ASIA

China: OBOR motivates the Party to enhance its role in driving companies' investments

Event

The Chinese authorities have strengthened the overseas investment policy. State-owned enterprises (SOEs) and private companies are further required to retreat from investing in unproductive industries such as real estate and entertainment, while Beijing bans investments that might go against the national interest. At the same time, companies and state-owned banks are urged to prioritise investments and lending to OBOR-related (One Belt, One Road) projects respectively. On this occasion, the Party legalised its role in influencing investment decisions within SOEs and JVs (i.e. including foreign companies) which will make them less market-based.

Impact on country risk

Beijing's latest decisions have several aims. One is to reaffirm the Party's power in a transition period and given calls for economic liberalisation. Another one is to confirm that overseas investments in 'irrational' sectors should be abandoned as they are seen as disguised capital flight and weigh on the RMB and foreign exchange reserves. It allows a more coherent foreign investment policy which prioritises acquisitions in high-tech industries and OBOR-related projects, a dominant political goal for President Xi Jinping. Formalising the Party's political influence in major business decisions is a way to reach such a goal and to assert the Party's economic role after the EU refused to recognise China as a market economy last year. Hence, it is likely to further deteriorate the business environment and affect China-based foreign groups' overseas investments given the high political emphasis on OBOR. From a recent statement made by the National Development and Reform Commission (NDRC), one can conclude that foreign groups (together with SOEs and main private Chinese companies) might be under political pressure to invest in OBOR-related projects. While investment amounts are fast-growing, companies would potentially face many underlying risks, be it at regulatory (e.g. Central Asia), political (e.g. Vietnam) or security (e.g. Pakistan) level, and more generally related to project profitability.

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Pakistan : Bilateral relation with the US to suffer from prolonged US military presence in Afghanistan and aid cut

threats

Event

In a reversal of his campaign pledge, President Trump announced that the US will maintain a military presence in Afghanistan for an undetermined time and might add an extra 4,000 troops (to the current 8,400). Also, the US threatened to withdraw military support to Pakistan unless it "does more against terrorism and stops being a safe haven for terrorists". Islamabad quickly denounced it as "the country is itself a major victim of terrorism in the region" and got an explicit vocal support from the Chinese government. Islamabad underscored as well that sticking to the military option in Afghanistan was a failed option for the US as the past 16 years have showed.

Impact on country risk

The long-established US-Pakistan bilateral relation matters for regional stability but might suffer under Trump's term. In fact, it had already been deteriorating since May 2011, when Bin laden was killed on Pakistani soil. Since then, the US has sporadically accused its ally for its ambivalent Taliban policy by turning a blind eye on Afghan Taliban militants while being at war against Pakistani Talibans. Hence, financial assistance has more than halved compared with 2013. The new US administration insists on making military assistance more conditional to Pakistan's fight against terrorism. This should have little or no impact at all on Islamabad, and should only bring it closer to its Chinese ally. Especially now the Pakistani government has weakened since PM Sharif had to step down last July for corruption charges and uncertain 2018 general elections are ahead. Over the past years, China has indeed become the country's strongest financial ally, through loans and foreign exchange supply, and might have to fill the gap if the US further cuts its aid. Moreover, Pakistan is highly reliant on China for its economic growth as a result of the huge ten-year USD 55 billion 'China-Pakistan economic corridor'. Therefore, though the relation with the US is there to stay for geopolitical reasons, it might weaken further and make future US pressures vain. In consequence, terrorism and the Taliban issue are increasingly likely to lead to two blocks, US-Indian and Chinese-Pakistani, facing each other. This is unwelcome for Pakistan's civilian government which, in practice, shares the rule with a powerful army and might lose more political weight in a new environment where China replaces the US as the top ally. Also, Afghanistan will stay a bone of contention between Pakistan and India as the latter has been invited by the US to be more involved there, which is an unacceptable prospect for Islamabad. In those conditions, prospects of improved stability and peaceful solutions in the region are very poor whereas one should see Pakistan follow China's rising leadership in potential peace talks.

