

## Country Risk

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By Laura Briant and Julien Marcilly

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This panorama first includes a study dealing with new emerging markets. While the 2008-2009 global crisis had highlighted emerging market resilience, game-changing events have taken place in those emerging countries since May 2013 indeed. The capital outflows linked to political, social and financial tensions attest to the heightened vulnerabilities of certain emerging countries. Their disappointing growth performances only confirm these, especially among BRICS' countries. Despite this still favourable consumption dynamic in the BRICS, they suffer from supply-side constraints: the downturn in investment is a sign that local businesses no longer have sufficient production capacity to respond to such strong demand. Therefore, we have tried to identify which countries are likely today to take over from them, by paying particular attention to the importance of the outlook for supply and hence for production, rather than for demand and hence consumption.

To do so, we first highlight the emerging economies whose high growth potential is accelerating. These are those with the most favourable prospects of increasing production capacity in the years to come. We then ruled out the countries which do not have a sufficiently developed financial system to support this expansion in production capacity before turning our attention to the importance of the quality of business climate to fully exploit this potential for growth. We identify **10 countries** in the end. In five of them (**Colombia, Indonesia, the Philippines, Peru and Sri Lanka**), the quality of the business climate is similar to the one in the BRICS. Business climate being more difficult in the five remaining countries (**Kenya, Tanzania, Zambia, Bangladesh and Ethiopia**), it could take more time for them to fully benefit from this high growth potential.

We also present, in this panorama, the latest adjustments to our country assessments (which measure the risk of company payment defaults in a given country) and to our business climate ones along with an update to the country studies being currently under the spotlight, like Russia, Ukraine, Venezuela, Thailand, Turkey and the United States.

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# Which emerging countries will take over from the BRICS?

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While the 2008-2009 global crisis and then the sovereign debt crisis in the eurozone had highlighted the weak long-term growth prospects of the advanced economies and the much more favourable outlook for emerging countries, game-changing events have taken place in those emerging countries since May 2013. Capital outflows linked to political, social and financial tensions attest to the heightened vulnerabilities of some emerging countries. Their disappointing growth performances only confirm this idea.

These capital outflows, reflecting international investors' weaker interest in emerging markets, are paradoxical: when the notion of «emerging country» came into use at the beginning of the 1980s, with the development of financial markets in emerging economies, it was a way of distinguishing those «developing countries offering opportunities for investors»<sup>(1)</sup>. Numerous more precise definitions have since been proposed. They generally emphasise that emerging countries:

- 1/ have an intermediate level of per capita income (i.e. above that of the less advanced countries, but below that of the more advanced economies);
- 2/ have a GDP growth rate higher than that of the most advanced economies;
- 3/ are undergoing major institutional transformations.

The BRIC<sup>(2)</sup> countries met all these criteria in the 2000s. They alone even symbolised the soaring growth of emerging countries. Grouping these 4 countries (subsequently 5 with the addition of South Africa) under this acronym in the early 2000s emphasised their common features. They all exhibited dynamic growth but, above all, had a total GDP as well as a population big enough to offer prospects of a rapid rise of the middle class and therefore of household consumption.

The criteria used a decade ago to identify the BRICS were therefore essentially aimed at evaluating the emerging countries' demand potential. This, moreover, has since been partially fulfilled and continues to be so, with household consumption currently remaining strong.

Despite this still favourable consumption dynamic in the BRICS, their growth is today slowing significantly. This seeming paradox is explained by the supply-side constraints from which they have since been suffering: the downturn in investment is a sign that local businesses no longer have sufficient production capacity to respond to such strong demand. Though having high potential on the demand side is a necessary condition for long-term dynamic growth, it is not in itself sufficient. In the present context, of a slowdown in the big emerging countries and, in particular, in the BRICS, we have, therefore, tried to identify which countries are likely today to take over from them, by paying particular attention to the importance of the outlook for supply and hence for production, rather than for demand and hence consumption.

In order to answer this question, this study first highlights the emerging economies whose high growth potential is accelerating. These are those with the most favourable prospects of increasing production capacity in the years to come. We then ruled out the countries which do not have a sufficiently developed financial system to support this expansion in production capacity before turning our attention to the importance of the quality of the business climate to fully exploit this potential for growth.

(1) Antoine Van Agtmael, then economist at the World Bank.

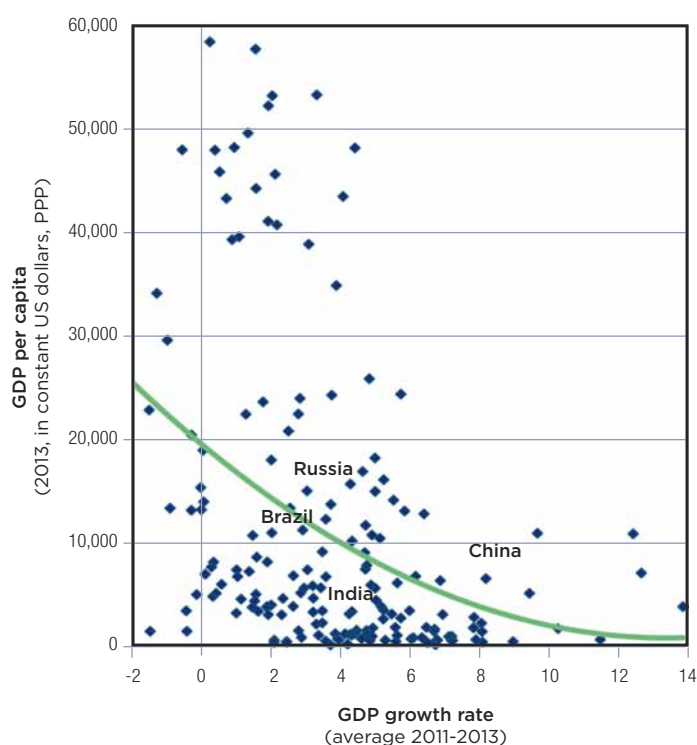
(2) Brazil, Russia, India, China then South Africa

# 1 / THE BRICS ARE SLOWING DOWN, BUT OTHER EMERGING COUNTRIES ARE ACCELERATING

## The BRICS partially closed the gap between themselves and the developed economies in the 2000s.

The first decade of this century was marked by strong emerging country growth. This trend is explained in part by factors such as the rise in raw materials prices (for example for Brazil, Russia and South Africa) or again by the dynamic growth of world trade (China). But it was above all a catch-up process for these countries. Emerging economies invest more than advanced ones because their initial capital stock is lower and they benefit from technology transfers. The more sustained growth of emerging countries is, accordingly, mainly due to a greater accumulation of capital and higher productivity gains. This finding is consistent with the theory of growth developed by Solow, a standard work on the topic (see *box 1*). Economies with a low per capita GDP therefore tend to have a higher GDP growth rate. Chart 1, which compares the level of growth and that of per capita GDP in all the countries of the world in 2013, confirms this.

CHART 1  
Growth rate and per capita GDP



Sources: FMI, Coface

## MEASURE AND DETERMINANTS OF LONG-TERM GROWTH

Though analysis of short-term economic cycle is more related to the components of demand<sup>(3)</sup>, it is advisable to place more emphasis on the supply side in order to assess an economy's long-term growth pattern. The model developed by Solow<sup>(4)</sup> is the standard approach. In its initial version, GDP growth depends on demographic growth, on capital accumulation (especially, that is to say, investment permitting the purchase of machines) and total factor productivity, which measures technical progress. This model was subsequently enhanced by adding the notion of human capital<sup>(5)</sup>, the level of which depends on the quality of education, training and healthcare systems.

GDP growth is therefore the result of these 4 factors: demographic growth, accumulation of physical capital and of human capital as well as technical progress. In the context of this study we have therefore calculated the long-term capital growth of a given economy for year  $t$  as follows:

$$y_t = pop_t + pt_t + x_t * hc_t + (1-x_t) * k_t$$

With:

$y_t$  : long-term GDP growth rate;

$pop_t$  : demographic growth;

$pt_t$  : total factor productivity growth;

$x_t$  : share of the labour factor in the total capital;

$hc_t$  : growth of the human capital;

$k_t$  : growth of the physical capital.

Moreover, this benchmark model assumes diminishing return to capital: an additional unit of capital enables a rise in GDP, but the lower the starting level, the greater the growth. Thus, the lower the country's per capita GDP, the higher its GDP growth rate.

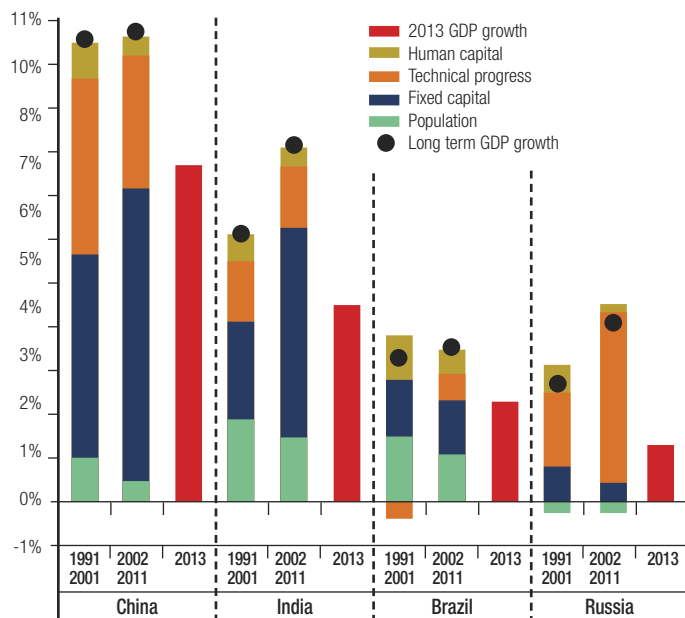
(3) Household consumption, investment in fixed assets, investment in construction, trade balance, and variation of inventories.

(4) R.Solow (1956): «A contribution to the theory of economic growth», Quarterly Journal of Economics, N° 70.

(5) R. Lucas (1988): «On the Mechanics of Economic Development», Journal of Monetary Economics, 22, July, 3-42.

This trend, characterised by rapid capital accumulation and high productivity gains favouring an acceleration of growth, has been shown to be the case in the BRIC countries. Growth there increased relative to the previous decade (see chart 2), mainly because of investments which favoured capital accumulation (China, India) or productivity gains (Russia, Brazil).

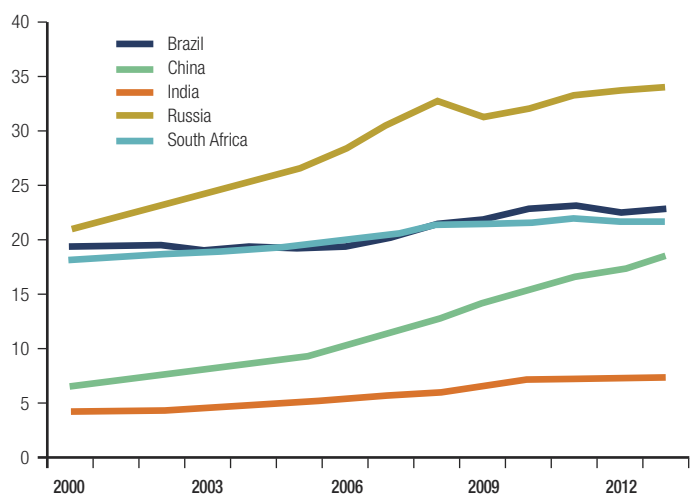
**CHART 2**  
Breakdown of the long-term growth of the BRIC countries <sup>(6)</sup>



Sources: Groningen Growth and Development Centre, Coface

This acceleration of growth enabled the BRICS to catch up relative to the more advanced economies. China's per capita GDP in 2013 was about 18% of that of the United States against only 6% in 2000. This ratio rose from 21 to 34% in Russia over the same period. It also increased in India, South Africa and Brazil, but to a lesser degree. This catch-up process was particularly marked between 2004 and 2010 (see chart 3).

**CHART 3**  
BRICS per capita GDP (PPP dollars) as a percentage of United States levels



Sources: IMF, Coface

## But after 10 years of unbridled growth, the BRICS are running out of steam

This catch-up process seems to have been distinctly running out of steam since 2010, with growth of the big emerging countries slowing noticeably since early 2013. For example, Chinese growth reached «only» 7.7% in 2013 and Coface expects it to be close to 7.2% of GDP in 2014. This is far from the annual average of 10.6% between 2000 and 2011. Chart 2 illustrates the gap between potential growth of the 2000s and growth observed in 2013. The trend is similar in the other BRICS countries: Coface's growth predictions for 2014 will be below average growth rates for the 2000s in India (5% in 2014 against 7.8% between 2000 and 2011), Russia (1% against 4.8%), Brazil (2% against 3.8%) and South Africa (2.5% against 3.6%).

Admittedly, origins of this slowdown are partly cyclical, these economies having been especially hard hit by the sluggish growth in most of the advanced economies. But the reasons also seem to be structural, that is to say, resulting from supply-side problems. According to the IMF <sup>(7)</sup>, potential growth fell markedly between 2011 and 2013 in India (-1.6 points), China (-0.9) and to a lesser degree in Russia (-0.5), Brazil (-0.4) and South Africa (-0.2). In these countries, the recent downturn in growth is to a large extent explained by the marked fall in investment. Solow's theory, therefore, seems to have once again been confirmed: after a strong rise in the per capita GDP of these countries in the 2000s, growth rate has since been trending more slowly.

This slowdown in the BRICS countries' economic growth also confirms the existence of a «middle income trap». After enjoying a period of strong growth linked to low labour costs and/or abundant natural resources, which allow a low-income country <sup>(8)</sup> to become a middle-income country, a country then undergoes a prolonged decline in growth. Higher incomes and therefore increased wage costs makes it less competitive relative to low-income countries, without, however, yet enabling it to compete with high value-added products of the more advanced countries. Eichengreen <sup>(9)</sup> confirms the difficulty emerging countries have in getting out of this trap: he emphasises that growth of emerging countries slows by 2 points a year when their per capita income reaches about \$17,000.

