RISK MONTHLY
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ASIA

China: Xi, the Party and China's ambitions celebrated at the five-yearly National Congress

Event

The Communist Party's 19th National Congress, China's most important political event, has just been held in October to appoint a new Politburo and Standing Committee. It will be remembered as having consolidated President Xi Jinping's power as Party leader. On this occasion, Xi Jinping made history by being the first living Party leader to have his "Thought" enshrined in the Party charter (alongside that of Mao and Deng Xiaoping). His Thought consists in a national rejuvenation policy for China for a new era after "one and a half centuries of humiliation", to make China a more spiritual, modern, self-confident, developed and militarised country in the next decade. Xi made it clear that, during this new era, the Communist Party will firmly remain the essential pillar for achieving the ambition of making the Chinese model and nation more influential worldwide.

Impact on country risk

The National Congress has further highlighted Xi's unique concentration of powers, which he increased during his first term, notably through the wide anti-corruption campaign and tightened control over Chinese society. The new composition of the core Politburo Standing Committee, welcoming 5 new members out of 7, allows Xi's power to be counterbalanced slightly as they represent the different Party factions. Still, the fact that they will all be too old to succeed Xi within five years leaves the succession race open. A third term for Xi cannot be ruled out (which would be a first and would also require a constitutional change). Whatever happens, Xi should remain very influential within the Party for the rest of his life through his Thought. Despite a largely renewed leadership within the Standing Committee, Xi Jinping is expected to ensure continuity in policies, particularly in pursuing the anti-corruption programme. Economically, the focus was placed once again on quality and efficiency rather than quantity (which might explain why long-term growth figures have no longer been mentioned explicitly). Yet, the key socio-economic stability will be maintained and will still sporadically justify pro-growth measures. In the next five years, the main aims will be to tackle overcapacities and huge corporate debt, while accelerating the development of high technology and widening the social security net. Also, the liberalisation of State companies will remain contained and limited whereas reducing environmental degradation has become a high priority for the Party's credibility. A big question is whether Xi will stick to his gradual and cautious approach to reforms which has contributed to an increase in the magnitude of risks (especially for debt) that China faces. Through his nationalist policies, his political power will also translate into a more influential dominating China abroad, economically via Chinese national champions and the OBOR (One Belt One Road), and geopolitically in the South China Sea and where China's growing interests have to be defended and promoted (particularly around the New Silk Road).

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India: State banks to benefit from a much larger recapitalisation

Event

The government has announced a much-needed wider two-year recapitalisation plan for State banks (SOCBs). The necessary capital for the USD 32bn (INR 2,100bn) programme will mostly (nearly 2/3) come from the State's recapitalisation bonds. Delhi foresees a direct budget contribution not exceeding USD 2.8bn by March 2019 while the banks will raise less than 25% of the total amount from the financial markets.

Impact on country risk

A sharp increase in the recapitalisation of SOCBs, which account for about 70% of bank assets, had long been requested and had become inevitable for the government. Indeed, the ongoing multi-year recapitalisation plan appeared far too modest (INR 700bn) to cover the high (estimated at over 13% of total loans at the end of June) and increasing non-performing loans (NPLs) and allow a recovery of credit supply growth, which has fallen to 5%, i.e. a 50-year low. Therefore, this is positive news as it is likely to restore investor confidence in a financially poor banking sector which is hindering economic activity and has contributed to the latest disappointing growth performances. Healthier SOCBs might not translate immediately into stronger credit inflows as weak credit demand will have to be fostered from a cautious and much-indebted corporate sector. The government plan will increase an already high general government debt (almost 70% of GDP in FY 2016) by less than 1% of GDP but the budget deficit should not be impacted as recapitalisation bonds are recorded off budget as an asset transaction. In the future, this plan would have to go together with banking reforms, especially management and governance. Political influence in lending decisions is often seen as largely responsible for the bad health of SOCBs. This is corroborated by private banks, which look stronger and have low levels of NPLs. Otherwise, there is a risk that the banking sector and the government will again be faced with rapidly increasing bad loans in the medium term. An effective implementation of the plan will be of high importance when it comes to supporting the one-year economic outlook.

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LATIN AMERICA

Argentina: An emboldened Macri accelerates a reform drive

Event

During this month’s legislative elections, President Macri was able to strengthen his position. Cambiemos, Macri’s coalition, won about 40% of the vote while the runner up, the Perronist opposition party Unidad Ciudadana, gained about 21% of the vote. The elections were a huge blow to Perronists as they lost some important strongholds and the party was left fractured. Despite the electoral win, Macri still lacks a majority in parliament as only half of the seats in the lower house and one third of the seats in the Senate were at play. Nevertheless, the larger support base is likely to facilitate the progress of Macri’s policy agenda.