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MENA

Iraq: Now IS in Iraq is almost defeated, the country is facing new significant challenges

Event

With the freeing of Mosul and Tal Aftar completed, the fight against IS in Iraq has entered its final stretch. This comes three years after the group rose to prominence by seizing large parts of Syria and Iraq and by declaring the establishment of its caliphate in the city of Mosul. While the group has no more strongholds left in Iraq, it continues to occupy some smaller parts of the country and still holds significant parts of Syria.

Impact on country risk

Now the defeat of IS in Iraq seems imminent, the country is entering a new phase in its history but at the same time the country is facing a number of significant challenges. First of all there is the humanitarian situation in the country. The conflict with IS has led to an estimated 3 million internally displaced people, 30% of the population in need of humanitarian assistance, and strong destruction of the country's infrastructure. Moreover, potential sectarian (Sunni-Shia-Kurdish) tensions are looming, as with the defeat of IS the common enemy of the different fractions battling against IS is disappearing. This is important given that the war against IS has succeeded in temporarily pushing toxic domestic politics struggle to the background. Now this threat risks resurfacing due to three main factors. First factor is the Kurdish bid for independence. On 25 September, a non-binding referendum for independence will be held in the Kurdish-controlled areas of Iraq. The Kurdish political parties will try to use the referendum as a basis to negotiate for more autonomy, something the central government strongly opposes. This matter is further complicated by the fact that the Kurdish security forces are currently controlling territory that is not officially territory considered part of the Kurdish region in Iraq. Secondly, a large part of the country north of Bagdad and south of the Kurdish region is currently controlled by Shia-dominated Popular Mobilisation Units (PMUs), this is an umbrella organisation for a large number of militia that are sponsored by Iran. While they are currently cooperating with the Iraqi government in the fight against IS, it remains uncertain how they will behave after the defeat of IS given that they also have their own agenda. Lastly, federal elections in Iraq will be held in 2018. It remains to be seen how these will turn out given that the re-election of the Prime Minister, Abadi, remains uncertain. The elections could lead to stability if they lead to a national settlement over the role of the different fractions in Iraq. But the next government could also remain hamstrung by sectarian infighting if it is not possible to reach this national settlement. The representation of the Sunnis population in the federal government, the role of the Kurds and the role of the PMUs in post-IS Iraq will for example be difficult topics. Nevertheless, the risk outlook for the ST political risk currently remains stable in category 6.

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Iran: Rouhani starts second term with new cabinet

Event

In the beginning of this month Rouhani was inaugurated for his second term as Iranian president. This comes after he was convincingly re-elected in May 2017. Rouhani also proposed his new cabinet this month. While some had hoped that the new cabinet would be a clear signal of reform, it was more an indication of continuity. His choice not to include any woman or members of the Iranian Sunni minority can also be seen as an attempt to try to preserve the relationship with Ayatollah Khamenei and the more conservative fractions in the country who have been increasingly vocal in their opposition against Rouhani's promised reforms.

Impact on country risk

The new cabinet provides little surprises and should be seen as a continuation of the previous government policy. Two important faces of the previous administration have been kept in the current government. Mohammad Javad Zarif, who helped negotiate the nuclear deal will remain minister of foreign affairs and Bijan Namdar Zanganeh, who helped sealing the recent Total deal will remain oil minister. The EU has used Rouhani's inauguration ceremony as a way of sending a clear message of support for the nuclear agreement given the presence of the EU's foreign policy chief Federica Mogherini and senior diplomats from the UK, France and Germany at the ceremony. The US Congress on the other hand further increased pressure on Iran this month by voting a bill that forces president Trump to take additional sanctions against Iran outside of the nuclear agreement. The sanctions are aimed at the Iranian Revolutionary Guard, human right abusers and the Iranian ballistic-missile programme. These sanctions are increasing the tensions between the US and Iran since Iran sees them as a violation of the nuclear agreement. Rouhani's focus during his second term in office is expected to be mainly on the Iranian economy. It has been difficult for the economy to translate the nuclear deal into investments in the country. While car manufacturers, oil companies and the airline industry are starting to enter the Iranian market, international financial institutions remain very hesitant to follow due to remaining US sanctions and the bad shape of the Iranian banking sector.