(6) In the case of Russia, average potential growth in the 1990s was calculated using data from 1995 to 2001 and not from 1995 to 2001 as for the other countries.

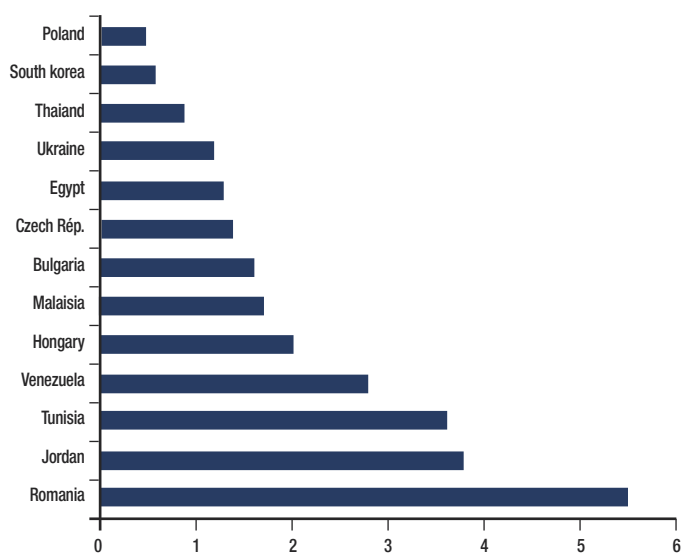
(7) World Economic Outlook, October 2013

(8) According to the World Bank, low-income countries are those where the gross national income per capita was less than \$1035 dollars in 2012. Those where the per capita GNI was higher than US \$12 616 in 2012 are considered as high-income countries. Those where per capita GNI is between \$1035 and \$12616 are middle-income countries.

(9) B. Eichengreen (2011): "When fast growing economies slow down: international evidence and implications for China", NBER Working paper No 16919, March.

The BRICS, moreover, are not the only emerging countries whose long-term growth is slowing, as is underlined by chart 4, which measures the fall in potential growth<sup>(10)</sup> in percentage points between the period 1999-2008 and the period 2010-2011 and shows figures for several countries of Central and Eastern Europe (Rumania, Bulgaria, Hungary, Poland, the Czech Republic). Asian economies, which benefitted from very dynamic growth in the 2000s, are also included (Korea, Malaysia, Thailand).

**CHART 4**  
Decline in long-term growth in percentage points between the periods 1999-2008 and 2010-2011



Sources: Groningen Growth and Development Centre, Coface

### Other emerging countries are now taking over

But this falling long-term growth trend for the BRICS and other countries is not common to all the emerging economies.

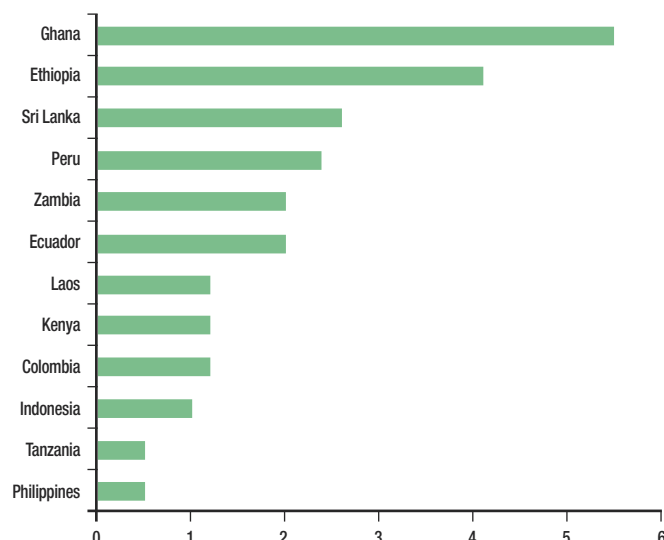
To determine which countries are now benefitting from high growth potential, we first focused on those which are not likely to suffer in the short term from this «middle income trap». The «high-income» countries according to the World Bank have therefore been excluded. Moreover, countries whose per capita GDP is below \$500 were also left aside. This threshold corresponds to the lowest level of the BRICS countries (India, as it happens) in the early 2000s when their period of accelerating growth began.

We then adopted Solow's approach and calculated the long-term growth rate of the economies according to the growth rate of the accumulation of fixed capital, technical progress, human capital and of the population. To do this, we used the annual data of the Groningen Growth and Development Centre<sup>(11)</sup> available for 167 countries<sup>(12)</sup>. More precisely, we found that the countries with strong growth potential fulfilled the following conditions:

- 1/ their average long-term growth rate for the period 2010-2011<sup>(13)</sup> is higher than or equal to 4%;
- 2/ this rate is higher than that of the decade before the 2008-2009 crisis.

This double condition is designed to ensure that only countries which have both high growth potential and an accelerating growth trend are included. Chart 5 highlights the countries where the potential growth rate is tending to accelerate, and shows the scale of this increase.

**CHART 5**  
Long-term growth rise in percentage points between the period 1999-2008 and 2010-2011



Sources: Groningen Growth and Development Centre, Coface

But, besides this accelerating long-term growth trend, other elements must be considered in order to determine which countries can be the «new BRICS».

It is appropriate, for example, to exclude countries whose sectoral diversification of the economy is weak. These are particularly countries almost exclusively oriented towards the export of raw materials. In theory, however, the advantage of natural resources is to enable a country to benefit from export revenues, which can be used to implement policies fostering economic development. But, in fact, countries whose productive system is to a very great extent directed to the exploitation of raw materials, very often suffer from the «Dutch disease»: the appreciation of the local currency linked to raw materials exports hampers the growth of the other activity sectors (particularly manufactured products) by damaging their competitiveness and thus slows the country's economic development process. We have, therefore, left out countries whose raw materials exports represented over 40% of GDP. Several Sub-Saharan African countries (especially Angola, the Ivory Coast and Nigeria) come into this category, as do the countries of the Middle East.

Finally, besides the level, the trend and the composition of growth, the prospects of long-term growth depend on its volatility and its resistance to economic shocks. To measure resilience, we eliminated countries in recession in 2009 after the Lehman crisis as well as those whose growth remained positive but declined by at least 10 points in this same year.

In the end, 21 countries met all these criteria. These are Bangladesh, Bhutan, Bolivia, Burkina Faso, Colombia, the Dominican Republic, Ecuador, Ethiopia, Ghana, Indonesia, Kenya, Laos, Lebanon, Panama, Peru, the Philippines, Rwanda, Sri Lanka, Tanzania, Uzbekistan and Zambia.

(10) Measured according to Solow's model.

(11) For a precise definition of the data, see R.Feenstra, R.Inklaar and M.Timmer (2013): "The Next Generation of the Penn World Table", available on the site [www.ggdcenter.org/pwt](http://www.ggdcenter.org/pwt).

(12) We have used the GDP growth rates observed for a restricted number of countries for which certain components of long-term growth were not available.

(13) 2011 is the last year available.



## 2/ BUT FINANCING INVESTMENT REQUIRES A MINIMUM LEVEL OF SAVINGS AND SUFFICIENTLY DEVELOPED FINANCIAL MARKETS

Among these countries not all will necessarily confirm their high growth potential. To achieve this, the economy in question has to be able to finance investments which favour capital accumulation and/or productivity gains. A minimum level of saving reflects these financing capacities. The presence of sufficiently large banking sectors and equity markets is also necessary to finance investment and therefore growth.

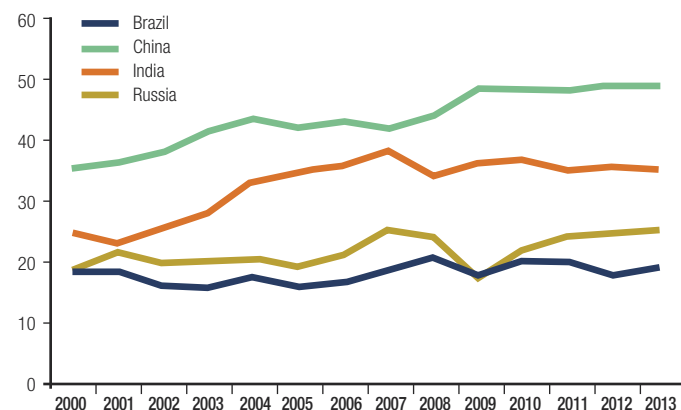
The experience of the BRIC countries bears this out: their economic expansion was accompanied by an increase in savings rate, expansion of credit, as well as a rapid development of equity markets. On the other hand, loss of momentum that these countries are currently experiencing is an indication of the deterioration of their financing capacities. We have therefore used these three indicators: savings rate, credit to the private sector and stock market capitalization, to assess a country's financing capacity.

### No investment without saving

Savings rate in the big emerging countries has grown strongly in the past ten years. Gross national savings represented 33% of GDP in 2013 (against 28% in 2000) for the BRIC countries, or a rise of 5 points. During this same period, the ratio fell by 3 points on average in the developed countries<sup>(14)</sup>. A minimum domestic savings level is one of the necessary conditions for financing development. It allows the country to finance itself and thus to avoid foreign debt. We have observed this recently through the outflows of capital experienced by numerous emerging countries, consequent particularly on changing expectations of monetary policy in the United States, which can have a destabilising effect on economy. Historically, accumulation of wealth enabled the second industrial revolution development: national savings rate as a percentage of GDP averaged 13% in France over the period 1870-1889, that is to say, at the beginning of the economic development process, 14% in the United Kingdom and 19% in the United States<sup>(15)</sup>. These levels are close to current levels in some emerging countries.

Saving has an effect on growth via investment by enabling the accumulation of physical capital and human capital, which are growth factors mentioned previously<sup>(16)</sup>. Investment developed strongly in the last decade and, relative to GDP, it rose from 24% to 32% in the BRIC countries between 2000 and 2013 (see chart 6), and fell by 3.5% in the developed economies. Moreover, accumulation of wealth and growth is improving household incomes and businesses, thus favouring an increase in the savings level.

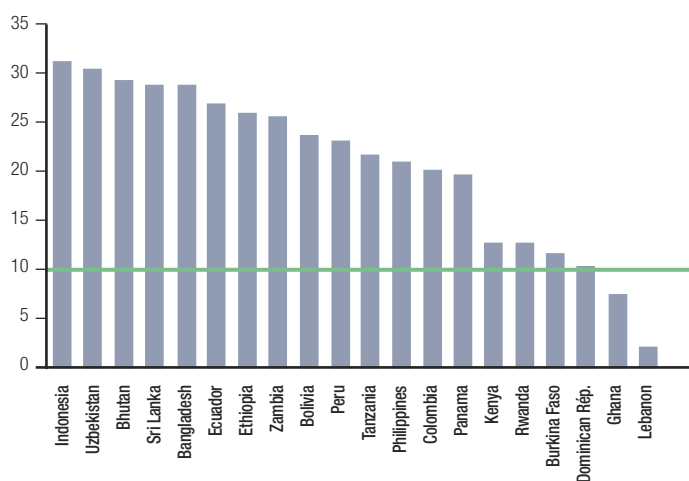
CHART 6  
Investment as a percentage of GDP in the BRIC countries



Sources: IMF, Coface

In this context we focus on gross national savings. We have estimated that countries having a savings level above 10%, the minimum necessary level to avoid large-scale use of foreign savings, are countries with sufficient financial capacity. In order to assess the long-term trend, we have also taken into account the growth rate of this ratio over the last five years, keeping only countries whose savings have developed positively (see chart 7).

CHART 7  
Savings rate as a percentage of GDP in the new emerging countries



Sources: IMF, Coface

(14) Source: International Monetary Fund.

(15) Angus Madisson (1992): «A long run perspective on savings», The Scandinavian Journal of Economics.

(16) Theory of endogenous growth developed by Robert J.Barro and Xavier Sala-i-Martin, «Economic growth, second edition», The MIT Press, 2004.

## Development of the financial system favours growth...

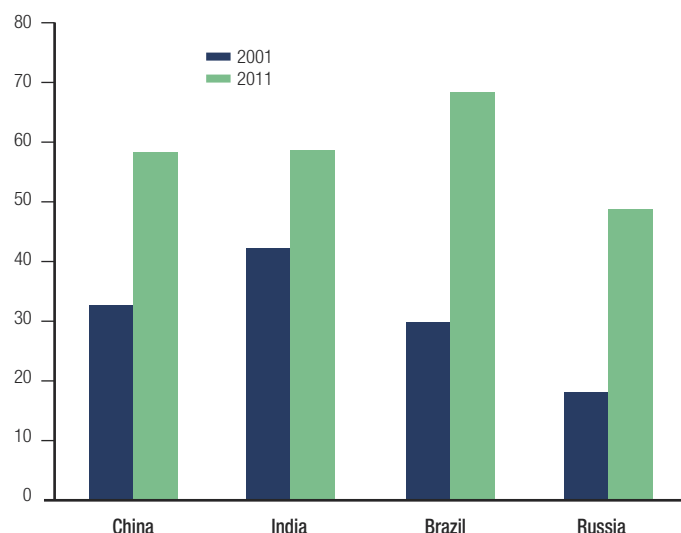
This minimum savings rate is, meanwhile, a prerequisite for the development of local financial systems which is essential for booming investment. Financial intermediation is a key factor in development: high cost related to acquiring and processing information, transaction costs as well as the costs linked to establishing contracts are obstacles that financial intermediation can reduce. The financial system favours a better allocation of resources, thus becoming a growth factor by acting on the 5 following levers:

- It facilitates collection and mobilization of savings by reducing transaction costs and costs related to contracts, thus household savings are more easily transferred to firms. Banks development was thus one of the factors explaining the industrialisation of England in the 19th century, by facilitating capital mobilization for «immense works»<sup>(17)</sup>.
- It makes it possible to share the costs of acquiring information on profitability and therefore to reduce the overall cost, thus allowing creditors to rapidly identify the most profitable businesses and investment projects.
- It facilitates corporate governance monitoring through shareholders and creditors.
- It facilitates diversification and therefore better risk management. Financial intermediation enables holders of capital, normally risk adverse, to invest in more profitable, if more risky, projects thanks to the creation of assets limiting the risk. Thus in 2007, a trillion dollars passed through developed countries to developing countries – though deemed more risky – an increase of 30% compared to the previous year<sup>(18)</sup>.
- Finally it increases good and service exchange by reducing transaction costs. It facilitates payments and allows inter-temporal access to credit, like money does.

