major factor behind the country's low regional infrastructure ranking.

A key strength in Vietnam's business environment is the country's proliferating membership of free-trade agreements. As part of the ASEAN Economic Community (AEC), Vietnam can ship almost all goods tariff-free to most other South-east Asian countries. Meanwhile, agreements between ASEAN and numerous other countries over the last 15 years have opened-up more regional markets; the efficacy of these deals has been reinforced by the recent Regional Comprehensive Partnership Framework (RCEP).

Of particular benefit over the last five years are the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and the EU-Vietnam

Free Trade Agreement (EUVFTA). The CPTPP entered into force for Vietnam in early 2019 and links together 11 economies on both sides of the Pacific. Vietnam is the only low- or middle-income country in Asia to have ratified the deal.

Although the pact extends well beyond tariff liberalization, the market access afforded via tariff reductions alone is substantial. For Vietnam, the largest gains will be widened access to Canada and Mexico, markets which Vietnam did not have agreements with before.

This is a boost to Vietnam's growing inclusion in upstream electronics supply chains, as Mexico itself is a major global electronics producer reliant on component imports. In the case of Canada, tariffs on Vietnam-produced textile and footwear products have been reduced substantially, opening the door wider to these major Vietnamese consumer products. The more recently signed EUVFTA came into force in August 2020, providing greater access for Vietnam to a market that accounted for 15.7% of its merchandise exports in 2019.

Footwear manufacturing saw the biggest gain from the pact. Around 40% of exports to the EU in this category faced 30% tariffs, which were reduced to 0% in August 2020. The majority of these were sports shoe products. In contrast, clothing and apparel recorded a relatively small share of immediate tariff reductions. However, over half of knitted clothing and apparel exports will see a reduction from 20% to 0% over a six-year period.

Meanwhile, Cambodia, a rising competitor to Vietnam in the footwear and garments sector, lost preferential trade access to the EU in mid-2020 owing to concerns over political repression, resulting in an uptick in tariff rates on these key goods.

Access to the U.S. market is similarly considered at risk for political reasons. Vietnam is not entirely free from risks to its current trade relations, yet expects only modest upward pressure on the cost of trade in the next five years as a result of international tensions. Chief among these will be frictions with the U.S. over Vietnam's growing bilateral trade surplus and persistent currency intervention. The projection is that the U.S. will likely impose a narrow range of import tariffs in 2021 on the grounds of alleged currency manipulation (it has already imposed preliminary tariffs on Vietnam manufactured vehicle tires in late 2020).

The wide range of incentives offered to foreign businesses and market access granted by numerous free-trade agreements, combined with competitive wage costs at the low-skilled end, will ensure Vietnam remains an attractive option for manufacturing operations and those seeking to diversify their supply chain in Asia.

India

In a decisive policy shift the Indian government has abandoned fiscal restraint and unveiled plans for a sharp increase in capital investment to support the economy, which has been battered by the pandemic. In addition, financial sector reforms including bank privatizations, liberalization of the insurance sector and protective tariff increases are to be stepped up over the next fiscal year.

The finance ministry announced plans to borrow an additional $11 billion from financial markets over the next two months to fund a capital spending push before the fiscal year ends on March 31. This means the country will end the current fiscal year with a deficit of 9.5% of GDP – far higher than 3.5% that was targeted for the year – before the pandemic hit India.

The move addresses concerns that the government has been too restrained in its response to the pandemic, because of fears of a rating agency downgrade. The IMF and world bank have urged countries that they should [where possible] spend their way out of the pandemic. For the next fiscal year, starting April 1, the finance ministry has set a deficit target of 6.8% of GDP, as it increases capital spending to $75 billion, up by 32% over the prior year. This includes plans to spend $13 billion on roads in West Bengal where the ruling BJP party hopes to oust the current state administration in elections due this year, and $15 billion for railway development.

According to its "fiscal guide path" the government optimistically hopes to reduce the deficit to around 4.5% by the 2025-26 fiscal year. The authorities have apparently been worried about losing the country's investment grade rating on its foreign debt. However, the priority of supporting economic recovery won the debate, following a 24% year-on-year contraction during the April-June 2020 quarter, when economic activities were restricted by strict lockdowns. As restrictions have been eased the economy has bounced back, with manufacturing now back to pre-pandemic levels, according to IHS Markit, while services still lag.

The IMF has projected that India's GDP growth will be around 11% in 2021, recovering from the 8% contraction for all of 2020. The expectation is that the announced expansionary policies will stimulate the economy, but this will likely stoke inflation.

The financial sector reforms include raising the cap on foreign direct investment in the insurance sector to 74%, up from 49% previously, and plans to privatize two state-owned banks. The government plans to establish a special asset management company to tackle the bad debts now weighing down Indian state banks. It will increase tariffs on several items made by small and medium-sized domestic enterprises, to shield them from competition.

Meanwhile, the Supreme Court of India has temporarily suspended the implementation of recently passed agricultural reforms after farmer protests turned violent in late January. The government has offered to postpone the changes by eighteen months, but farmers remain unwilling to engage with a committee set up by the court. The escalation of tensions has weakened the farmers' negotiating power and will likely strengthen the government's resolve not to make any further concessions. The agricultural reforms are likely to be implemented, albeit with a delay, despite the ongoing protests. In addition, it is expected that labor reforms (which were also passed in 2020) will be implemented this year. Although these reforms also change the balance of power among stakeholders, labor unions have been unable to organize themselves in the way farmers have to launch a protest. It is unlikely that Prime Minister Modi will give up on his broader policy agenda of bolstering economic growth through market-oriented reforms, but given the recent protests, it seems prudent that the government will focus on less contentious market reforms in the short-term.

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