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Africa

AFRICA

Angola : Handpicked successor of ruling party wins presidency

Event

As widely predicted, Angola's elections of 23 August were won by the ruling People's Movement for the Liberation of Angola (MPLA) with approximately 64% of the votes. After being in power for 38 years, José Eduardo dos Santos stepped down in favour of his handpicked successor João Lourenço, former general and current defence minister. Seemingly, dos Santos' undisclosed health problems have worsened considerably over the past year. Despite a voting swing of over 7% towards the opposition, the MPLA's control over the media and ministry of territorial administration gives it extensive power over the electoral process. Even though the EU will criticise the election result, absence of independent observers will mute any condemnation.

Impact on country risk

Incoming President Lourenço should help safeguard the dos Santos family's assets and interests. Besides, dos Santos will remain head of the MPLA and will receive immunity and sizeable benefits during his retirement. Henceforth, his national powers will remain far-reaching, while his eldest son still runs Angola's sovereign-wealth fund and his daughter the national oil company Sonangol. The start of the new president's administration will be stained by Angola's wretched economic conditions. Indeed, the country has been in crisis since oil prices plummeted, depleting the fiscal balance and creating significant dollar shortages. In 2016 the economy stagnated and inflation reached almost 42%, while it is expected to touch wood at 20% by the end of 2017. Recent elections have secured policy continuity in a difficult economic climate with opaque public finances and a lack of transparency.

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Gabon: Improved stability after cabinet reshuffle, one year after disputed election victory

Event

On 22 August, President Ali Bongo reshuffled his cabinet and introduced opposition politicians to the government. Nonetheless, no major ministries were handed over, mainly honorific posts and the Vice-Presidency. This followed a 'national dialogue' that took place between March and May 2017 and had a large turnout of political parties and civil society groups. Leading opposition figures like Ping – who claimed to be the rightful winner of the August 2016 disputed presidential election – did not take part in the dialogue and will continue intermittent protests.

Impact on country risk

Even though the ICC (International Criminal Court) investigated human rights abuses during the disputed 2016 election period, chances of criminal charges against either party have been ruled out. With the dialogue and the inclusion of opposition members in the government, president Bongo is dodging the possible imposition of EU sanctions against him and his allies as well. Despite prolonged lobbying by opposition leader Ping and his allies, the EU is not very likely to take actions anymore. What's more, the IMF approved a 642 million US dollar support programme in June 2017 which is likely to catalyse more international support and boost investor confidence, while it should help depressurise the deteriorated public finances. Indeed, the oil-exporting country has been going through a crisis following the fall in international oil prices. In the near term, opposition protests and public sector strikes will further intensify, albeit they are unlikely to topple Bongo before his term ends in 2023 as he still enjoys strong military backing.

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Kenya: Turbulent election increases economic and political uncertainty

Event

The supreme court in Kenya has ruled that the elections that where organised on 8 August are invalid due to irregularities in the electoral process that are large enough to jeopardise the integrity of the vote. This means that new elections are to be held in 60 days. It comes after the incumbent president, Uhuru Kenyatta, was declared winner of the elections by the election commission. Immediately after the election, his opponent Raila Odinga claimed that the election was fraught. Violence that erupted after the vote has killed at least 18 people.

Impact on country risk

This is the third time that the election is disputed. Political violence after the 2007 elections has led to the deaths of 1,200 people and to 600,000 people being forced to leave their homes. In 2013, Odinga has also claimed that the poll was rigged, but his case was then rejected by the Supreme Court. The election dispute is likely to lead to a period of increased economic and political uncertainty in the country. It comes at a time when the country is trying to implement a fiscal consolidation plan in order to reduce the significant public deficits which stood at 8% of GDP in 2015 and around 7% in 2016. In line with the current IMF programme it is currently foreseen that the fiscal deficit is brought into line with the East African Monetary Union's budget deficit ceiling of 3% by 2020. Increased political uncertainty is making it less likely that this target will be achieved. This would be problematic given that the external debt build-up is already impeding the country's MLT political risk outlook (which currently is in category 5). The interest rate cap introduced in August 2016 to address high borrowing costs weighs on the systemic commercial risk (which is currently already in category C). After all, instead of lowering interest rates, the rate cap – at 4% above the central bank's benchmark rate - is reducing commercial borrowing. While the rate cap is expected to be changed or annulled, this is likely to happen only after the new government has taken office and it will therefore continue to put pressure on the country's commercial risk rating.