Although historically banking sector preceded the development of capital markets, the strong growth recorded over the last twenty years on capital markets of the main emerging countries suggests that the two sectors have developed in parallel. The growth of bank intermediation level is not inconsistent with the development of financial markets and particularly of equity markets, each sector providing different services<sup>(19)</sup>.

In 2001, stock market capitalization relative to GDP was 42% for China, 32% for Brazil, 25% for India and 18% for Russia. Today, these countries have capital markets as developed in terms of size as the G7 countries (59% on average against 78% in 2011) and can therefore be considered as mature markets (see chart 8). Financial market deregulation, openness to foreign capital, as well as the good economic performances of emerging countries have favoured this development.

CHART 8  
The BRIC countries market capitalization as percentage GDP



Sources: World Bank, Coface

Similarly, credit to the private sector has increased strongly because of expansionary monetary policies and weak regulation in some emerging countries. Over the period 2002-2012 the ratio of credit to the private sector as a share of GDP rose from 26 to 59% in Brazil and from 31 to 51% and from 18 to 53% respectively in India and Russia. This rapid rise was associated with an acceleration of GDP growth.

## ... but up to a certain point

However an over-developed financial system can destabilise economy and be prejudicial for growth, as the 2008-2009 financial crisis showed. The boom in private sector credit observed in the United States, Ireland, Iceland, Spain and the Baltic States was one of the triggers. Moreover, financial markets of the G7 countries deteriorated strongly during this period with average capitalization falling from 106% of GDP in 2007 to 68% in 2009 at the height of the crisis. The numerous emerging banking crises observed since the 1990s also illustrate this risk linked to a too rapid expansion of credit.

In order to assess these excesses, the countries at risk of a credit bubble have been eliminated from our panel. The IMF<sup>(20)</sup> defines a credit bubble as a period during which the growth of the ratio of credit to private sector as a share of nominal GDP significantly exceeds its long-term level or when it increases significantly by more than 20 points a year<sup>(21)</sup>. We have therefore estimated that the countries likely to experience a credit bubble were characterised by a ratio of credit to the private sector as a share of GDP above 100%, such as China (147%) or Thailand (119%), as well as an increase of this ratio by more than 15 points in the past year<sup>(22)</sup> (see chart 9).

(17) Walter Bagehot (1873): «Lombard streets».

(18) Banque Mondiale (2008): «Global Development Finance: The Role of International Banking».

(19) Ross Levine (2005): «Handbook of Economic Growth», Elsevier.

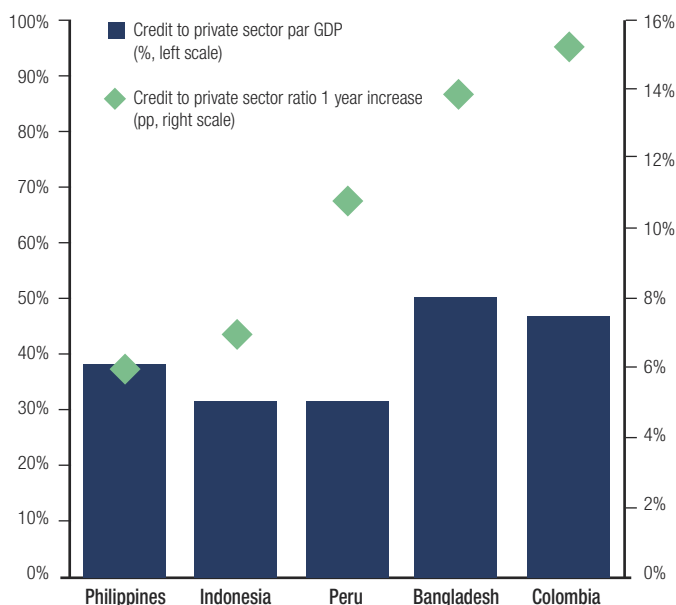
(20) International Monetary Fund (2013) «Policies for Macrofinancial Stability: How to deal with Credit Booms», Staff Discussion Note 12/06, June.

(21) Difference between the growth achieved and typical average long-term growth above 1.5% and the growth of the ratio of credit to the private sector as a share of GDP above 10 points.

(22) Coface (2013) Country risk panorama: «Transformation of emerging country risk», March.

We also considered necessary to keep only financial markets with market capitalization rates below the developed countries level, because they are considered as markets which had already reached maturity. These markets are, moreover, more sensitive to variations of the external context and therefore more volatile. We have taken as upper limit the average capitalizations of the G7 countries during the period 2006/2011, namely around 80%.

**CHART 9**  
Growth and level of credit to the private sector



Sources: Datastream, Coface

In short, 10 countries have both high growth potential and faster trending growth, as well as sufficient financing capacities to

achieve this growth: Bangladesh, Colombia, Ethiopia, Indonesia, Kenya, Peru, the Philippines, Sri Lanka, Tanzania and Zambia.

## BRICS, CIVETS, EAGLES, ... OVERVIEW OF ACRONYMS

Following in the wake of the acronym BRICS, created by Goldman Sachs in the early 2000s (see introduction), several others have sprung up:

- **Next-11:** groups together Bangladesh, Egypt, Indonesia, Iran, South Korea, Mexico, Nigeria, Pakistan, the Philippines, Turkey and Vietnam. Term coined by Jim O'Neill from Goldman Sachs, this refers to the most populous countries after the BRIC nations.
- **CIVETS:** groups together Colombia, Indonesia, Vietnam, Egypt, Turkey and South Africa. Term coined in 2009 by Robert Ward, analyst at The Economist Intelligence Unit; these countries are characterised by a dynamic and diversified economy and have a young, rapidly growing population.
- **EAGLES:** this stands for Emerging and Growth Leading Economies and refers to Brazil, China, South Korea, India, Indonesia, Mexico, Russia, Taiwan and Turkey. In 2010, BBVA introduced the countries whose contribution to world economic growth in 10 years time will be higher on average than that of the 6 largest industrialised nations. The EAGLES'NEST is a group of 11 countries which could catch up with the EAGLES, and which will make a bigger contribution to world growth than the smallest contributor in the G7, namely Italy.

## 3/ THE GROWTH POTENTIAL COULD ALSO BE HELD IN CHECK BY SHORTCOMINGS IN THE BUSINESS CLIMATE

Identifying the countries with both high growth potential and a financial system capable of financing it is a necessary condition but not, on its own, enough to determine the «new emerging countries». Country's economic outlook depends also on the quality of its business climate: a developing economy with substantial production capacity can, paradoxically, grow weakly if its business climate suffers from shortcomings of a nature that hinders investment.

Several studies have looked at the question of the link between economic growth and governance<sup>(23)</sup>. The large majority of these conclude that there is a positive correlation between the two<sup>(24)</sup>. For example, Rodrik, Subramanian and Trebbik<sup>(25)</sup> stress that good

quality governance and institutions impact on the level of development via three transmission channels:

- 1/ they reduce information asymmetry, insofar as the existence of institutions ensures better transmission of information;
- 2/ they reduce risks by establishing the rules governing property rights;
- 3/ they limit the ability of interest groups to limit growth by guaranteeing competitive practices or by fighting corruption.

(23) Governance is a very broad term defined by the United Nations as «the exercise of economic, political and administrative power enabling a country's affairs to be managed at all levels. It comprises the mechanisms, processes and institutions through which citizens express their interests, exercise their legal rights, fulfil their obligations and settle their differences».

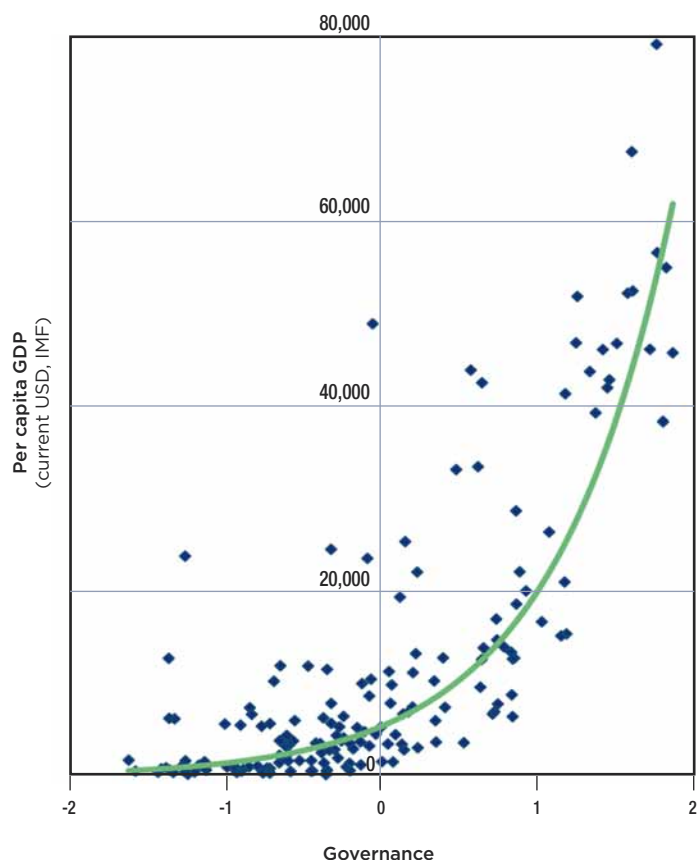
(24) The causal link between governance and economic development is, however, often difficult to define: the more advanced economies have greater resources to improve the quality of institutions and governance.

(25) D. Rodrik, A. Subramanian et F. Trebbik (2002): «Institutions Rule: The Primacy of Institutions over Geography and Integration in Economic Development», NBER working document no 9305.



Chart 10 illustrates this link between governance and economic development: countries with good quality governance generally have a high per capital GDP.

**CHART 10**  
Per capita GDP and quality of governance in 2012 in 186 countries <sup>(26)</sup>



Sources: World Bank, Coface

Coface has produced its own assessment of the business climate since 2008 so as to identify business-specific risks. It takes account of the quality of governance in its assessment of the business climate of 160 countries. This is a key component of the country risk assessment, as is the payment experience of the Coface group in the country in question, and of the assessment of the macro-economic and financial risk.

Assessing the business climate consists in measuring the quality of a country's private governance, that is to say the financial transparency of companies and the effectiveness of the courts in settling debts. At Coface, this business climate assessment is based on internal work involving all its entities across the world, as well as on business climate assessments produced by international organisation. Coface relies on its risk assessment and microeconomic experience to determine:

- whether a company's accounts properly reflect its true financial situation;
- whether, in the case of non-payments, the local legal system provides fair and effective recourse.

(26) The individual governance indicators for each country are calculated by taking the average score of the 6 World Bank dimensions of governance: political freedom, regulatory quality, control of corruption, political stability, rule of law, government effectiveness. The higher the indicator, the better the country's governance.

To do this, the company carries out a survey involving its entities throughout the world. This assessment, therefore, is based on its global network and the expertise this gives it regarding risk underwriting, information on companies and debt management. Like the country assessments, the business climate assessments are on a scale with 7 risk levels, A1, A2, A3, A4, B, C, D, in ascending order.

The table below shows Coface's 2013 business climate assessments for the countries selected according to their long-term growth prospects and the size of their financial systems.

**TABLE**  
Coface business climate assessments, 2013, by country

Country	BCA
Colombia	A4
Indonesia	B
Peru	B
Philippines	B
Sri Lanka	B
Kenya	C
Tanzania	C
Zambia	C
Bangladesh	D
Ethiopia	D

Sources: Coface

Several observations must be made regarding this table. First, none of the countries identified has a very satisfactory business climate, which is to say a assessment of A1, nor even A2 or A3.

Second, 5 countries, Colombia, Indonesia, Peru, the Philippines and Sri Lanka, have an acceptable business climate, i.e. A4, or B, so a level similar to that of the BRICS countries today: Brazil and South Africa score an A4, while China, India and Russia get a B.

Lastly, 5 other countries, Kenya, Tanzania, Zambia, Bangladesh and Ethiopia suffer from very difficult (C) or extremely difficult (D) business climate. By way of comparison, the quality of these climate is similar to those of Paraguay, Cameroon, Mongolia, Argentina (all assessed C), or Venezuela, Ukraine, Pakistan and Haiti (assessed D).

In this context, if in the first 5 countries, the business climate does not seem to be hampering the full exploitation of their growth potential, the last 5 could, in contrast, encounter more difficulties, although these need, nonetheless to be put in perspective: in 2001, Brazil, China, India and Russia were placed in 78<sup>th</sup>, 116<sup>th</sup>, 94<sup>th</sup> and 150<sup>th</sup> place by the World Bank <sup>(27)</sup> in terms of governance, namely close to where Bangladesh (139<sup>th</sup>), Ethiopia (144<sup>th</sup>), Kenya (131<sup>st</sup>), Tanzania (110<sup>th</sup>) and Zambia (85<sup>th</sup>) are today, meaning that governance issues were not so strong as to prevent them from enjoying a decade of sustained growth.

