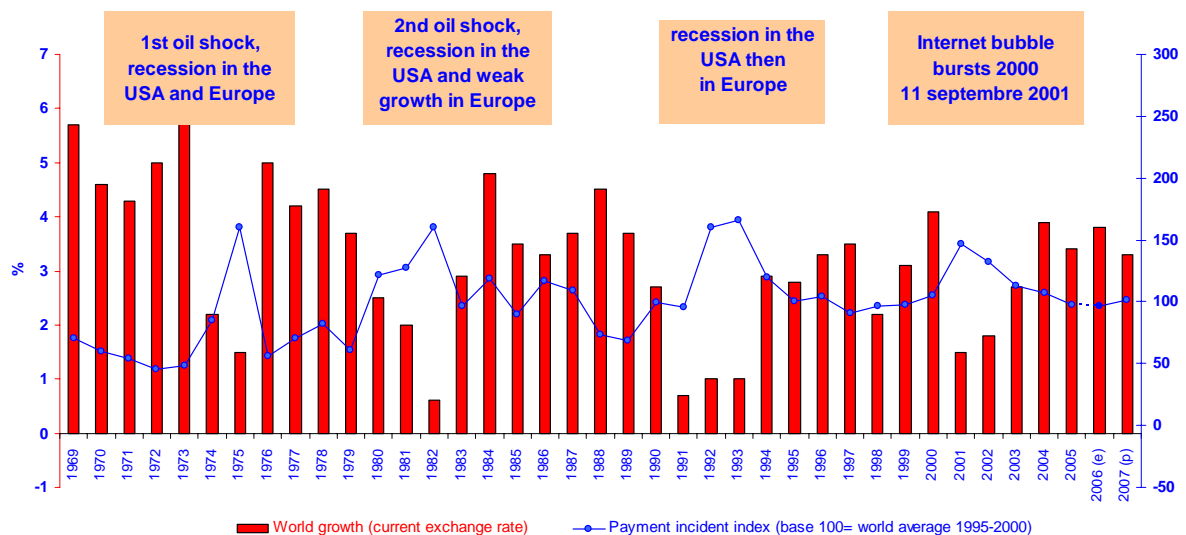


### Coface forecasts small increase in risks for 2007 following broad improvement in recent years

- GDP growth will be slower in **industrialized countries** with risks higher in some economic sectors and growth rates converging for the United States and European Union.
- Growth of foreign currency debt owed by companies would hamper **emerging countries** in face of an exchange rate crisis, a sudden downturn, or a loss of operator confidence linked to the governance problems in some of those countries.
- **Asia** continues to post record growth rates, but corporate risk is not improving. In China, a deterioration in payment behavior is being noted.
- **Latin America** is the only region where risks will decline significantly in 2007, with the major economies in the region coming out of debt and thus fostering a more stable business environment.
- Activity in **Central Europe** and **Turkey** will remain dynamic but their companies have been taking on too much debt with the region by far the most vulnerable to currency risk.
- In the **CIS**, growth will remain robust but the risks associated with governance shortcomings cannot be ignored.
- **North Africa, the Near & Middle East** will continue to benefit from a favorable economic environment, but remain vulnerable to regional geopolitical developments and persistent governance weaknesses.
- Although **sub-Saharan Africa** will continue to consolidate its economic situation due notably to raw material prices, it will also remain affected by continuing political and governance deficiencies.

*Coface country ratings measure the average level of risk expected on companies in a particular country. They reflect how a country’s macroeconomic, financial, and political environment affects corporate solvency and payments on average in the framework of short-term commercial transactions.*

#### 2007: moderately higher credit risk



## **Industrialized countries: Risks concentrated in a few sectors**

Industrialized countries will experience more moderate growth with growth rates converging between the United States and European Union. Companies will suffer from a demand slowdown and continued fierce competition. The overall payment default rate\* for industrialized countries will rise about 3% in 2007. But the deterioration will remain moderate overall, which explains why the ratings for industrialized countries remain unchanged. The United States, Japan, France, the United Kingdom, and Germany are still rated A1. Italy, Portugal, and Greece are still rated A2.

The risks are concentrated on certain economic sectors with slowdowns undermining the financial health of companies in these sectors.

### ✚ **Construction** (A- to B downgrade in the United States and A- to B+ in Europe)

After several exuberant years in the **United States** and certain European countries, prices and activity in residential construction should continue to drop in 2007 affecting the solvency of medium-sized and recently created companies.