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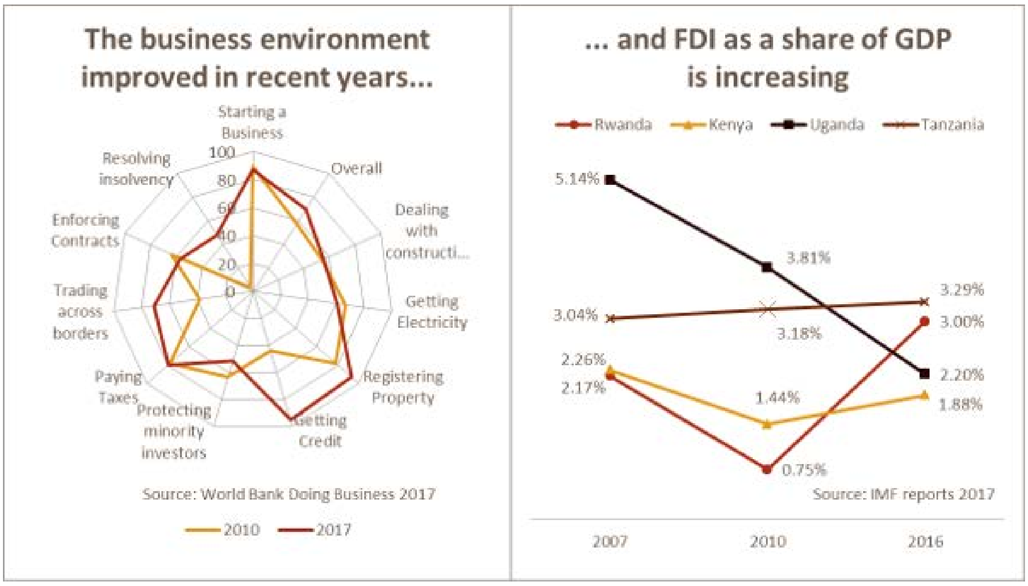
Rwanda: Presidential election provides no surprise, economic reform programme expected to continue

Event

This month, Paul Kagame was re-elected as president of Rwanda. He has been de facto in power since the end of the genocide in 1994. While Kagame has been responsible for significantly transforming the Rwandese economy, he has been criticised by US and EU human rights groups for silencing virtually all political opposition to his rule. His current bid for the presidency was only possible after the constitution was amended in December 2015 which made it possible for him to run a third time for re-election.

Impact on country risk

The re-election of Kagame does not come as a surprise since the amendments to change the constitution where approved in a referendum by 98% of the votes. In the last 15 years the economy has undergone a significant transition. The country has been growing by almost 8% on average, poverty has been strongly reduced and the business environment has improved significantly. But at the same time the economy continues to face a number of challenges. Indeed, external imbalances are large. While the current account deficit was around 7% of GDP in 2011, it rose to around 14% of GDP in 2016. This increase was mainly due to an increase in good imports and a reduction in development aid on which the country depends heavily. The re-election of Kagame means that the current economic policy will continue. Currently, the government is trying to address external imbalances and become less reliant on aid. The increased exchange rate flexibility has led to an appreciation of the currency and thereby a slight reduction of imports in 2017. At the same time the government is implementing a ‘made in Rwanda’ programme in which they try to replace the imports of goods in 4 specific sectors by local products. The government has also tried to attract more tourism and become a conference destination in East Africa. This is done via large investments in RwandAir and the Kigali Convention Center. But while these investments still have to pay off, they already led to an increase in public debt. While public debt was around 22% of GDP in 2013, it was at 45% in 2016. Nevertheless, this remains a sustainable level. Additionally, the country has been trying hard to attract more FDI. While FDI as a share of GDP has increased the inflows of investments into the landlocked country, they remain relatively small and not sufficient to fund the large current account deficit. This is leading to a build-up of external debt. Nevertheless, both the MLT and ST political risk outlook remain stable in category 6 and 4 respectively.



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