(27) Source: World Bank worldwide governance indicators, available on the website: [www.govindicators.org](http://www.govindicators.org)

## Opinion from

**JOËL PAILLOT,**  
**Group Risk Underwriting Director**  
**with the Coface group,**  
**on the business climate**  
**in Colombia and Ethiopia**

### ***What is your opinion on business climate in Colombia, one of the high-potential countries identified in this study?***

The country has for a long time remained unattractive for European companies due to the conflict with the Farc rebels. The reputation certain cities, like Cali or Medellin still have, has been undeserved now for many years. This is clear from our coverage of this country, as our exposure there has increased markedly in recent years. It is, clearly, not on a level with Mexico or Brazil, but it shows that companies are now interested in this high-potential market, with a rapidly expanding middle class and rising purchasing power. It is no surprise that the retail sector is, therefore, strongly represented in our portfolio, as are electronics. Telecommunications and automotives too generally confirm that Colombian households are consuming more than they did in the past. Finally, the chemicals and metals sectors are well represented. It is also worth noting that our payment experience with Colombia is very satisfactory. It is fairly easy to access financial information, making it easier to analyse the solvency of companies. We insure over 10 000 companies, covering exporting firms and Colombian companies selling on the domestic market.

### ***What about Ethiopia, a country that also has high potential but where the business climate is noticeably less favourable?***

Our clients, whether French or European, have to date hardly been interested in developing commercial relations with Ethiopia. A country which, however, offers many opportunities: a good, cheap workforce as well as government policy favourable to foreign investments. Our total exposure in this country has grown very little in the past three years. Some sectors, though, seem to interest our clients: the aeronautical sector, vehicles and parts, automotives, telecommunications, construction (because of the presence of certain Italian companies, in particular), food and perfumes. Our payment experience is good even though it should be stressed that we are selective in our assessment of risks. The quality of the financial information that is accessible is acceptable.

## Conclusion

Following the slowdown in growth in the BRICS, for which the Coface average growth forecast for 2014 is 3.2 points lower than the average growth recorded over the past decade, we have sought to identify countries whose long-term growth prospects are especially favourable. In our opinion, ten countries have high growth potential and sufficient capacity to finance this accelerating growth. Nevertheless, when we consider too the Coface business climate assessment, which is needed in order to take account of any obstacles to the realisation of this potential, we can split our panel into two groups: Colombia, Indonesia, Peru, the Philippines and Sri Lanka, where the business climate is more favourable than in Kenya, Tanzania, Zambia, Bangladesh or Ethiopia. Some countries will, therefore, find it more difficult and will take longer than the others to fully exploit their growth potential. However, these shortcomings in the business climate should be seen in perspective: in 2001, the quality of governance in Brazil, China, India and Russia was comparable with that of these last 5 countries today.

Still, the 10 new emerging countries we have identified do not have the population of the BRIC countries in the early 2000s (they represented 43% of the world's population in 2001, against 11% for "the 10" at present, i.e. only 30% of the population of the BRIC nations in 2001). Meanwhile, the GDP level of our panel represents 70% of the total BRIC GDP in 2001, which is equivalent to the current GDP of France. Finally, the BRIC countries recorded an average current account surplus while the new emerging countries today have an average deficit of 6% of GDP. In the years to come, these countries may, moreover, benefit less from world trade than their BRIC predecessors, as growth in the mature economies is now structurally weaker. Their rate of expansion will thus be more dependent on their domestic markets and their exports to other emerging countries, especially as many of them are net exporters of raw materials. But despite this less promising external environment, these "new emerging countries" have some advantages compared with the BRIC countries in 2001. They have, for example, nothing to be ashamed of when it comes to inflation or public debt: the former is on average 2.8 points lower than the BRIC 2001 and the level of public debt is around only 40%<sup>(28)</sup> of GDP (against 54% in the BRIC countries in 2001). These countries currently have the credentials to become the new high-growth emerging economies.

(28) However, this average hides the contrasts in performance: Colombia, Ethiopia, Indonesia and Peru have low levels of public debt, lying between 18 and 32%, against 80% for Sri Lanka.

# COUNTRY RISK AND BUSINESS CLIMATE ASSESSMENTS CHANGES

Assessment either upgraded, or removed from negative watch list or placed under positive watch list

## COUNTRY RISK ASSESSMENTS

Country	Previous	New
United States	A2↗	A1
United Kingdom	A3	A3↗

### United States: A1

- Dynamic and balanced GDP growth.
- Robust private consumption, driven by declining unemployment, lower savings rate, higher income and lower household debt service.
- The real estate market is gradually recovering.
- Strong investment growth, as corporate profits are back to their pre-crisis level and the corporate debt to GDP ratio is still comparatively low.
- Risks related to the government shutdown and the public debt ceiling have abated in early 2014.

### United Kingdom: A3↗

- Comparatively high GDP growth expected this year
- Very dynamic household consumption driven by ease credit conditions and low unemployment.
- Business confidence and capacity utilization rate point to stronger investment growth ahead, even though some sectors (mainly manufacturing) are lagging far behind other ones (construction, financial services).

## BUSINESS CLIMATE ASSESSMENTS

Country	Previous	New
UAE	A3↘	A3
Algeria	B↘	B
Indonesia	C↗	B
Rwanda	D	C

### UAE: A3

A new Companies Law, closer to international standards, was adopted in mid 2013. This act provides for improvements in corporate governance and changes in business creation, accounting, appeals and IPOs. However, the possible revision of the rule preventing foreigners to hold the majority of a business (more than 49% of its capital) has been postponed.

### Algeria: B

An easing of the legal business framework has been introduced by the 2014 Budget Law. Procedures for the approval of foreign direct investment or investment in partnership with foreign capital are alleviated. In addition, while since 2009 letters of credit had become compulsory for payment of imports, the law allows again payment with documentary collection.

### Indonesia: B

Indonesia is still facing corruption issues but the country has made significant strides with the Corruption Eradication Commission. The country has improved prosecution of financial crimes including high level officials.

### Rwanda: C

The country has enforced reforms allowing significant progress for business creation. Rwanda has a sound institutional framework and the regulatory environment for business is keeping improving, sustaining the development of the private sector. Significant efforts have been made for the control of corruption. The efficiency of the judicial system is improving to ensure the protection and exercise of the property rights.

Assessment either downgraded, or removed from positive watch list or placed under negative watch list

## COUNTRY RISK ASSESSMENTS

Country	Previous	New
Brazil	A3↘	A4
Thailand	A3↘	A4
Turkey	A4	A4↘
Ghana	B	B↘
Russia	B	B↘
Venezuela	C	C↘

### Brazil: A4

- Tighter fiscal & monetary policies
- Decelerating consumption
- Low investment
- Impact of real depreciation on firms indebted in foreign currencies
- Impact of Argentine misshape on industry (automotive)

### Thailand: A4

- Thailand's prolonged political crisis is impacting private consumption, investment and tourism. Consumer confidence has plunged and companies are also worried (a Japanese car manufacturer has postponed an investment).
- Household indebtedness (80% of GDP) is also weighing down on consumption and restraining the central bank ability to support growth.
- The government is operating in a caretaker capacity and is not allowed to implement fiscal stimulus measures.

### Turkey: A4↘

- Corruption allegations are destabilizing the government. Risks of escalating political tensions ahead of upcoming elections.
- 2014 GDP growth should slow to 2.0% reflecting the impact on domestic demand owing to a combination of the lira depreciation, the higher inflation (7.9% YoY in February 2014) and the large interest hikes (+425bp in January).

### Ghana: B↘

- Recurring late payments from the State, including to foreign creditors in the context of high fiscal deficit. The Government is struggling to control public expenditures and to reduce the elevated deficit (11% in 2013).
- Depreciation of the local currency (cedi) leading to the central bank decision to raise the key rate to 18% in February 2014 and to introduce foreign exchange control measures.
- However long-term economic prospects remain favourable (significant oil and gold reserves and a positive business climate).

### Russia: B↘

- The Ukrainian crisis will have a negative impact on an already low growth level (1.3% in 2013), due to a declining investment.
- Rubble depreciation led the central bank to hike its key rate (+150 bp to 7%). This will weigh down further on growth, by constraining further credit and investment.
- Risk of higher capital outflows, which reached 62.7 Bns \$ in 2013.

### Venezuela: C↘

- Worsening business climate (shortages, foreign currency scarcity, violence, import and price control, hyperinflation)
- Expected recession in 2014
- Falling foreign currency reserves.

## BUSINESS CLIMATE ASSESSMENTS

Country	Previous	New
South Africa	A3	A4
Tunisia	A4	B
Madagascar	C	D
Ukraine	C	D
Venezuela	C	D

### South Africa: A4

- Less easy access / availability of financial information: financial statement publication is not compulsory for private companies which are reluctant to make publication due to the deterioration of their financial situation.
- Deterioration of collection / creditor protection due to the enforcement of «business rescue» legal process allowing supplier to continue supplying a default debtor.

### Tunisia: B

The institutional business climate suffers from drawbacks linked to the former political regime and the instability in Tunisia since 2011.

2013 World Bank's governance indicators are deteriorating. Moreover. In addition, the 2014 version of the World Economic Forum's «Report on International Competitiveness» shows a sharp deterioration in Tunisia, mainly due to the development of the informal sector, corruption and smuggling, as well as social conflicts.

### Madagascar: D

Significant shortcomings in investor's protection, contract enforcement and property transfers handicap the business climate. The enforcement of reforms is slowed down by a fragile political situation which weighs on the business climate and the development of the private sector.

### Ukraine: D

The situation of the country has been strongly deteriorating for some years concerning the fight against corruption, the quality and the enforcement of the rules. The strong political instability weighs on the prospects for effective implementation of reforms which could improve the business climate through the upgrading of regulatory quality and corruption control.

### Venezuela: D

shortages, foreign currency scarcity, violence, import and price control, hyperinflation.

## Coface Assessments

<b>D</b>	Country risk
<b>C</b>	Business climate
<b>VERY HIGH RISK</b>	Medium term

### Main economic indicators

	2011	2012	2013 (e)	2014 (f)
GDP growth (%)	1.0	-1.1	0.8	2.0
Inflation (yearly average) (%)	3.7	2.0	-0.1	1.1
Budget balance (% GDP)	-2.9	-2.7	-2.2	-1.4
Current account balance (% GDP)	-9.9	-9.7	-7.9	-7.6
Public debt (% GDP)	40.5	45.1	44.9	42.8

(e): estimate  
(f): forecast

## Risk assessment

### Soft growth weighed down by weak domestic demand

In 2013, economic activity stabilised, underpinned by exports which were driven by a recovery in European demand (55% of goods exports) during the second half of the year and competitive gains resulting from wage moderation. Although it has been met with domestic obstacles, such as austerity measures which have restricted consumer spending, this trend has continued in 2014. Despite the wage increases granted to public-sector workers and pensioners in September 2013 (3.5% and 5% respectively), household spending has been curbed by unemployment which is still running at between 25% and 45% of the labour force, according to estimates. In this context, 20% of the population is now affected by poverty. Furthermore, production is being hindered by political negligence under the economic privatisation process launched after the 1995 Dayton agreement. Most of the former public enterprises have met with difficulties. However, the metals, timber and clothing sectors will benefit from an increase in demand from the euro zone.

In 2014 state investments and expenditure will remain limited, in compliance with IMF recommendations, while private investment may contract. The banking sector is likely to restrict credit, in order to limit the rise in non-performing loans, which total 14.9% of outstanding borrowing. Furthermore, the deteriorating political context is weighing on business outlook and discouraging investment.

### Public finances remain dependant on international aid

The recent slowdown in the Bosnian economy has involved a second IMF agreement of EUR 405 million in September 2012, further to the 2009 agreement. The federal budget (excluding debt interest) has been frozen for 3 years. However, the weakness of political institutions has delayed the adoption of structural reforms required to improve public finances, particularly concerning tax collection. In order to meet its deficit target, in January 2014 Bosnia-Herzegovina has requested for an augmentation of the latest IMF arrangement with an extra EUR 150 million granted, accompanied by a 9-month extension (until June 2015).

With regard to the external accounts, the country imports twice as much as it exports. A more dynamic external demand and steady immigrant workers' remittances (8% of GDP) would reduce the current deficit. With foreign direct investment (2% of GDP) covering only a small part of the financing need, external aid remains indispensable. Furthermore, Bosnia-Herzegovina has adopted a restrictive foreign exchange system, with a currency board arrangement, based on a fixed exchange rate against the

euro. Foreign currency reserves represent more than 5 months of imports, which reinforces the central bank's capacity to support the convertible mark against the euro.

### Rising social tension

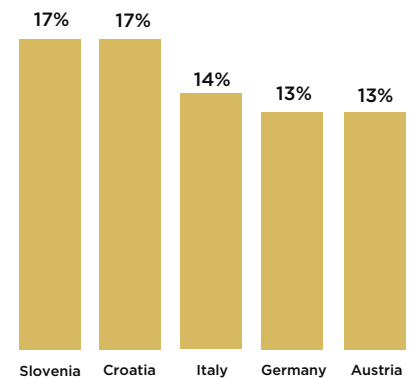
Following the Dayton agreement, the Bosnian administration split into two distinct entities: the Bosnia-Herzegovina federation, composed of 10 cantons, and the Bosnian-Serb Republic. The complexity of this structure weakens the central executive power, led by the Prime Minister Mr Vjekoslav Bevanda. The rotating presidency chaired between the three representatives of the Bosnian muslim, Croatian catholic and Serbian orthodox communities maintains political inertia and struggles to transcend the ethnic divisions. In this context, widespread frustration has increased, culminating in February 2014, in an unprecedented outbreak of violence since peace was restored in 1995. The demonstrations were instigated by workers who were exasperated by the negligent attitude of the privatised companies and who had not been paid for several months. Although most social classes and ethnic groups joined the protest, the movement was strongest within the Bosnia-Herzegovina federation, where 4 of the 10 canton prime ministers resigned. This situation highlights the deep unease caused by widespread corruption in a country which is incapable of undertaking reforms. Meanwhile, plenums were formed within a number of cantons to voice demands. At the end of February, the Sarajevo canton Assembly adopted all of the popular demands and thus effectively legitimised the citizens' democratic institution. This should help to ease the situation ahead of the forthcoming legislative and presidential elections in October 2014. It is therefore highly likely that the country will remain in a political crisis until then. Nevertheless, the fundamental problem of the country split will remain. Meanwhile, in February 2014 the European Commission announced the end of negotiations regarding EU membership, after seven years of discussions, given the lack of reforms undertaken by the authorities. Finally, the business environment is hampered by corruption, inefficiency in the administrative and judicial systems, as well as the size of the informal sector.

