Major Country Risk Developments
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By Byron Shoulton

Overview

Vaccine rollouts are proceeding at varied stages around the world. China, Israel, U.S., UK and several countries in Asia lead in the numbers of their respective populations who have received vaccines. The pace of inoculations has quickened in recent months and continue to build.

U.S. employers added 916,000 jobs in March, surpassing expectations and bolstering hopes for a strong economic rebound. Other data showed that the U.S. services sector is making gains after being battered by lockdowns, stay-at-home orders and consumer caution stemming from the pandemic. The Institute of Supply Management's services index rose to an all-time high of 63.7 in March from 55.3 in February. Activities related to services have lagged behind manufacturing, and investors have been watching for a pick-up in industries like leisure, restaurants, bars, movies, hotel reservations, air travel, etc., as key indicators of a broader economic rebound.

Clearly, with more Americans receiving vaccines, confidence has picked-up, allowing for a greater willingness to venture out again. Recent CDC guidelines will make it easier for cruise lines to begin returning to normal operations.

There are concerns that huge amounts of central-bank bond buying and government spending could jolt U.S. inflation out of its decades-long lows, which would prompt the Federal Reserve to tighten monetary policy, thereby unsettling financial markets. However, that juncture has not yet arrived. Federal Reserve officials insist that they seek full recovery in the jobs market, together with sustained 2% inflation, before contemplating changing interest rates or altering monthly bond purchases.

The European Union has experienced setbacks in its attempts to make vaccines available in adequate supplies. Only one vaccine has been approved even now. Furthermore, inept management and public mis-education resulted in millions going unvaccinated. In addition, a lack of public trust in the efficacy and safety of the vaccine itself only made matters worse in Europe. Sufficient vaccines were not delivered, and people were suspicious anyway. Hence, valuable time has been lost as the authorities, in recent weeks, have pursued new avenues to speed-up delivery. So far, the European Commission appears woefully unprepared, inefficient, and have been ineffective in getting a reliable vaccine program off the ground.

In the UK the rating outlook was upgraded to "improving" from "stable" due to recent efficient vaccine rollouts. The British Prime Minister warned of an impending "coronavirus vaccine war" that pits the UK against Europe. That was in response to EU measures that would halt vaccine shipments to the UK and others – if those countries failed to export vaccines manufactured at their factories. The EU's proposed export restrictions represent an about-face for the bloc. Until recently, the EU was one of the strongest international voices backing the open trading system. It spent years fighting populists who are skeptical of trade. Now the EU advocates a kind of reverse protectionism in which countries do not stop imports from getting in but instead stop critical supplies from getting out. Europe's apparent retreat from international markets follows a broader global shift brought on by the pandemic.

With varying stages of vaccine availability and distribution levels, and ongoing threats of fresh outbreaks, the pandemic has already begun to alter the once seemingly inexorable trajectory of globalization. With vaccine access and national security at stake, wealthy democratic governments have pushed liberal open market principles aside in favor of aggressive restrictions aimed at meeting new internal political demands. National self-interests are fraying alliances and normalizing open state intervention in global markets to a degree not seen in recent memory. In the future, many countries may look to protect themselves in similar ways—defecting from global rules that they believe are rigged against them.

Early efforts to coordinate global vaccine production floundered as the advanced countries would not commit to a cooperative system that limited their ability to secure vaccines for their citizens. Early in the pandemic, the United Kingdom and the United States went to the front of the vaccine line, making large advance orders at high prices and pressed arrangements with pharmaceutical companies that would give them first rights over production and supply. Both countries have had good success getting citizens vaccinated. More recently, developed countries have promised long-term cooperation and aid through the COVID-19 Vaccine Global Access Facility (COVAX), an initiative co-sponsored by the World Health Organization. Best-case expectations are that adequate vaccine supplies become available to countries around the world in 2022-23.

OPEC and an alliance of other top oil producers agreed to boost their collective crude production over the next three months, betting on a return of demand as Covid-19 vaccinations roll out at various speeds around the world.

