Major Country Developments
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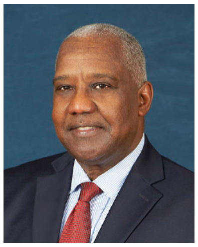

By Byron Shoulton

Overview

Ongoing high stakes U.S.-China negotiations have caused tensions to rise and harden as the U.S. press China to acknowledge and desist from engaging in intellectual property theft and forced technology transfers involving U.S. companies. Legal charges pending against leading Chinese executives and companies for violating U.S. sanctions and stealing U.S. technology have added to already intense strains in the relationship between the world's two largest economies. Both sides are not backing down but China appears to have already conceded on a number of issues raised by the Trump Administration. The U.S. however, wants China to go further in permanently changing its unfair behavior toward foreign trade and inward investments.

Among concessions by China: it resumed buying U.S. soybeans in December, after a months-long boycott instigated by the imposition of high U.S. tariffs. In retaliation China stopped imports of U.S. soybeans in May 2018. China is the world's largest consumer and importer of soybeans, but has become less dependent on U.S. supplies. China's appetite for stockpiling more of the commodity appears to be waning. While China grows some soybeans it imports vast quantities for pig rearing, fish farming and other livestock. Meanwhile, soybeans are key to the U.S. farming industry as the commodity is America's largest agricultural export. Prior to the trade conflict, as much as 25% of U.S. soybean production went to China. Brazil has now overtaken the U.S. to become China's largest supplier of soybeans as well as the world's biggest exporter of the commodity. The most recent data shows that in the first 10 months of 2018, the U.S. exported just $3 billion worth of soybeans to China. That represents a steep decline from previous years. Chinese negotiators have also indicated they are willing to commit to future Chinese purchases of U.S. liquefied natural gas (an item high on President Trump's list of must haves). China also recently changed its foreign investment rules making it less burdensome for U.S. companies to invest in the Chinese market going forward. This concession is a major breakthrough and has long been sought by foreign companies facing numerous barriers to entry that prevent many prospective foreign investments into the Chinese market.

Although Chinese exports have been somewhat resilient since the trade war began last year, companies have begun to feel the pinch. Four-fifths of respondents in a recent survey of Chinese companies who said the U.S. was their biggest market, revealed that a majority had lost U.S. business last year. Seventy percent said sales were flat or down compared to the previous year. Some companies are relocating factories elsewhere in Asia - to allow selling into the U.S. while avoiding high tariffs on Chinese-made goods. Others reported splitting the cost of higher tariffs with U.S. importers. None said their business had increased over the past year. A majority of Chinese business executives are optimistic that a deal between both countries will be forthcoming in 2019. Others feel the standoff will last longer. Most companies are actively seeking to sell into new markets.

To prevail further against China the U.S. will likely need to illicit support from other countries that feel aggrieved by Chinese policies that hurt domestic industries. Meanwhile, China's economic slowdown is negatively impacting global growth, as sluggish demand continue to hit China's trading partners in Asia, Europe and North America. The U.S. has threatened to impose tariffs on all Chinese goods entering the U.S. if China does not agree to a deal for a more equitable trading relationship. If the two sides are unable to agree by a March 1 deadline, 10 percent tariffs on $200 billion of U.S. imports from China are set to rise to 25%. This has the potential to cause more volatility in the global economy and in financial markets.

One noticeable development evolving from the U.S. confrontation with China are seemingly growing close ties between China and Russia. Both countries were recently cited by U.S. intelligence agencies as forging tighter cooperation and pouring resources into a race for technological and military superiority. The current tensions between the U.S. and China [and by extension Russia and Europe] seem set to help define the role that each region [and their respective corporations] play in the development and appropriation of leading technological engines that will drive economic growth over coming decades. Which countries and which companies will dominate 5G networks, artificial intelligence, electric cars and driverless technologies are at the core of ongoing trade negotiations. The outcome of this struggle is far from being settled.

Meanwhile, Russia has embarked on the construction of cutting edge missile enhancement technology which will likely set the agenda for future advances in nuclear military applications among competing countries especially the U.S. Some see this advance as the beginning of a renewed war for nuclear superiority. Not coincidentally, the U.S. Administration announced that it will pullout from an existing nuclear defense treaty with Russia that previously restricted medium range missile development. Both countries accuse the other of violating the treaty.