### ✚ **Automotive** (B to B- downgrade in Europe)

The auto market will remain sluggish in 2007. American and European automakers will continue to struggle with tight operating margins despite the leveling off of input prices. Parts manufacturers, vulnerable to their customers' difficulties, will be the first to suffer. As was the case in North America, sector ratings in Europe have been downgraded.

### ✚ **IT** (IT: B+ to B- for Americas and stable B- for Europe; TLC equipment: A- to B+ for Western Europe)

Cutthroat competition and weakening demand in industrialized countries will heighten the pressure on sector company margins and on telecommunications equipment manufacturers. Some production units recently acquired by Asian companies in Europe and the United States present high risk, along with wholesalers and retailers.

### ✚ **Mass distribution** (A to A- downgrade in North America; B+ to A- upgrade in Europe and Japan)

Although less cyclical, this sector underwent a downgrade in the United States due to the expected slowdown in household consumption and poor performances by some major firms. Conversely, restructuring and dynamic consumption have prompted rating upgrades for the sector in Europe and Japan.

### ✚ **Pharmaceuticals** (A to A- downgrade)

The rating downgrade reflects the public spending restrictions on health insurance and competition from generics buffeting the sector. The pharmaceutical market continues to enjoy high growth (up 5% in 2007) but not the two-digit expansion of recent years. The laboratories have to adjust to a more competitive context by further developing their research programs and by finding new markets and products. Concentrations and asset sell-offs will remain commonplace, with margins squeezed and the solvency of the weakest players likely to be jeopardized.

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\* Ratio between late or default payments and recorded commercial transactions, calculated with information from the Coface database

## Emerging countries: Growing foreign currency debt has increased company risk

The overall financial situation of emerging countries improved noticeably over the past five years due to the strengthening of external accounts and sounder fiscal policies. But growing foreign currency debt held by many companies has offset that improvement and would likely cause a chain reaction of defaults in case of a sudden growth slowdown, currency crises, or loss of operator confidence in certain countries.

The period of declining risks will end in 2007. Unlike previous years, there have been as many negative as positive changes in country risks.

	January 2006	January 2007
<u>Positive evolution</u>		
Slovenia	A2	A1
Mexico	A4	A3
Bulgaria	B↗	A4
Brazil	B↗	A4
Colombia	B	A4
Morocco	A4	A4↗
Tunisia	A4	A4↗
Cap Verde	C	B
Dominican Republic	C	B
<u>Negative evolution</u>		
Taiwan	A1	A1↘
Thailand	A2	A2↘
Hungary	A2↘	A3
Philippines	B↗	B
Turkey	B↗	B
Jordania	B	B↘
Kenya	C↗	C
Lebanon	C	C↘
Chad	C	D

### Summary of 2007 forecasts for emerging countries

- Devaluation in Central Europe and Turkey
- Fall in commodity prices in Near and Middle East and Latin America
- Bursting of property or stock market bubble in Asia and Middle East
- Company over-indebtedness in currencies sometimes linked to governance shortcomings in Central Europe and Russia
- Overcapacity in China
- Geopolitical tension in Near and Middle East

## **Asia: no further risk improvement expected in 2007**

After a very good period, risks on Asian companies are no longer improving. Their margins have been shrinking in face of competition (notably in the electronics sector), currency appreciations, and weaker American demand in 2007. The ratings of Taiwan (A1) and Thailand (A2) have thus been negative watchlisted and the Philippines' B rating removed from positive watchlist status.

➤ In **China (A3)**, credit risk has increased even though only a very slight growth slowdown (9.5%) is expected in 2007. Overcapacity in certain sectors has been squeezing the margins of some companies. As in past years, Coface has done a survey of Chinese company payment behavior trends. The survey carried out at the end of 2006 revealed a worsening trend with private sector companies the most vulnerable due to their more difficult access to bank credit. Also, the practice of delaying payment has now spread to mixed and foreign companies. The stiff competition in the domestic market is still the main contributing factor to corporate financial difficulties. A substantial portion of the outstandings is attributable to a lack of transparency (financial data often unreliable when available, sometimes chaotic management). In this tense environment, the prospect of even a moderate slowdown has affected credit risk.

➤ In **India (A3)**, corporate payment behavior has been improving amid continuing durable growth. Late payments are still commonplace, often for administrative reasons. Although Indian companies have been very healthy overall, hard financial data continues to be very difficult to obtain. Court proceedings are likewise still very long.