The Organization of the Petroleum Exporting Countries and a group of other major producers led by Russia agreed to add some 350,000 barrels a day in production, starting in May, and expand that loosening over the next three months. The agreement was a compromise between Saudi Arabia, OPEC's de facto head, and Russia. Saudi Arabia had sought to maintain current output levels, wary that the pandemic's ebb and flow could still threaten oil demand. The production increase in May would be followed by another 350,000-barrel-a-day boost in June and then further easing of some 450,000 barrels a day in July. Saudi Arabia would also start easing separate, unilateral cuts of one million barrels a day that it put in place earlier this year. It plans to end those cuts altogether by the end of July.

China

Rising raw-materials costs and unrelenting supply-chain constraints are prompting many Chinese exporters to increase prices for the goods they sell abroad, raising fears it may add to global inflationary pressures. Fears deepened after a grounded container ship blocked the Suez Canal, further straining global supply lines stretched by the pandemic and stronger-than-expected demand for computer chips and other goods.

One outdoor furniture manufacturer based in the southern China, reported plans to raise prices by around 7% on new orders this summer. That is largely due to prices of chemicals and metals used to produce cushions, foams and frames in the company's factories in China and Indonesia that have climbed rapidly in recent months. Shipping freight rates have also climbed roughly 90% since last June, though these costs are often paid by clients. Other Chinese exporters raising prices include apparel businesses and toy wholesalers that raised prices for new orders across the board by 10% to 15% since the beginning of March.

Price increases from Chinese factories alone may not necessarily be enough to push inflation higher in the U.S. and elsewhere. Much of the sting could be absorbed if Western retailers choose to eat the cost increases without passing them on to consumers, though doing so would squeeze retailers' profit margins. Official inflation calculations in the U.S. encompass far more than just the consumer goods people buy from abroad. Before the pandemic, more than 60% of consumer spending in the U.S. was on services like dining out or traveling, rather than on consumer goods.

Still, price increases by Chinese factories add yet another source of upward pressure on global prices at a time when the cost of everything from lumber to steel and cotton is higher. Some worry that the trillions of dollars of stimulus unleashed world-wide will ultimately lead to more inflation than policy makers anticipate, though there are fierce debates over how bad the problem could become. There is a risk [that inflation will increase]. That includes the bottlenecks caused in global shipping and the idea that the stimulus might unleash more demand than supply can keep up with. Even so, it is premature to assume that we are going to see runaway inflation.

What is clear is that Chinese manufacturers making products for the rest of the world are finding it increasingly hard to hold the line on costs, especially after the pandemic and lockdowns hurt their profits last year. In the past, Chinese factories with cheap labor were often a force for keeping global prices lower, but that is becoming less true as the factories' own costs climb.

Shipping rates, which soared in recent months amid port bottlenecks and container shortages, are part of the problem. In some cases, clients ask Chinese suppliers to share the burden. In other cases, Chinese factories themselves are having to pay more to ship in imported raw materials, like lumber.

Meanwhile, prices for many commodities have stayed high or kept climbing, and some businesses are choosing to pass those costs on to customers. Prices for imports from China to the U.S. rose 1.2% over the past year, the fastest increase since 2012, with most of the increase coming in the three months ending in February, according to data from the U.S. Bureau of Labor Statistics.

One positive note for U.S. consumers is that the dollar has remained stronger this year than many expected, which gives U.S. shoppers more buying power when paying for imported goods. Many families accumulated savings during the pandemic, making it easier for them to pay a little more. Prices are moving higher primarily on stronger demand. Manufacturers will find ways to pass on costs in this circumstance. This is unlikely to derail the global recovery.

Some Chinese manufacturers, meanwhile, have said they have been reluctant to increase prices for fear of losing market share, and expect raw materials costs to cool off. However, there is little sign at the moment that the forces pushing costs higher in China will ease soon.

Other factors may be contributing to higher costs in China. Authorities are trying to limit fossil-fuel consumption to help China achieve its goal of reducing carbon emissions, which may be making it harder for steel and other sectors to increase production. Chinese officials in January reiterated their goal of ensuring that crude steel output will decline year-over-year in 2021, even as steel demand is projected to increase this year as the economy recovers. Factory owners and Chinese experts also suspect some players are hoarding commodities, adding to price pressures. Cotton prices jumped to around $2,600 a ton in early March, compared with around $1,990 a ton in mid-February.