A faceoff between the Venezuelan government of President Nicolas Maduro and opposition forces, is the latest example of a strengthening Russia-China alliance against the U.S. While the U.S. [along with Canada, Europe, and several Latin American countries], support the Venezuelan opposition leader Juan Guaido, [president of Venezuela's National Assembly], who has declared himself interim president and is calling for immediate elections, both Russia and China - which are owed billions of dollars by Venezuela - continue to support the Maduro government. U.S. opposition to Maduro, including the blocking of future crude oil payments to state-owned oil giant PDVSA from getting into the hands of the Maduro government, has taken the Venezuelan crisis to a precarious and highly uncertain stage. The strategy deprives the sitting Venezuelan government access to crucial foreign exchange at a time when the country's FX reserves are thread bear and the economy is at a virtual standstill. If successful, it means cutting off one vital source of income used to pay and maintain the military brass on whom the Maduro government's continued survival depends.

Meanwhile, it appears the three powerful nations [U.S., Russia & China] are in a battle over the survival of an unpopular regime, meant as a show of force in a country on the brink of economic and social chaos. Sitting on top of one the world's largest petroleum deposits presumably qualifies Venezuela for such a high-stakes faceoff. Already an estimated three million Venezuelans are living as refugees in other countries. What follows in Venezuela will have consequences on the credibility of whichever side that evolves into control of the country. The Venezuelan constitution grants the opposition leader Juan Guaido, 30 days during which he can serve as interim president, then elections must be called.

The U.S. Treasury Department has allowed a three-month wind-down period that gives time for businesses on U.S. territory to disentangle from PDVSA and its assets. The department also issued special licenses to a number of U.S. companies operating in the oil sector to continue operating in Venezuela. This will enable the American firms to maintain access to the country and ensure the nation's ongoing crude production.

Europe

Downbeat forecasts from the IMF which cut 2019 global growth forecast to 3.5% largely due to weaker than expected economic performance in Europe, particularly Germany and Italy – and the slowdown in China are instructive. The forecasts indicate that Europe's economic recovery is running out of steam, while its politics is shaken by the growing strength of nationalist politicians in many European countries. The continent is still getting over the effects of the global financial crisis which occurred over a decade ago. In its wake are evidence of rising polarization, populism and growing inequality. The result: politics is in a funk across many EU countries. From Brexit to France's street protests and the reaction in Italy and countries of Eastern Europe against policy prescriptions of the European Union and increased immigration – there's an image of a clouded path forward, which threatens to undermine the economic recovery. In recent years, China has become a much more important customer for European manufacturers. By 2017 China was the second largest export market for the Eurozone after the U.S. Chinese retail sales growth weakened to near record lows in 2018. Slower consumer spending is affecting trade with other sectors as well.

For Italy, where the 2019 growth forecast was downgraded to an anemic 0.6% - the IMF observes that there are sovereign and financial risks and the connections between the two have added to the weaker growth trend. This underlines unfinished business following the last crisis, and continuing worries in Italy in particular about so-called sovereign- bank doom loop – the links between shaky banks and weak government borrowers. Without over blowing immediate economic gloom it is important to note that the Eurozone has enjoyed 22 consecutive quarters of growth, the region's debt is down and nine million jobs were created since the global crisis. So while it appears the economy is weakening, Europe has much better fundamentals than it did five years ago. Necessary overhauls of the euro are advancing slowly: a small capacity for fiscal-policy action at a Eurozone level has been approved and a euro-wide deposit insurance system is set to move forward. Nevertheless, there are differing prospects across the continent, which is part of its problem, given that divergent Eurozone economies now have to live with the same monetary policy.

German government analysts insists that the country's growth setback is in part caused by one-time factors and that it is now in the longest period of economic expansion since the mid-1960's. On the other hand, Italy's government which has been battling Brussels, point to the fact that Italy's economy is still 5% smaller than in 2008 and Italians have suffered a retreat of the state as well as labor market changes that promised better lives but never happened.

Because of the euro, national governments no longer have the policy discretion they once had. Countries using the common currency have ceded monetary policy to the European Central Bank in Frankfurt, and their fiscal policies are thus constrained.
When Italy tried to disregard the eurozone's budget rules a few months ago, it paid with sharply increased borrowing costs. After a compromise between Rome and Brussels those costs fell – and will fall further according to recent forecasts.

At the European Commission level, increasing political differences among the 28 countries – soon to be 27 after Brexit- make decisive policy-making highly problematic. Unless it's in the midst of a major crisis, the European Union usually moves slowly. This year, decision making could be further hampered after EU parliamentary elections take place in May. Anti-EU parties are widely expected to make headway in the European Parliament. While the established center-right and center-left parties are forecast to retain a reduced majority in the Parliament, any majority for anti-EU politicians would create even greater gridlock in Brussels. Already sluggish EU decision-making process contrasts with the speed of action in China and other countries. Some business interests complain that by the time the bureaucrats make a decision in Brussels, the opportunity has gone somewhere else. Changing this will be difficult at all levels. It applies to the level of investment that Europe has in artificial intelligence, for example.