## Strengths

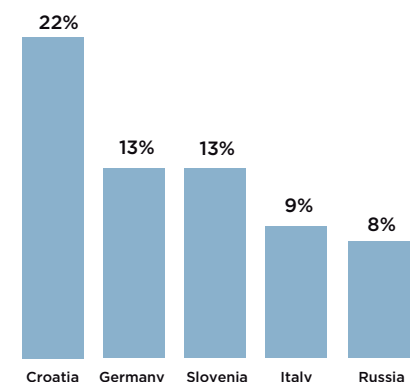
- Financial assistance from IMF
- Substantial immigrant workers' remittances
- Stabilisation and Association Process concluded with the European Union in June 2008

## Trade exchanges

### Exports of goods, as a % of total



### Imports of goods, as a % of total



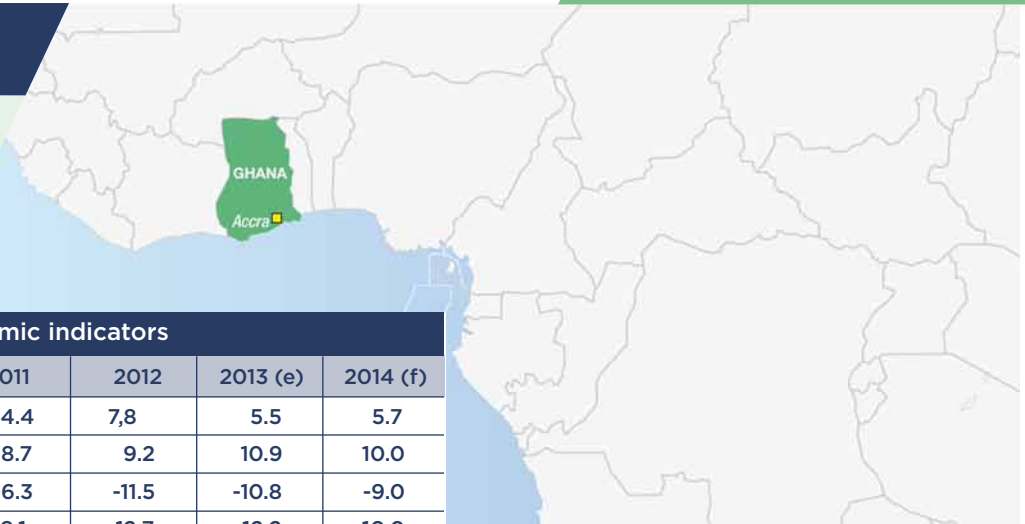
## Weaknesses

- Weak diversification of exports
- Very high unemployment rate
- Scale of the informal sector
- Infrastructure and business environment shortcomings
- Institutional and ethnic fragmentation



## Coface Assessments

<b>B</b>	Country risk
<b>B</b>	Business climate
<b>RATHER HIGH RISK</b>	Medium term



### Main economic indicators

	2011	2012	2013 (e)	2014 (f)
GDP growth (%)	14.4	7,8	5.5	5.7
Inflation (yearly average) (%)	8.7	9.2	10.9	10.0
Budget balance (% GDP)	-6.3	-11.5	-10.8	-9.0
Current account balance (% GDP)	-9.1	-12.7	-12.2	-10.0
Public debt (% GDP)	42.5	50.2	51.4	52.5

(e): estimate  
(f): forecast

## Risk assessment

### Growth in 2014, driven by the oil and gas sector, will be held back by weaker domestic demand

Following the slowdown in 2013, a very slight increase in growth is expected in 2014. The driving force for the Ghanaian economy should be the oil and gas sector, even if the rise in production from the Jubilee field is slower than expected because of recurring technical problems disrupting operations. The completion of the Bui hydro-electric dam at the end of 2013 and the start of gas production in Atuabo, scheduled for 2014, should improve electricity supplies and help boost output from the manufacturing sector. The services sector (finance, telecommunications) are expected to remain positive factors in the economy. Household consumption in 2014 could however begin to feel the effects of the slowing in wage growth and social expenditure in the context of public expenditures control. The cut in subsidies will lead to higher costs for energy and transport, reducing purchasing power. The high level of interest rates will continue to limit access to credit and weigh on investment. Inflationary pressures, accentuated in 2013 following the lowering of fuel subsidies in February 2013, and the increase in wages, are set to continue into 2014. The relative weakness of household demand should hold back price rises which will however continue to move upwards as a result of higher import costs following the depreciation of the cedi. The banking sector remains very fragile, particularly the public banks (20% of assets). The weaknesses in terms of regulation and inadequate supervision constitute a risk of higher bad debt.

### The long-expected improvement in public finances and current account deficit still yet to be completed

Despite the commitments made by the government to reduce expenditure, the budget deficit is set to remain high in 2014. The growth in tax revenues is likely to be lower than initially hoped for because of the ongoing technical issues holding back oil production and the weakness of the economic recovery. The government needs to continue its efforts to stop the rise in public expenditure and especially wages, but gradually, in order to avoid triggering discontent among a population waiting for the benefits of the "oil manna". On top of this the increasing cost of servicing the public debt, because of higher interest rates and the depreciation of the cedi (44% of the debt is denominated in dollars), will hinder attempts to improve the budget situation. The need to import capital goods for the development of the country's infrastructures, particularly for the oil sector, will continue to put pressure on the current account. Exports in 2014 could be higher with an increase in oil production. The less favourable outlook for the prices of raw materials, which account for

three-quarters of export earnings (gold, oil, cocoa) will however make it difficult to reduce the deficit. Doubts about the government's ability to deal with the worsening current account balance and public finances are driving the cedi down, leading to the decision of the Ghanaian Central Bank, at the beginning of February, to raise its official market rate by 200 bp (to 18%). The authorities have also introduced exchange controls aimed at limiting the depreciation of the cedi, which lost over 20% of its value in 2013 and almost 9% so far in 2014. Without an improvement in the current account, the cedi is likely to continue its depreciation.

### The political situation remains stable and the business climate relatively favourable

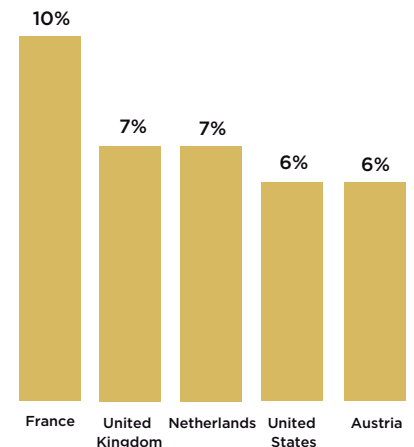
John Dramani Mahama, who had held the presidency since the death of President Atta Mills in July 2012, was re-elected and his party (National Democratic Congress) took the majority of the seats in the Assembly, in December of the same year. This result, contested by the opposition Nana Akufo Addo (New Patriotic Party, NPP) was finally ratified by the Supreme Court at the end of August 2013 without provoking a reaction from the opposition, which decided not to appeal. This episode in Ghana's political life has rather strengthened its image as a democratic model. Since the discovery of oil reserves, the population has high expectations in terms of improved living standards. Popular impatience is reflected in strikes and demonstrations, such as those of public sector doctors and teachers in April 2013, which do not challenge the country's political stability. The business climate continues to improve (access to credit, administrative procedures). But new issues have arisen in terms of governance with the management of the revenue flows generated by the start of oil exploitation.

## Strengths

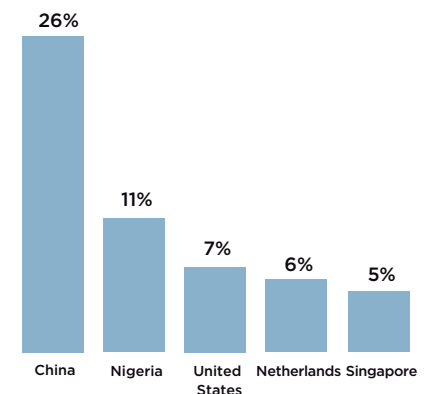
- Substantial mining (gold), agricultural (cocoa) and now oil resources
- Democracy installed, political and social stability
- Good governance and attractive business environment favourable to direct foreign investment
- Support from multilateral (IMF, World Bank, EU...) and bilateral (United States, Russian Federation, China) donors

## Trade exchanges

### Exports of goods, as a % of total



### Imports of goods, as a % of total



## Weaknesses

- Infrastructure shortcomings (energy, transport)
- Dependence on raw materials prices (gold, oil, cocoa)
- Rapid increase in the deficit and in public debt
- Weak public banks, which affects the whole banking sector

## Coface Assessments

<b>B</b>	Country risk
<b>B</b>	Business climate
<b>RATHER LOW RISK</b>	Medium term

### Main economic indicators

	2011	2012	2013 (e)	2014 (f)
GDP growth (%)	4.3	3.5	1.3	1.0
Inflation (yearly average) (%)	8.4	6.5	6.8	6.0
Budget balance (% GDP)	1.6	0.0	-0.5	-0.7
Current account balance (% GDP)	5.3	3.7	1.7	1.0
Public debt (% GDP)	11.7	10.9	10.4	10.5

(e): estimate  
(f): forecast

## Risk assessment

### Slowing of growth to worsen in 2014

The slowing in the rate of growth seen in 2013 is likely to accelerate further in 2014. Private consumption, the key driving factor in economic activity in 2013, sustained by rising public sector wages (the sector employs almost a quarter of the working population), will be boosted by the low unemployment rate. However, household demand is running out of steam, limited by high inflation, debt levels and economic and political uncertainties. Investment, depressed in 2013, dropped sharply in January 2014 (-7% against January 2013) and is likely to remain very limited through 2014. Companies will benefit from the frozen utility prices (water and energy) but the low level of corporate confidence will continue to hold back investment spending. On top of this, the large rise in interest rates by the central bank (CBR) in March 2014 will weigh on credit and investment. Industrial output could pick up thanks to the slight upturn taking place in the EU markets and the continued high growth in China. Oil exports however are not expected to rise with the slow growth in the volumes exported and the relative stability of prices.

The rise in public service tariffs, even if limited for individuals, together with the consequences of the autumn 2013 floods on food prices (almost 40% of household expenditure), will put upward pressure on prices. The depreciation of the rouble will also increase the cost of imported goods, further driving up the rate of inflation which is likely to go again above the 5% limit set by the CBR.

### Slow, but persistent decline in budget and current account balances

The fiscal balance is expected to continue deteriorating and should post a slight deficit in 2014. Oil revenues (50% of the total) are not likely to increase and the weakness of economic activity will hold down non-oil revenues. The modest growth is likely to complicate the decline in social expenditures and wages. Moreover, the federal budget will have to cover a new deficit in the pension system. Russian public finances however remain solid with a level of public debt of around 10% of GDP, giving the government a certain amount of room for manoeuvre, at least in the short term.

The current account should remain in surplus in 2014, but will continue to deteriorate. Exports, dominated by oil and gas (2/3 of export earnings) will be constrained by market prices which, at best, are expected to stabilise. Slow growth in imports will however limit the decline in the current account surplus. Uncertainties surrounding the outcome of the situation in Ukraine, and any political and economic repercussions for Russia, are likely to lead to increased capital outflows, already at \$63bn in 2013. The level of private company debt has also increased significantly.

The rouble lost almost 10% between January and March 2014, triggering a rise in interest rates (from 5.5% to 7%) as well as the intervention of the CBR on the currency markets. Despite the prospect of a floating exchange rate regime in 2015, the CBR could further intervene to stabilise the rouble in 2014.

The overall performance of the Russian banking system has improved but the risk of insolvency among the private banks remains high, heightened by the depreciation of the rouble given the scale of the dollarization of the sector.

### A tense social and political context, with an unsatisfactory business environment

The Ukrainian crisis and the military intervention in Crimea have led to a marked deterioration in relations between Russia, the US and the EU, with the imposition of political sanctions that could be increased if the situation intensifies.

The impact of the Ukrainian crisis on the internal political and social situation is likely to be limited. Despite the emergence of A. Navalny, an anti-corruption activist, as a spokesman able to bring together the various protests, the opposition struggles to be heard. The measures enforced by V. Putin since his reelection (laws restricting demonstrations, controls on NGOs and Internet sites, etc.), have further reduced the opportunities for protestors to express themselves. Levels of expectations among the middle class however remain high in the face of increasing inequalities and the persistent shortcomings in the business environment. If there is further delay in implementing the structural reforms promised by Putin, the social climate could deteriorate further.

The business context continues to be undermined by the failures in terms of protection for property rights and a lack of corporate transparency (in particular in terms of the shareholders). Russia is ranked 176th place (out of 215) in terms of control of corruption according to the World Bank Governance indicators.