## **Latin America: stronger giants**

Latin America is the only region with a significant decline of risk for 2007. Current account surpluses have enabled a significant reduction in debt. In a slightly weaker international environment, domestic demand will make a positive and crucial contribution in 2007. The subcontinent has been reaping the benefits of more finely tuned monetary and fiscal policies. Corporate solvency has improved overall in a still-imperfect business environment. The victorious left wing candidates in recent presidential elections have brought with them very different influences in each country. Policies should be pragmatic in many cases (Brazil, Chile, Peru, and Uruguay), populist and socialist-leaning in others (Bolivia, Ecuador, and Venezuela). Concurrently, in many Andean countries (Bolivia, Ecuador, and Peru), demands on controlling and sharing natural wealth have emerged. Those results have highlighted the essential challenge now facing the country: develop more sustained and better distributed economic growth.

### ➤ **Brazil (B to A4)**

The country's greater economic and financial stability and continuing policy commitment to maintaining fundamental macroeconomic equilibrium has provided a more favorable environment for companies with their solvency generally improved.

### ➤ **Colombia (B to A4)**

Improved economic and financial conditions and pursuit of tight economic policy has fostered strong growth with corporate payment behavior remaining satisfactory.

### ➤ **Mexico (A3)**

Despite the economic slowdown in North America on which Mexico continues to be very dependent, the country has retained its A3 rating due to solid economic and financial fundamentals coupled with improved corporate solvency.

### → Argentina (C).

The improved economic conditions in Argentina have remained unsteady. The high growth paving the way for improvement in certain economic and financial ratios as well as corporate health cannot hide the country's many weaknesses and uncertain outlook.

## **Central Europe and Turkey: Companies assuming too much debt amid high exchange rate risk**

This region has been by far the most vulnerable to exchange rate risk. Its economic activity has not faltered even though a slowdown will be likely in Hungary as it implements an austerity plan. The regional economy will continue to benefit from strong domestic demand with companies enjoying satisfactory solvency overall, notwithstanding occasional payment failures in weak or very competitive sectors. However, emerging Europe continues to exhibit weaknesses. A loss of appetite for reforms and growing populism has delayed consolidation of public finances and adoption of the euro, a situation compounded by worsening external deficits and a resulting increase in vulnerability to exchange rate risk. The region now has the highest external financing needs in the emerging world, mostly generated by Turkey. While current account deficits remain limited in Poland and the Czech Republic, they have reached high levels in Slovakia, Croatia, Turkey, and Hungary and peak levels in Romania, Bulgaria, and the Baltic States. Although foreign direct investment has covered a high proportion of financing needs in the Czech Republic and Bulgaria, the coverage rate has been moderate elsewhere, even very low in most of the Baltic States and Hungary. Those imbalances have pushed exchange rate risk to high levels especially with the private sector carrying heavy foreign currency debt.

### → Turkey (B rating removed from positive watchlist status).

Turkey is still the country most vulnerable to a crisis of confidence with current account deficits reaching record heights and with high levels of volatile capital susceptible of suddenly leaving the country. Although public sector finances and banks are now in better shape, some private companies with massive foreign currency debt are now weaker.

### → Hungary (A2 to A3 downgrade)

Also in shaky condition, deteriorating public sector finances have been the economy's Achilles heel. The austerity plan announced in June 2006 should facilitate reduction of the fiscal deficit, but government debt will continue to grow. This situation is compounded by a persistently high current account deficit, a sharp rise in foreign debt, and a weakening of the private sector and banks resulting from the rapid expansion of credit denominated in foreign currencies.

## **CIS: High growth that cannot mask governance shortcomings**

### → Russia (B)

Continued high growth and the overall improvement in the country's financial situation contrast with relative deterioration of a business climate marked by the great instability of property rights. The government has made a strong comeback as shareholder in a range of sectors, which could disrupt the investment dynamic. Companies are still characterized by a lack of transparency on their accounts and ownership.

## **North Africa, Near & Middle East: Growing geopolitical instability and continuing governance weaknesses have been a counterweight to economies strengthened by the oil boom.**

The petrodollars have benefited not only the major hydrocarbon exporting countries but also the other regional economies via investments and emigrant worker remittances. The region's geopolitical instability, governance weaknesses and poor business environment have, however, particularly affected the ratings of Saudi Arabia, Israel, and Algeria (rated A4), Egypt and Iran (B), and Libya, Syria, and Yemen (C).

### **→ Algeria (A4)**

This country, which has built up large foreign currency reserves, has paid off debts and launched a broad public investment program. However, it will long remain dependent on the energy sector since there are continuing impediments to private sector growth including an inefficient banking sector, a lack of training, and a deficient administration.