Impact on country risk

The electoral win could be good news for FDI in the country. Though portfolio and bond investors have demonstrated a robust appetite in Argentina, fixed-asset investors have remained on the sidelines. Many have waited for the midterms for signs of continuity for Macri’s macroeconomic stabilisation programme. Therefore, the electoral win might convince investors. The election outcome is also likely to accelerate President Macri’s reform drive. One week after the elections, Macri had already unveiled sweeping proposals to cut taxes in the first of an expected series of pro-market reforms. Despite an improvement in the economic fundamentals, Macri still has some work cut out. The relative high inflation is tenacious. The stubbornly elevated fiscal deficit (estimated at 6.6% of GDP in 2017) needs to be tackled, as it is forcing the government to rely on international credit. The current-account deficit is growing (expected at 3.6% of GDP in 2017), swelling the external debt (forecasted at a moderate 37% of GDP but a high level vis-a-vis exports of almost 300%).

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AFRICA

Congo (Democratic Republic): Political crisis will continue to anguish the African giant for at least another year

Event

On 5 November, the Democratic Republic of the Congo's electoral commission (CENI) announced that the delayed elections – originally planned for late 2016 – would take place on 23 December 2018. This announcement dealt a final blow to the shaky 31 December 2016 agreement between the ruling Presidential Majority party and the opposition Rally coalition, which committed them to holding elections in 2017. Opposition leaders have denounced the new date, claiming this will give President Kabila another year to remove the presidential term limits and cling on to power, just like his neighbouring presidents in Rwanda and the Republic of the Congo. International pressure on Kabila was increased (targeted sanctions), yet, ironically, deteriorating relations with donors are further slowing the prospects for credible elections as there is a shortfall in funding and technical support for organising simultaneous elections in this vast and highly unstable country.

Impact on country risk

Disorganisation and Kabila's strategy of nurturing splits within the opposition have degraded the Rally's ability to mobilise mass popular support, despite widespread anger against Kabila. Consequently, renewed large violent protests against the delayed elections are not likely to be opposition-led but rather spontaneous civil demonstrations, making them difficult to control. Moreover, the political crisis is fuelling violence and conflicts in the east and in the centre of the country. In fact the Kasai provinces have been wracked by violence since clashes with militias and security forces escalated in August 2016. More than 3,000 people were killed and around 3 million people are now at risk of starvation as a result of the violence. Kabila's delaying strategy is further destabilising the country, inflicting great harm on the economy, and this will continue for at least another year. Today, foreign exchange reserves are already practically depleted, the Congolese franc has collapsed and inflation is expected to reach 50% by the end of the year. Henceforth, the outlook is gloomy and a peaceful solution seems increasingly further away.

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Sudan : Lifting of US sanctions barely improves the economic outlook as structural problems remain

Event

In October the US administration decided to permanently revoke a number of economic sanctions that were first imposed on Sudan in 1997 and were temporarily relaxed by the Obama administration in December. This is because of Sudan's cooperation in combatting terrorism and its reduction of military activities in Darfur and against South Sudan. At the same time, US sanctions related to Darfur will remain in place and the country remains on the list of countries the US considers to be state sponsors of terrorism.

Impact on country risk

In recent years, there has been a modest improvement in the economic situation in Sudan. Average inflation has fallen (17.8% in 2016) compared to 2012, when it was around 36.5%, and the economy has been growing again in recent years (3% in 2016) compared to 2012, when the economy was in recession. The government has also implemented a number of limited economic reforms such as the reduction of fuel subsidies and has made attempts to diversify the economy. Nevertheless, the economic challenges for Sudan remain enormous. Due to the split with South Sudan in 2011, the country lost 75% of its oil reserves. The fiscal measures taken by the government therefore cannot compensate for the loss in oil income. Inflation remains high given that the central bank has helped to finance the large remaining energy subsidies. The exchange rate also remains strongly overvalued. Additionally, there are currently two very worrying factors concerning the state of the country's economy. First of all, the country's central bank holds only very limited foreign-exchange reserves, which indicates a major shortage of foreign currency. Sudanese foreign-exchange reserves have been under severe pressure for quite some time due to the structural current-account deficit combined with low FDI and the inability to borrow externally. Secondly, the largest part of the external debt stock remains in arrears, notably to the IMF, the World Bank (WB) and the African Development Bank (AfDB). Given their preferred creditor status, this is very problematic. There are currently no indications that Sudan is able or willing to pay back its external debt. Sudan's external debt is marked as unsustainable by the IMF. Therefore, Sudan is eligible for debt relief under the HIPC ('Heavily Indebted Poor Countries') initiative but has not yet met all the requirements. For this, Sudan would have to repay its debt to the multilateral institutions and have a track record of performance with the IMF and there are also political obligations relating to the peace agreement of 2005 that was drafted to end the civil war. This makes debt relief very unlikely in the coming years. The lifting of the US sanctions is expected to lead to increased levels of trade and investment. This could over time help improve the country's economic outlook. Nevertheless, Sudan's economy currently remains in such a dire state that no upgrade of the political risk classification (currently in category 7) is expected in the medium term.

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