## Strengths

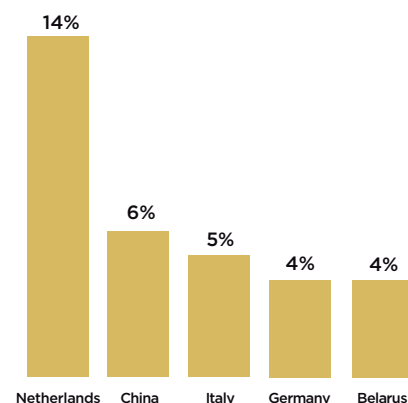
- Abundant natural resources (oil, gas and metals)
- Skilled labour force
- Low public debt and comfortable foreign exchange reserves
- Assertion of vigorous regional and energetic power

## Weaknesses

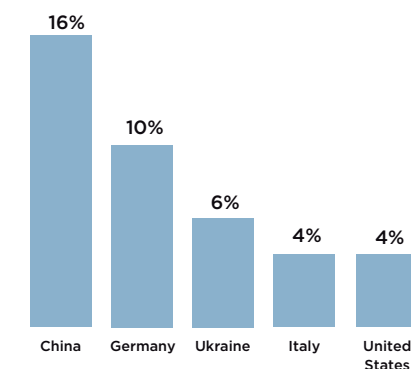
- Increased 'rentier' character of the economy
- Industrial sector's lack of competitiveness
- Weak private banking sector
- Weak infrastructures
- Declining population
- Persistent shortcomings in the business environment

## Trade exchanges

### Exports of goods, as a % of total



### Imports of goods, as a % of total



## Coface Assessments

**A4**

Country risk

**A3**

Business climate

**RATHER  
LOW RISK**

Medium term

### Main economic indicators

	2011	2012	2013 (e)	2014 (f)
GDP growth (%)	0.1	6.4	2.8	2.5
Inflation (yearly average) (%)	3.8	3.0	2.2	2.1
Budget balance (% GDP)	-1.8	-4.5	-4.3	-4.2
Current account balance (% GDP)	1.7	0.7	0.4	0.9
Public debt (% GDP)	42.1	45.4	47.1	48.2

(e): estimate  
(f): forecast

## Risk assessment

### No upturn predicted for 2014

Growth slowed significantly in 2013 amidst a context of political crisis and high household debt. Activity is unlikely to recover in 2014. Domestic demand will continue to be held back by uncertainty on the outcome of the political crisis. Confidence among investors and consumers has been undermined by the political disruption the country has been experiencing since November 2013. Companies, including Toyota, have postponed investments, and factories are operating at only 60% capacity. The country has endured regular episodes of political instability ever since the 2006 coup. Whilst the economy has held up relatively well despite these, the perception of Thailand among investors has nevertheless suffered. Household debt is running at a high level (80% of GDP), preventing households from increasing their consumption and limiting the ability of the central bank to cut interest rates, despite the slowing in economic activity. Levels of consumption in rural areas will also suffer, with the rice subsidy not being renewed, against the wishes of the farmers. Moreover, until a stable government has been confirmed, public expenditure will continue at a minimum level, slowing the implementation of the «Thailand 2020» infrastructure plan. Tourism is also suffering from the climate of political confrontation. Economic growth will nevertheless be sustained by foreign trade, which is feeling the benefits of the recovery in the advanced economies. The raw materials sector, however, will continue to feel the negative impact of falling prices.

### Solid financial situation

The budget deficit should remain at a high level in 2014, even though the recovery measures are coming to an end and the interim government is only able to spend under the supervision of the electoral commission. Despite this, public debt will remain sustainable in 2014. Externally, the current account balance will improve in 2014 thanks to stronger growth in exports, driven by the upturn in the developed economies. In addition, imports will feel the effect of the weakness of domestic demand. Thailand remains a favoured manufacturing base for the automobile and electronics industries, though the scale of FDI flows will depend on how the political situation evolves. The country is vulnerable to a crisis of confidence among investors in the context of the political crisis and the decrease in available liquidity following the expected tightening in US monetary policy. Foreign exchange reserves, however, are at a satisfactory level (8 months of imports in January 2014) and mean the country has a satisfactory capacity to weather any sudden capital outflows.

### Early elections have not yet brought a solution to the political crisis

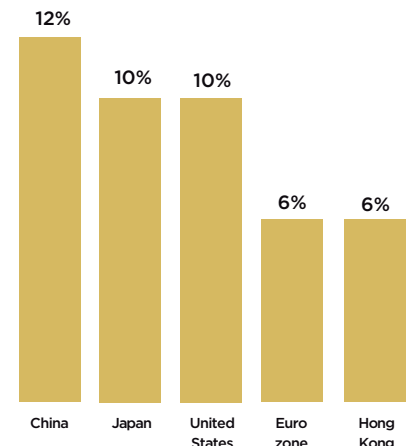
Yingluck Shinawatra (sister of the former Prime Minister, Thaksin Shinawatra), Prime Minister following the victory of Puea Thai in the 2011 elections, was forced into dissolving Parliament in December 2013 and called early elections in February 2014. Yingluck was faced with large-scale demonstrations triggered by her amnesty law proposal, which rekindled tensions between the pro- and anti-Thaksin (Democratic Party) factions. Thaksin, overthrown in the 2006 military coup, has been sentenced in absentia to 2 years in prison for corruption, and the opposition believe that the amnesty law was created to enable his return to Thailand. The opposition, however, boycotted the elections and blockaded certain polling stations. The demonstrations have continued since November 2013, and Bangkok was the subject of a virtual siege for 2 months before the opposition decided to open the streets of Bangkok and to organise its demonstrations in a park in the city. Partial elections will need to be held before a government can be formed, as only 89% of the districts were able to elect their representatives whilst the Constitution requires a minimum of 95%. Senatorial elections are also scheduled for 30 March. The Puea Thai, which is very popular in the rural areas, has a very good chance of winning these elections. Yingluck is currently subject to legal action for her inept management of the rice subsidy programme and for murder, following court proceedings initiated by the families of two people killed during the demonstrations. If she is removed, it is likely that the current Minister of Foreign Affairs, also a member of Puea Thai, will replace her.

## Strengths

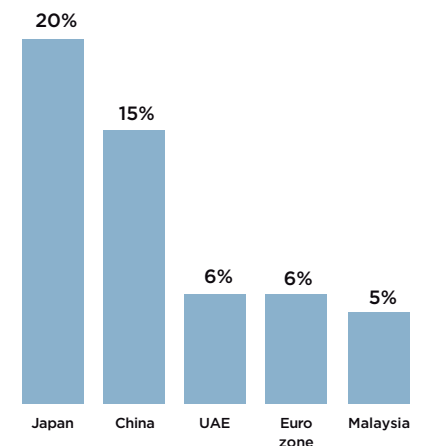
- Diversified and efficient agricultural and industrial production
- Manufactured goods moving increasingly upmarket
- Regional crossroads, open to dynamic neighbours
- Strengthened banking system

## Trade exchanges

### Exports of goods, as a % of total



### Imports of goods, as a % of total



## Weaknesses

- Ongoing political instability since 2006
- Thai foreign trade dependant on Chinese economy
- Inadequacy of structural reforms
- Business climate marked by persisting links between the private sector and the political elites
- High levels of household debt

## Coface Assessments

<b>B</b>	Country risk
<b>B</b>	Business climate
<b>RATHER HIGH RISK</b>	Medium term

### Main economic indicators

	2011	2012	2013 (e)	2014 (f)
GDP growth (%)	-1.9	3.6	2.7	3.0
Inflation (yearly average) (%)	3.5	5.6	6.1	5.5
Budget balance (% GDP)	-3.5	-5.7	-7.0	-6.5
Current account balance (% GDP)	-7.4	-8.2	-8.2	-7.0
Public debt (% GDP)	44.5	45.5	49.0	52.0

(e): estimate  
(f): forecast

## Risk assessment

### Persistence of socio-political tensions and numerous economic and social issues

The October 2011 elections to the Constituent Assembly gave a relative majority to the Islamist conservative party Ennahda and led to the formation of a coalition with two secular parties, with the most important post, that of Prime Minister, going to Ennahda. Assassinations in February and July 2013 of two figures of the secular opposition triggered a political crisis leading end January 2014 – just after the adoption of a relatively consensual and progressive constitution – to the formation of a new transition government, composed of independent and technicians.

Following the presidential and parliamentary elections, postponed to the second half of 2014, the most likely outcome is the formation of a new coalition composed of Islamists and secularists, while the new government will experience the same difficulties in conducting a liberal economic programme.

The state of emergency in force since the revolution in January 2011 was finally lifted in March 2014, although the authorities are still confronted with a radical and violent Islamist movement. They will also continue to face many social and economic challenges, and popular expectations in this regard will continue to result in strikes and social unrest. The main issues remain job creation and better social and geographic sharing of growth, the country's interior remaining disadvantaged compared with the coastal regions.

### GDP growth expected to increase slightly in 2014

The authorities are targeting a growth rate of 4% for 2014, based on sustained development of manufacturing industries and services, but more moderate development in the agricultural sector. Besides, a limited fall in the non-manufacturing sector is forecast. With regard to domestic demand, consumption and investment are expected to rise by about 5%. This rebound in the economy, however, could be impeded by socio-political tensions until completion of the transition process, as well as by a moderately buoyant world economic situation and weak recovery in the European Union (EU), the country's major economic partner. A growth rate hardly above that of 2013 seems, therefore, more likely.

### Slight decrease in the substantial twin deficits, alleviated by international financial aid

Due to cuts in current expenditure and subsidies, the fiscal deficit could decrease slightly in 2014, but there could be a lack of fiscal policy continuity because of the prospect of a succession of different governments during the year. Public debt – already higher as a proportion of GDP than the average for comparable emerging countries – is increasing gradually but it is partly domestic and the rest is contracted on concessional terms.

The external accounts will remain under pressure. Exports will grow modestly because of political and social instability and the sluggish economic situation of the country's main trading partner, the EU, while imports will again suffer from the high cost of imported energy (15% of the total). Moreover, expatriates' remittances will be resilient, although the rebound of tourism will depend on the improvement of the political and security situation and, as a whole, the current account deficit will remain high, despite narrowing slightly.

2014 will be marked by further deterioration of foreign debt ratios. However, since the 2011 G8 summit, Tunisia has obtained financial support from bilateral and multilateral institutions to cover its public and external deficits. For this purpose, loans from the World Bank and the African Development Bank are likely to be rolled over, to which will be added those from the EIB (European Investment Bank) and the AFD (*Agence Française de Développement*). Moreover, in June 2013, the IMF agreed a loan of \$1.75 billion over two years. Nevertheless, those institutions require, in return, an acceleration of economic reforms, unlikely at this stage. Meanwhile, the authorities also want to make use of Islamic funds. These loans will nudge up the level of foreign exchange reserves, which (with about four months of imports) will remain well below the emerging countries' average.

### Weak banking sector and business environment

Bank solvency, asset quality and profitability, already poor before 2011, have since deteriorated. Banking sector weakness could thus undermine macro-economic stability.

Because of the relatively recent fall of the previous regime and the subsequent insecurity, the business environment remains problematic – with the development of the informal sector, corruption, smuggling and social conflicts – although improvements to the law on bankruptcy and the investment code are planned for 2014.

Moreover, Coface has observed an increase in payment incidents and longer debt recovery periods.

## Strengths

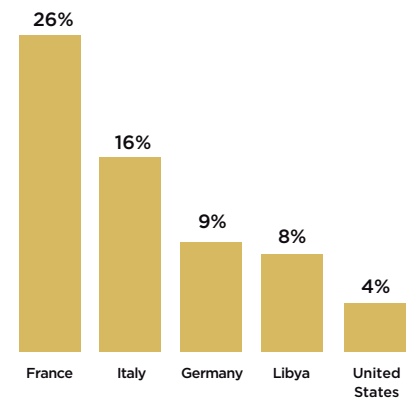
- Natural resources (gas, phosphates), agricultural resources and tourism
- Economy undergoing diversification and fairly skilled labour
- Proximity to the European market and association agreement with the EU

## Weaknesses

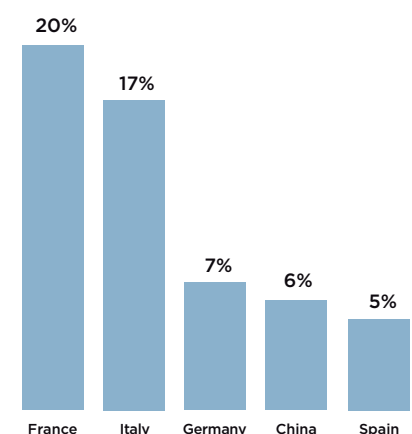
- Large social and geographic inequalities
- Significant fault lines dividing society between Islamism and secularism, tradition and modernity
- High unemployment, mainly among the young and particularly graduates
- Significant weight of agriculture in the economy
- Tourism sector facing political and security problems and increased competition
- Size of the informal economy (about 40% of GDP) and business environment in need of improvement

## Trade exchanges

### Exports of goods, as a % of total



### Imports of goods, as a % of total





## Coface Assessments

**A4**

Country risk

**A4**

Business climate

**MODERATE RISK**

Medium term

### Main economic indicators

	2011	2012	2013 (e)	2014 (f)
GDP growth (%)	8.8	2.2	3.8	2.0
Inflation (yearly average) (%)	6.5	8.9	7.5	7.0
Budget balance (% GDP)	-0.7	-1.9	-1.2	-2.0
Current account balance (% GDP)	-9.7	-6.2	-7.8	-6.0
Public debt (% GDP)	39.1	36.2	35.0	34.9

(e): estimate  
(f): forecast

## Risk assessment

### Growth rate suffers from weakening domestic demand

In 2014, household consumption, the main engine of growth (70% of GDP), will suffer from the combined effects of the depreciation of the Turkish lira, high inflation, rising interest rates and the measures aimed at controlling imports (namely increased taxes on imported cars). In this climate of slowing growth, new arrivals on the labour market could have difficulty finding a job. As a result unemployment could increase to more than 10% of the active population (9.9% in November 2013). As for industry, the improvement in price competitiveness associated with the depreciation of the lira as well as the upturn in external demand should benefit the high added value export sectors (automobile, durable consumer goods) and the tourism-related services. In addition, public investments will continue in the run-up to the local and presidential elections, respectively scheduled for March and August 2014. The banking sector is well capitalised, with non-performing loans held at less than 3% of total loans. The increases in interest rates will however be a burden on private sector investment as well as on household credit. Finally, together with other pressures on consumption, inflation will rise with the cost of imported products following the depreciation of the Turkish lira.

### Exchange rate vulnerability

Management of public finances remains conservative. This has resulted in a primary balance (excluding debt interest payments) that is in surplus. The level of revenues in 2014 will suffer as a result of weak consumption. As a result, the current public deficit does not undermine the viability of the public debt: the level of which is moderate while maturity and proportion of local currency increasing.