### **→ Saudi Arabia (A4)**

Saudi Arabia has substantially reduced public sector domestic debt and has accumulated extensive financial assets abroad. A very liquid market, spurring household consumption and investment in infrastructure, industry, and real estate, has supported the economy. Regional geopolitical instability and continuing governance weaknesses have, however, affected the outlook.

**→ Iran (B)** Public spending has been driving growth with private investment undermined by a lack of confidence in the government's economic policies and especially by geopolitical uncertainties. This situation has hampered oil sector modernization and gas sector development. Tensions with the international community over the nuclear issue have maintained a climate of uncertainty detrimental to the economy.

## **Africa: On the path to consolidation**

High raw material prices and debt cancellation under the HIPC and MDRI programs have improved the financial situation of many African countries. The average level of risk has remained high in the region with continuing political weaknesses and governance shortcomings blocking upgrades. In that context, the ratings of Nigeria (D) and Angola (C), sub-Saharan Africa's leading oil producing countries, have remained unchanged despite their comfortable financial situations. Their oil revenues notwithstanding, a difficult political situation has also kept Sudan's rating at D and even contributed to the downgrade of Chad to D. Southern African countries have enjoyed healthier situations, with the exception of Zimbabwe.

### **→ South Africa (A3)**

South Africa generates 40% of the region's GDP and has benefited from a favorable business environment and healthy public finances. However, the recent emergence of external deficits has contributed to keeping exchange rate risk at high levels.

## CONTACTS

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*Founded in 1946, Coface, rated AA+ by Fitch Ratings, AA by S&P and Aa3 by Moody's, is a subsidiary of Natixis whose share capital (Tier 1) was 9.9 billion euros end 2005 (pro forma data). Coface's mission is to facilitate global business-to-business trade by offering its clients four product lines to fully or partly outsource trade relationship management and to finance and protect their receivables: credit insurance, company information and ratings, receivables management and factoring. Coface also offers three other business lines: guarantee insurance, receivables management training, and, in France, management of government export guarantees. Coface operates a quality local service for its 85,000 clients thanks to its 4,850 staff in 60 countries where Coface has a direct presence. This local service also covers in 93 countries via partners in the CreditAlliance worldwide network, organised around an integrated credit risk management tool, the Common Risk System.*

## Country @rating Methodology

**Coface Country @ratings for 154 countries are available and updated regularly via [www.coface-usa.com](http://www.coface-usa.com) under the “Country Risk Information” link. They can be accessed freely for consultation purposes.**

A Country @rating assigned by Coface reflects the average level of **short-term** non-payment risk associated with companies in a particular country. It reflects the extent to which a country’s economic, financial, and political outlook influences financial commitments of local companies. However, those involved in international trade know that sound companies can operate in risky countries and unsound companies in less-risky countries and that overall risk will depend not only on a company’s qualities but also on those of the country in which it operates. In assessing overall risk associated with a particular operation, Country @ratings are thus complementary to @rating Credit Opinions on companies.

### *How ratings are assigned*

Ratings are based on twofold expertise developed by Coface:

- Macroeconomic expertise in assessing country risk based on a battery of macroeconomic indicators
- Microeconomic expertise that draws on Coface databases covering 50 million companies worldwide and 60 years experience with payment incidents in trade flows it guarantees.

Coface groups the indicators in seven families and rates each one individually. The seven risk families are:

- Political and institutional instability
- Growth vulnerability
- Foreign currency liquidity crisis
- External over indebtedness
- Sovereign financial vulnerability
- Banking sector’s fragilities
- Company payment behavior

**Coface determines an overall rating for each of the 154 countries monitored. Like rating agencies, Coface ranks country ratings on seven risk levels:**

A1: The steady political and economic environment has positive effects on an already good payment record of companies. Very weak default probability.

A2: Default probability is still weak even in the case when one country's political and economic environment or the payment record of companies is not as good as in A1-rated countries.

A3: Adverse political or economic circumstances may lead to a worsening payment record that is already lower than the previous categories, although the probability of a payment default is still low.

A4: An already patchy payment record could be further worsened by a deteriorating political and economic environment. Nevertheless, the probability of a default is still acceptable.

B: An unsteady political and economic environment is likely to affect further an already poor payment record.

C: A very unsteady political and economic environment could deteriorate an already bad payment record.

D: The high risk profile of a country's economic and political environment will further worsen a generally very bad payment record.