German Chancellor Merkel hinted at the threat to Germany's established manufacturers, including its storied car industry, from internet platforms. In the era of driverless cars, ownership of data, knowhow, research and expertise will be critical. Will it be Europe's car makers, or American, Japanese or Chinese platforms? Who will dominate?

While Europe has some of the world's great universities and many innovative startups, venture capitalists point out that those are only part of the answer. For example, when Europeans want to expand their companies, they often have to rely on the much larger pool of capital available in the U.S. Even if a company can stay European and succeed, the U.S. digital giants have almost limitless resources to eventually swallow them up. Together, this presents an enormous challenge for Europe. To keep up with the next generation of potential growth engines, the European bureaucracy needs to change decision making and move fast in order to adjust and catch up with aggressive competition from China, the U.S. and Japan.

German and European companies also face challenges of an aging workforce which is hurting progress in productivity and innovation. Companies are investing in ways to keep older workers physically fit and to team them together with younger workers to create a unity of age and experience and push more innovation. These small teams on factory floors could provide a part of the equation that help to transform the outlook for European manufacturing. The country is promoting age diversity on the factory floor as one way to build loyalty and gain employee retention throughout the workforce. Companies leading in robotics – known for giant, steel-bending robots that work securely in cages – are among the fastest growing products to aid workers who have monotonous and physically demanding tasks. Without such investments, European companies risk losing their competitive advantage, experience and skills, because 50% of blue collar workers across the continent are expected to begin retiring in the next five years.

Asia

Higher interest rates in Indonesia and the Philippines damped consumer appetite for new loans in the final quarter of 2018, but rising incomes in those countries and in Vietnam helped bolster the region's measure of consumer sentiment. The ASEAN Consumer Sentiment Index based on a survey of 5,000 consumers across Indonesia, Malaysia, the Philippines, Thailand and Vietnam – ticked down to 66.6 in the fourth quarter from 66.8 previously. The latest was the weakest reading since mid-2017, but remained comfortably inside positive territory, suggesting household consumption remains robust across the five economies.

The consumer borrowing index declined in the fourth quarter to 62.1 from 64.1 previously, led by huge drops in Indonesia and the Philippines, where central banks have repeatedly raised policy interest rates to support weak currencies and in the case of the Philippines, to fight inflation. Bank Indonesia lifted rates 175 basis points in 2018, contributing to record low of 62.7 points for the Indonesian index. Recent surveys concluded that Indonesia and the Philippines have less need to borrow given their rising incomes. The regional Household Income Index ticked up to 69.8 from 69.3, helped also by Vietnam, where rising incomes pushed the country index up to 81, its highest level since 2014. Higher incomes drove non-essential purchases in four of the five ASEAN [Association of Southeast Asian] economies, with Thailand being the exception.

A slowdown in manufacturing will hurt Taiwan more than Korea because Korea has more support from non-manufacturing sectors, including services and construction. Both countries are key Asian manufacturing hubs at risk from slowing demand globally, particularly in China. The Purchasing Managers' Index (PMI's) in both countries fell below 50 in 4Q 2018 with Taiwan's December PMI the lowest since September 2015. There will be less room for complacency if this trend continues. The expectation is for Taiwan's GDP growth to slow to 2.2% this year with South Korea's moderating to 2.6%; both economies are estimated to have expanded 2.7% in 2018.

Japanese exports shrank at the fastest pace in two years in December as shipments to China stumbled, adding the world's third largest economy to the growing list of Asian nations reporting a fall in the metric at the end of 2018. If the U.S.-China trade war is not resolved soon, the expectation is that Japanese exports will continue to reflect weakness as a consequence.

The year-on-year drop of 3.8% following two months of growth was double the pace forecast and marked the sharpest fall since October 2016, according to the Japanese Finance Ministry. Exports to Asia shrank 6.9% with those to China, Japan's largest market in the region, falling 7% and shipments to Hong Kong and South Korea down 17.3% and 11.6%, respectively. Shipments to the U.S., Japan's largest market globally, rose 1.6%.

The decline in China was driven by falls in exports of chip making machinery and communications equipment in the wake of the US-China trade dispute and Washington's complaints to Beijing over technology transfers. Japanese companies are already feeling the fallout from the dispute between the U.S. and China. One Japanese supplier issued a profit warning in January, blaming U.S.-China tensions for a sharp drop in orders of its motors for Chinese auto and appliance makers at the end of 2018. The impact of tremors in the global economy on Japanese exports continues to loom larger. However, while exports from regional economies have shrunk (China, South Korea, Indonesia, Thailand, Singapore), some believe December's exports probably overstated the weakness in global demand, with other surveys of orders and confidence remaining positive. Looking ahead some Asian analysts expect export demand could pick-up. They say the current slowdown will be short-lived (a soft-patch stemming from the inventory cycle in manufacturing).