Although imports should fall, the current account deficit in 2014 will remain substantial. The scale of this, the second highest in the world by value after the United States, represents the principle point of vulnerability of the Turkish economy and its financing will continue to depend on volatile capital inflows. The ongoing tightening of US monetary policy, heralded in May and begun in December 2013, has triggered an outflow of capital from the major emerging economies. Turkey has been hit especially hard with risk aversion further exacerbated by the political conflicts that surfaced in December. The Turkish lira depreciated by 20% in 2013. The late reaction from the central bank at the end of January 2014 was significant with the raising of its main interest rates from 425 to 550 base points. The central bank reserves (excluding gold) previously had declined by USD 10 billion to USD 105 billion. They are still however sufficient, representing 5 months of imports. In 2014, reflecting the political tensions and the continuing high level of the current account deficit, the Turkish lira could again prove to be highly volatile.

### Political context under pressure

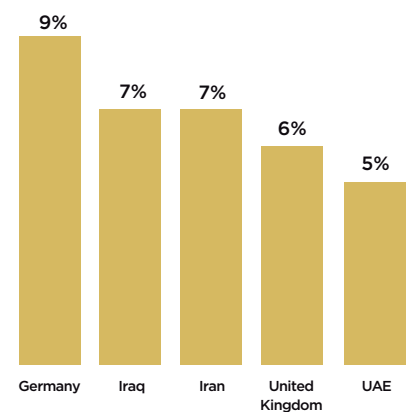
The lack of political visibility is also a destabilising factor for the Turkish economy. The government of Prime Minister Erdogan has been weakened following the revelations of December 2013 concerning corruption involving ministers' families, members of the AKP and various business people close to the government. The second instalment of the scandal began in early February with phone recordings between the Prime Minister and his son. At the same time large-scale purge have been carried out by the government involving the reassignment of thousands of senior members of the police, judges, the reform of the HSYK (Judge and Prosecutors High Council), as well as the passing of a law aimed at controlling the internet. The designated responsible is the Gülen movement, a powerful worldwide network with schools (dershane) and Turkish cultural centres. Indeed, Fethullah Gülen says he is becoming concerned about the increasingly authoritarian drift of the Prime Minister. AKP wants to find ways of limiting the spread of this movement. The upcoming local elections, at the end of March, will be held in this extremely sensitive political context. AKP could lose its domination. If not, and if its ascendancy is confirmed, bearing in mind the lack of alternatives, Prime Minister Erdogan could be a candidate in the presidential elections in August (the first with universal suffrage), especially as he cannot hold the office of Prime Minister for a third time in succession. The political climate will therefore remain tense, intensified by the weariness among the population with regard to the current executive power. Moreover, the peace process begun in May 2013 with the Kurdistan Workers Party (PKK) remains precarious. Finally, the presence of 500,000 refugees and the Syrian military attacks on Turkish territory are also sources of tension that could worsen during 2014.

## Strengths

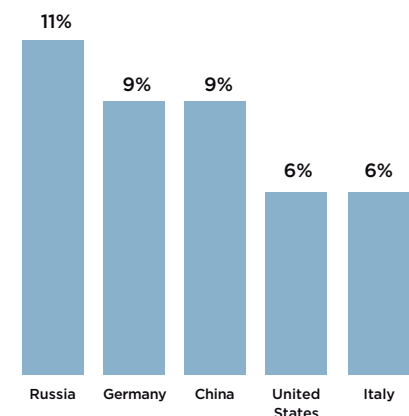
- Public finances under control
- Resilient banking sector
- Demographic vitality and highly skilled workforce
- Positioned as a regional hub, which reinforces attractiveness of the Turkish market

## Trade exchanges

### Exports of goods, as a % of total



### Imports of goods, as a % of total



## Weaknesses

- Insufficient domestic savings, substantial current account deficit and heavy dependence on foreign capital
- Increased external indebtedness of companies raises their exposure to currency risk
- Rising political tensions
- The Kurdish issue remains a source of social and political instability
- Geopolitical stability tested by the Syrian conflict



## Coface Assessments

<b>D</b>	Country risk
<b>D</b>	Business climate
<b>VERY HIGH RISK</b>	Medium term

### Main economic indicators

	2011	2012	2013 (e)	2014 (f)
GDP growth (%)	5.2	0.2	-1,5	-1.0
Inflation (yearly average) (%)	8.0	0.6	-0,3	5.0
Budget balance (% GDP)	-2.7	-4.5	-5,0	-6.0
Current account balance (% GDP)	-6.3	-8.4	-5,0	-9.2
Public debt (% GDP)	36.8	37.4	41.3	44.7

(e): estimate  
(f): forecast

## Risk assessment

### Growth still lacking in 2014

The Ukrainian economy, which has been in recession since the end of 2012, is not going to recover in 2014. Consumption, the main driving force for growth, is likely to be held back by the slowdown in wage growth reflecting the level of budgetary constraints as well as by rising prices. Industrial output, which dropped 5% in January 2014 year-on-year, should continue to suffer from the political situation, the weakness of domestic demand and increased production costs (imported gas).

Consumer prices, which were helped by the freeze in utility prices in 2013, are likely to be once again heading upwards in 2014. Inflationary pressures will be increased with the non-renewal of the 30% reduction in gas prices granted by Russia in the first quarter of 2014. In addition, the financial aid promised by the IMF is going to be subject to conditions concerning budget reforms and in particular the cutting of subsidies on gas prices. Finally, the devaluation of the hryvnia will drive inflation up.

### An extremely precarious financial situation

The budget deficit is likely to deepen further in 2014. Any increase in revenues will be limited by the decrease of GDP. In addition, despite the expected slowing in wage increases, expenditure (which now accounts for over 50% of GDP) is likely to remain high, at least until after the Presidential elections scheduled for May 2014. The measures that would have to be implemented as part of a new IMF agreement would help to prevent any further worsening of the deficit.

The current account is set to deteriorate in 2014. The slow improvement in the global world economy, and in particular in the EU, should help maintain demand for and the price of steel, Ukraine's leading export. Sales of agricultural products (wheat, corn) should remain strong. The increased tensions with Russia, its leading trading partner, will however have repercussions for its exports. The rise in the cost of imported gas, as of April 2014, and any further trade sanctions that may be imposed by Moscow, will further increase the current account deficit. This would deteriorate even further as a result of the devaluation of the national currency.

The level of foreign debt due for repayment by the State in 2014 is estimated at \$10bn, of which \$3bn to the IMF and \$1bn in Eurobonds maturing in June. The suspension of the \$15bn of aid promised by Russia has deprived Ukraine of the essential financing required to pay its foreign debt. Multilateral (IMF, EU) and/or bilateral aid is not likely to be released before the elections scheduled for May 2014. The danger of a sovereign default cannot therefore be totally discounted.

Given its lack of reserves to support the currency, the central bank (NBU) abandoned the pegging of the hryvnia to the dollar in February 2014. The depreciation of the currency is likely to continue given the extremely uncertain political and economic context. Any major devaluation, which cannot be excluded, would have serious repercussions for its foreign debt, 70% denominated in foreign currency. Private companies, as well as the banking sector, already struggling with bad debt and insufficient capitalisation, would be particularly hard hit.

### Serious worsening of social conflicts and significant threats to the territorial integrity of the country

The protest movements triggered at the end of 2013 by the decision not to sign the Association Agreement with the EU, resulting in over 80 deaths, led ultimately to the removal of the country's President, V. Yanukovich. The extremely precarious political and social situation is likely to continue for some time. The lack of a leader with sufficient charismatic appeal to unite the various protest movements, with their competing claims, as well as problems in forming a coalition government following the overthrow of the President, means that situation will remain very changeable until at least the early elections in May 2014 and perhaps beyond.

The decision taken by Parliament in February 2014 to end bilingualism in certain Russian-speaking regions significantly increased tensions between the eastern, wealthier and majority Russian-speaking regions and the western, more European focussed regions. The deployment of Russian troops in the Crimea has increased the danger with regard to the territorial integrity of Ukraine.

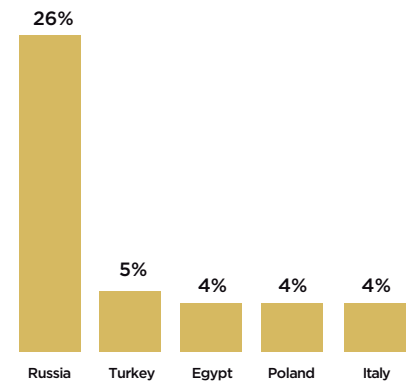
Improving the business environment, in particular with action to control the corruption that is rampant in the country, should be one of the priorities for the new Ukrainian government. Any implementation of measures in this regard will take time, especially as they would run up against opposition from sections of the Ukrainian oligarchy.

## Strengths

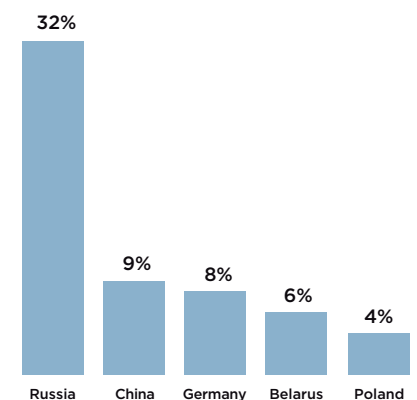
- Strategic position between Russia and the European Union
- Considerable agricultural potential
- Skilled low-cost labour force

## Trade exchanges

### Exports of goods, as a % of total



### Imports of goods, as a % of total



## Weaknesses

- Inter-regional strains and serious tensions with Russia that could endanger the integrity of the country
- Extremely precarious political and social context
- Little economic diversification and dependence on metal prices and cost of imported gas.
- Over indebtedness of private sector and rapid rise in public debt.
- Extremely fragile banking system because of high level of bad debt and lack of liquidity

## Coface Assessments

**A3**

Country risk

**A1**

Business climate

### Main economic indicators

	2011	2012	2013 (e)	2014 (f)
GDP growth (%)	1.1	0.1	1.9	2.1
Inflation (yearly average) (%)	4.5	2.8	2.2	2.3
Budget balance (% GDP)	-7.8	-7.9	-6.4	-6.0
Current account balance (% GDP)	-0.9	-3.6	-3.5	-2.8
Public debt (% GDP)	84.3	88.8	92.1	95.3

(e): estimate  
(f): forecast



## Risk assessment

### Dynamic growth led by volatile sectors

Growth in 2013 was driven by a resurgence of household consumption and a positive inventory effect, with the services and construction sectors as the leading contributors. In 2014, household consumption will remain the leading contributor to growth. The unemployment level nonetheless remains high compared to the long-term average (7.8% in 2013 compared to 5% from 2000 to 2008). The Bank of England (BoE) has committed to maintaining an expansionist monetary policy however, as long as unemployment remains at 7% or higher, with inflation stable at 2% (31%). According to the latest forward-looking statement from the central bank, monetary policy is unlikely to be tightened before 2015. In this context, households and investors will continue to benefit from historically low interest rates during 2014. Although household debt is at a very high level (132% of disposable income in June 2013), average net worth is also high (700% of annual income), boosted by stronger property prices (+7.5% in 2013). Consequently, consumer confidence is strong, amid anticipations of a rise in real wages in 2014. In January, the finance minister Mr Osborne argued in favour of an 11% hike in the minimum wage in the UK by 2015. Furthermore, the state is also supporting the construction sector via stimulus measures in the property market (Help to Buy). In 2013, the government ploughed almost 1% of national wealth, i.e. close to £17 billion, into infrastructure construction and home-building projects, at the same time announcing its intention to prioritise the improvement of the road network. This sector will therefore remain on a positive trend in 2014. In the manufacturing sector, production remains 15% below the pre-crisis level, similar to the beginning of the 1990s. Business manager surveys carried out in January 2014 reflect rising confidence in the UK economy over the medium term. With a strong rate of production capacity utilisation (82%), economic activity will be supported by an increase in investments, particularly the renovation of fixed capital. Loans to non-financial companies and small enterprises increased during Q4 2013. This type of credit will continue to grow during 2014, as the BoE intends to help SMEs with financing by providing cheap liquidity facilities to the lending banks. Furthermore, corporate tax will be reduced by one point (23%). The state plans to cut welfare benefits in 2014 (excluding health-care, education and retirement pensions) and to reduce charges weighing on companies (lower employer contributions) and also lower the top income tax band (to 45% compared to 50% previously). Inflation will remain in the target range, at slightly above 2%, driven by upbeat domestic demand and increased trade with European partners.

### Stronger exports in 2014

The uptick in economic activity in the euro zone (47% of exports) will accentuate positive input to growth from external trade. Growth will accelerate within the UK's two main trading partners, Germany and the US (each representing 11% of exports). Furthermore, although British products enjoy limited price flexibility, they will nonetheless benefit from a relatively weak pound. In 2013, the exchange rate was effectively around £0.85 for 1€, compared to £0.65 from 2000 to 2007, i.e. over 20% lower. The UK current account balance remains highly dependent on financial services. The global trade deficit to GDP is approximately 7 points, whereas the services trade balance stands at a 5-point surplus. London remains the world's leading financial market. A more rapid pace of growth among developed economies will boost UK financial services. In this context, the current account deficit will contract slightly in 2014.

### The banking system remains over-dimensioned

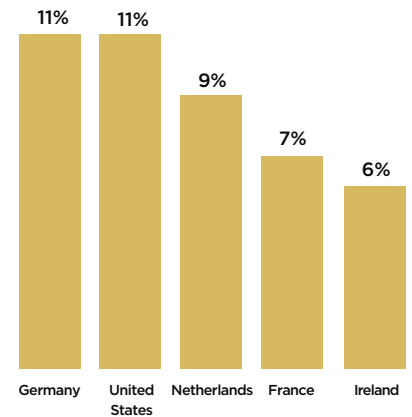
Banks constitute a weak point in the economy. In absolute value terms, the UK banking system is effectively the third-largest in the world, after the US and Japan (£11,000bn representing 900% of GDP). In order to limit systemic risk resulting from a default or a recapitalisation of one of the majors, the UK banks have had to streamline their balance sheets. They have therefore reduced their balance sheets by almost 20% and amassed deposits in order to limit refinancing risk. The two major nationalised financial institutions in particular (RBS and Lloyds) are ahead of schedule in terms of implementing the restructuring plans imposed by the European Commission. However, banks with the strongest domestic market presence remain heavily exposed to property risk. Recent government measures supporting the property sector (the state can underwrite up to 20% of loans) could encourage banks to grant more loans and inflate the property bubble.

## Strengths

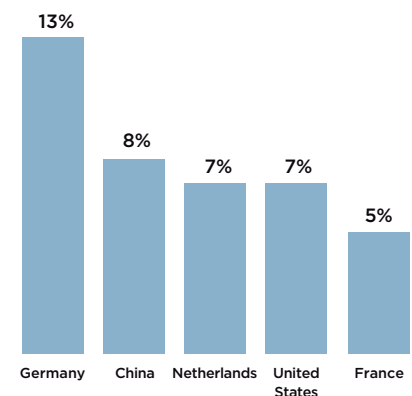
- Bank of England's flexible monetary policy
- Hydrocarbon production meeting three quarters of energy needs

## Trade exchanges

### Exports of goods, as a % of total



### Imports of goods, as a % of total



## Weaknesses

- Economy highly dependent on financial services and property market
- Disagreement within the government coalition over European question
- High public debt and deficit levels
- High private debt
- Weak banking system
- Significant share of young people in the unemployment figures, possible source of social tension

## Coface Assessments

A1

Country risk

A1

Business climate

### Main economic indicators

	2011	2012	2013 (e)	2014 (f)
GDP growth (%)	1.9	2.8	1.7	2.7
Inflation (yearly average) (%)	3.1	2.1	1.4	2.0
Budget balance (% GDP)	-9.7	-8.3	-5.8	-4.9
Current account balance (% GDP)	-2.8	-2.6	-2.3	-1.9
Public debt (% GDP)	99.4	102.7	106.0	107.3

(e): estimate  
(f): forecast

## Risk assessment

### Growth in the US accelerates in 2014

Throughout 2013, growth in the US was underpinned by household consumption and also by the construction sector. In 2014, growth will once again be driven by household spending, but also by corporate investment. Firstly, the dynamic job market is driving consumer spending. The unemployment rate has been gradually declining since January 2010 and fell below 7% in January of this year (6.6%). President Obama announced a decree increasing the minimum wage paid to new federal employees, as of 1st January 2015, to \$10.10 per hour indexed to inflation, representing a 40% hike. He also encouraged Congress to extend this measure. Furthermore, disposable household income increased by 1% in 2013, which is also positive for spending. Consumer spending will grow at a slower pace than before the crisis however (3.1%, 2003-2007). Household savings have effectively increased (to an average 5.1% of disposable personal income [DPI] since 2012 compared to 3.5% from 2003 to 2007). Furthermore, household debt has fallen back to the 2003 level (103% of GDP). Janet Yellen, the new Chair of the Board of Governors of the Federal Reserve (FED) declared that she would proceed cautiously regarding tapering the ultra-accommodating monetary policy. Her predecessor, Ben Bernanke, had announced a reduction in monthly purchases of government bonds and mortgage-backed securities in December 2013. Furthermore, the FED is unlikely to hike its leading base rate before 2015, even if unemployment falls below 6.5%, in order to avoid slowing economic activity. Inflation remained well below target (2%) at the end of 2013 (1%).

### Robust companies

Corporate profitability in the US hit a new all-time record in 2013 (12% of GDP), with company debt also falling (50% of GDP compared to 67% in the euro zone and 77% in the UK). The financial strength of companies, coupled with dynamic domestic consumer spending and firm global demand, is driving investment. Corporate confidence was also high during H2 2013. The automotive and retail sectors will continue to expand in 2014. The construction industry may be weighed down however by steeper long-term rates. Real estate investment was effectively boosted by low interest rates.

### Net exports will boost growth

Net exports will contribute positively to growth. The US trade deficit contracted in 2013, as a result of increased energy independence. Between January 2012 and June 2013, there was effectively a 35% swing in the energy trade deficit. The US exports coal to Europe and Asia, as domestic gas is now cheaper to use. In 2014, growth in China, the leading trade partner, will be broadly in line with 2013. Growth will accelerate among the other major partners, with the exception of Japan, with US exports benefitting fully from this trend. Healthy domestic demand will also stimulate imports, to a lesser extent. The current account deficit will therefore continue to contract under the influence of ongoing growth in repatriated earnings from US companies, a surplus balance among services, buoyant agricultural commodity prices and a reduction in energy imports.

### Recurrent political confrontations

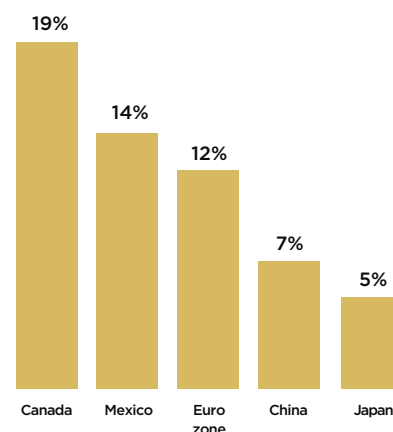
Public debt remains at a high level (106% of GDP). Budgetary streamlining, initiated in 2011, is weighing directly on economic activity. Public expenditure effectively contributed negatively to growth in 2013, by -0.5 points. Federal expenditure will increase slightly in 2014, particularly in the defence sector. The budget was ratified in December 2013 as the result of a temporary agreement signed in October, following the 18th administrative shutdown in US history, which lasted 16 days. Furthermore, the debt ceiling was raised in February to \$17.2bn. The US will therefore be able to honour repayments until March 2015. The agreement was unconditionally approved by the Republican-led House of Representatives. Constant deadlock in the economy was effectively damaging the party's reputation according to opinion polls. The Republicans therefore accepted a compromise in order to improve their political image, a few months ahead of the mid-term elections. The Democrats still appear to be in a position to win the forthcoming elections and increase President Obama's hold on power.

## Strengths

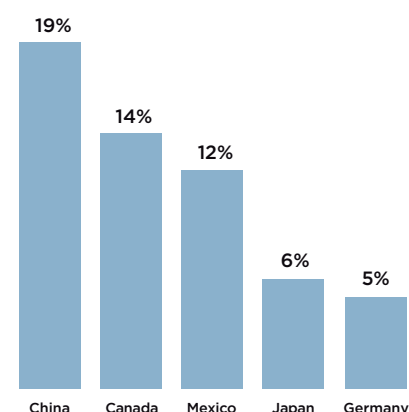
- Flexible job market
- Full employment is also one of the objectives of the Federal Reserve
- Predominant role of the dollar in the global economy
- Nearly 60% of public debt held by residents
- Growing energy self-sufficiency (shale gas)

## Trade exchanges

### Exports of goods, as a % of total



### Imports of goods, as a % of total



## Weaknesses

- Significant portion of unemployment is structural
- Limited geographic flexibility of households
- Polarisation of political life
- Falling birth rate
- Many dilapidated infrastructures



## Coface Assessments

<b>C</b>	Country risk
<b>D</b>	Business climate
<b>VERY HIGH RISK</b>	Medium term

### Main economic indicators

	2011	2012	2013 (e)	2014 (f)
GDP growth (%)	4.2	5.6	1.6	-1.0
Inflation (yearly average) (%)	26.1	21.1	40.0	68.0
Budget balance (% GDP)	-13.1	-19.6	-18.0	-16.0
Current account balance (% GDP)	7.7	2.9	2.8	2.2
Public debt (% GDP)	43.3	46.0	50.0	52.0

(e): estimate  
(f): forecast

## Risk assessment

### Recession and hyperinflation in an atmosphere of political and social tensions

After declining in 2013, growth will be replaced by recession in 2014. Despite the scale of social support and the price limits imposed on a number of consumer and durable goods, the relentless slowdown in private consumption will continue. With the ending of the election period, public expenditure will be cut back. The fall in investments by private companies will continue. The worsening political and social situation will not encourage households to spend, or companies, whether local or foreign, to invest. Inflation will remain at a very high level. This is being stoked by a shortage of certain goods (cars, health and hygiene products and basic foodstuffs) resulting from the inadequacies of the agricultural and industrial sectors and the difficulty in obtaining foreign currency for imports, as well as from the monetary financing of the public deficit.

### High budget deficit funded by the creation of money

The budget deficit will remain significant, leading to a further rise in debt. Even though the majority of the deficit is being financed by the creation of money by the Central Bank, the rest is being borrowed from local banks. These are, moreover, required to lend to certain sectors, to allocate 5% of their profits to social programmes and to apply the interest rates as set by the government. Public expenditure, which includes the subsidies, most notably on fuel prices, accounting for one-third, will remain high. Against these expenses, income, one-third of which comes from the operating earnings of the national oil operator PDVSA, falls well short. In addition, the funding by PDVSA of certain public expenditure, mainly of a social nature, works to hide the true reality of public finances. To get a better idea of the level of public debt, part of the debt held by PDVSA also needs to be included in this. The use of the resources of PDVSA, without which no new extraction project can start, is detrimental to its investments and future oil production, on which relies a quarter of the economy.

### Declining current account surplus that can no longer cover capital outflows

The current account surplus is in steep decline. Oil exports (90% of all exports) are declining as a result of increased domestic consumption and the slow falling-off in production. Against this, the controls on foreign exchange and trade flows are not preventing the enormous scale of imports of consumer goods and durables, as well as of refined oil products, a direct consequence of the pitiful state of the non-oil sector and the lack of refining capacity. Payments to foreign service providers, both for extraction and shipment, are expensive. Any increase in oil production in the Orinoco Belt and the development of offshore gas fields in cooperation with Trinidad will require even greater use of foreign partners. Whilst new foreign direct investments are much reduced, foreign involvement in the oil and gas partnership companies implies the repatriation of profits. Lastly, despite the strict currency controls, there is a large-scale leaking of capital facilitated by the extent of corruption and encouraged by the financial repression and expectations of inflation. The bond

issues by PDVSA on the international market and recourse to bilateral loans (China, Russia) are not enough to achieve the balance of payments, such that the country has to use its reserves which are now much reduced. The fall in the price of gold, which forms the main part, has also had an impact.

### Very difficult business environment

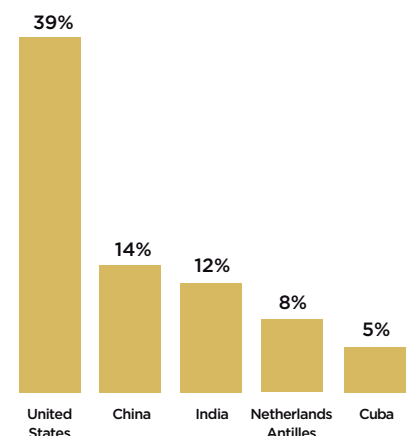
The April 2013 Presidential election was won by a narrow margin by Nicolas Maduro, the PSUV (Partido Socialista Unido de Venezuela) candidate and former Vice-President to the late Hugo Chavez. However, at the beginning of 2014 there were demonstrations by students in the west of the country against the high level of crime. The hard repression of these, resulting in a number of deaths and a large number of arrests, led to radicalisation and the spread of the movement to other regions and other groups of the population also dissatisfied with the shortages, corruption, nepotism, patronage and control being exerted by the government over the media. Part of the political opposition is supporting the movement. The authorities are counting on the support of its popular electoral base, who have benefited from the reduction in extreme poverty, improvements in health and hygiene, and increased employment in the public sector, as part of the "Bolivarian revolution". The outcome of the protest movement is uncertain given that the opposition is not united and that dissensions could appear among the supporters of the President, who lacks the charisma of his predecessor. The uncertainty will continue until at the earliest the legislative elections in September 2015, and especially for companies. The threat of nationalisation, the rationing of imports and the controls on prices and margins, with the intervention of the army inside stores, remain current issues. Suppliers, both foreign and local, to the State and the oil sector are reporting significant delays in payment. Importers are finding it extremely difficult to get hold of currency to pay their suppliers, even though they have had to obtain prior permission to import. Locally based foreign-owned companies are experiencing the same problems when it comes to repatriating their profits. With hyperinflation, currency controls and the flow away from the bolivar, there is an enormous gap between the official exchange rate, totally anomalous despite the occasional devaluations, and that offered on the parallel market. The essential goods that can be imported at the official rate are then subject to intense racketeering that increases the shortages.

### Strengths

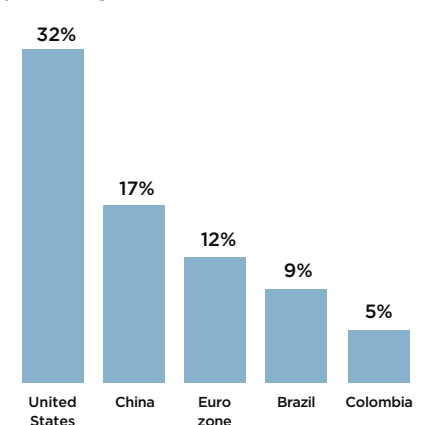
- Significant oil reserves in the Orinoco river oil belt and potential offshore gas
- Geographic proximity to the United States, Venezuela's biggest oil export market
- Influence in the Caribbean thanks to the Petro Caribe initiative
- Assets (including in the United States) of the national oil company, PDVSA
- Reduction in extreme poverty

## Trade exchanges

### Exports of goods, as a % of total



### Imports of goods, as a % of total



### Weaknesses

- Economy heavily dependent on hydrocarbons
- Discretionary management of oil revenues
- State interventionism (controls on foreign exchange, prices, margins, imports, credit)
- Level of influence of the authorities over institutions
- Rampant inflation and shortages
- Corruption and insecurity