As for imports to the region, analysts say the effect of high energy prices was falling away, but volumes would likely rise as Japanese shoppers race to beat the consumption tax rise due in the second half of 2019. If this were to happen, the Japanese trade balance would be trending toward zero. The Japanese central bank kept interest rates on hold in January but lowered its inflation expectations for the year. Whereas previously expectations were for consumer prices to rise by 1.4%, excluding food and the effects of a consumption tax rise, it has been cut back sharply to 0.9%. Lower crude oil prices is a major cause, but the direct impact is expected to be temporary. The long-term outlook hasn't changed much.

Mexico

Mexico issued two global bonds in international markets in January, with one successful $2 billion placement early in the month followed by another at the end of the month. However, the bonds carry a higher coupon than a similar bond issue made a year ago. The issuance were the first by the new government of Andres Manuel Lopez Obrador [AMLO], which took office in December. The ten-year bond was issued with a 4.5% coupon and an initial yield of 4.6%. The issuance benefited from a decline in Mexico's risk premium over the course of January, in line with that of a number of emerging markets. Previously, Mexico's risk premium had spiked following the cancellation of a new airport project for Mexico City, in late October, which also led to a depreciation of the peso.

The second bond issue was oversubscribed by a factor of four, with as much as $8 billion in demand. Nevertheless, the bond carried a higher price tag than the first issue earlier for a similar $2 billion ten-year bond. There has been concerns about possible ratings downgrade, particularly given the lengthy dispute with bondholders of the airport project; a dispute that was only resolved in mid-December. The success of these latest bond issues should offer some reassurance with regard to Mexico's access to finance. The passage of a 2019 budget, which targets a primary surplus in 2019, was seen as positive.

Fitch later in January downgraded PEMEX's [the state-owned oil company] long-term foreign and local currency issuer default ratings to BBB- from BBB+. The rating agency said its downgrade reflected the continued deterioration of PEMEX's standalone credit profile due to its under-investment in the company's upstream business. Fitch projects the PEMEX will face negative free cash flow in 2018-2019 because of this lack of investment. PEMEX saw its rating downgraded in October as well. A recent investment tour taken by government officials on behalf of PEMEX had mixed success and it is likely that the indebted company will face continued scrutiny as the new government's agenda emerges.

The latest inflation data shows that consumer prices rose 0.7% in December to bring annual inflation to 4.8% for 2018. This marked two consecutive years during which consumer inflation remained above the 2-4% target range set by the central bank. The increase has remained above the target ever since the government mandated a 20% increase in fuel prices in January 2017, with the rate currently standing at a ten-year high of 8.25%.

Given fuel shortages in January that resulted from the government's efforts to combat fuel theft, prices for agricultural goods and energy are likely to rise further. The effects of shortages and the ability of transport to get agricultural products to market are negative factors. However, the effect of this should be offset by the strengthening peso in recent weeks, to below Ps20:U.S.$1. Real interest rates remain high in Mexico, and the economy faces challenges from policy uncertainty from the new AMLO administration, as well as continued global weakness. Still, consumer optimism prevails following AMLO's election. All categories of the consumer index expanded as household sentiment and national sentiment rose 6% and 4.7%, respectively. Confidence was reportedly up in December at the fastest pace in a year and was projected to remain high in 2019. However, fuel shortages in January had a noticeable negative impact, especially as the shortages began affecting nearly every major city in the central part of Mexico, including Mexico City. The central bank has warned that the shortages will hit inflation further and feed into lowering confidence levels.

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FCIA's Deals Of the Month

Non-Cancelable Key Account Limits Policy: $36,000,000 limit of liability, providing excess coverage on buyers in the consumer electronics sector in the U.S.

Facultative Reinsurance Policy: $25,000,000 limit of liability, auto parts sector in North America

What is Trade Credit Insurance?

If you are a company selling products or services on credit terms, or a financial institution financing those sales, you are providing trade credit. When you provide trade credit, non-payment by your buyer or borrower is always a possibility. FCIA's Trade Credit Insurance products protect you against loss resulting from that non-payment.

* ***Non-Cancelable Limits:*** *Subject to policy terms and conditions, after issuing the policy, the insurer may not unilaterally reduce any country or buyer limits.*