Brazil

While agricultural and raw material exports have strengthened because of recovering demand in China, Asia and the U.S., domestic demand remains depressed and sections of the economy have suffered due to the pandemic. The economic outlook has deteriorated in recent months amid renewed escalation in new Covid-19 cases [the so-called second wave]. Tightened containment measures are set to remain in effect over months until a successful vaccine program is put in place. The government of President Bolsonaro appears under siege as civic groups including leading business figures, health professionals and the "man in the street", show growing dissatisfaction with Bolsonaro's leadership during the pandemic. Government inactivity, its opposition to lockdowns and misinformation about the virus - have left Brazilians exposed and vulnerable to a more contagious variant strain.

The healthcare system is overwhelmed, hospitals lack capacity to handle the number of new cases, and there is a need for more ventilators; amid reports of inadequacy in getting oxygen to patient's hospital beds. In short, the country is in the midst of a public health crisis, with a record death toll and little confidence in a quick solution. The heads of the army, navy and air force have resigned in protest over the sacking of the defense minister, who criticized President Bolsonaro's lack of leadership in getting the pandemic under control.

The Pan-American Health Organization reported that the P.1 variant driving the second wave in Brazil has been found in 15 countries across the Americas. Senior members of Brazil's Congress who had supported Bolsonaro are having second thoughts. The speaker of the lower house has sent a warning for the first time hinting at the possibility of impeaching the president.

Meanwhile, Brazil's biggest banks which have enjoyed huge profits over many years, now face low interest rates and fintec challengers which are forcing changes. A few banks have dominated Latin America's largest economy, known for its costly banking fees and borrowing rates. For decades profitability among the top tier banks was impressive. The group of big banks now face low interest rates, [due to the economic impact of the pandemic] as well as digital banking start-up's, which are putting pressure on traditional lenders. This is forcing an acceleration of reforms in banking aimed at providing better value to clients. With that, competition has become fierce.

For decades a few institutions dominated the banking system. They include Itau, Bradesco, Santander Brazil, along with state-controlled Banco do Brazil and Caixa Economica Federal. These banks have recently launched investments in technology in a bid to stop customers switching to challengers such as Nubank, Brazil's leading internet banking start-up.

The changes unfolding in the sector are good for both consumers and the so-called traditional banks. However, the traditional banks will need to be quicker and better in providing products and services to compete effectively. Since the pandemic, the banks have deepened cost-cutting measures, including branch closings and cutting jobs. The need for reforms has become more urgent with the pandemic having hastened the pace of digital change.

Regulators too are attempting to boost consumer choice: the central bank is rolling out an "open banking" initiative, aimed at giving clients greater control over their data and boosting competition among banks. Recently, the CB also introduced an instant payment system that is free to individuals. The "Pix" as it is known, offers a way for regular Brazilians to avoid at least some of the range of charges that banks have typically attached to standard services, such as current accounts and money transfers.

According to a Moody's estimate the banks could lose $2.9 billion of those fees over the next year (that is almost 10% of the total), as free or cheaper alternatives become available. Fees account for approximately 30% of bank earnings according to the ratings agency. As with many Latin American countries, margins in Brazil's banking sector are the envy of peers elsewhere. The average return on equity (ROE), an important metric for profitability, stood at 17% in 2019, according to S&P Market Intelligence. That compared with 10.6% in the U.S., 8.8% in Asia-Pacific and 5.8% in Europe. Debates on how the big banks will stay profitable going forward, now that interest rates have come down, suggest they will not be able to rely mainly on buying government securities, but in addition will need to lend more. The banks are trying to react. In addition to closing approximately 1,500 branches and 13,000 job cuts in 2020, they have launched their own digital banks and investment brokerages and have tapped into the wave of new retail investors in Brazil by acquiring stakes in promising start-ups.

For consumers and businesses, a shake-up in Brazil's banking sector is overdue. Credit has traditionally been very expensive and often hard to access, partly a reflection of high interest rates that were a legacy of the country's long-running battles with inflation. For many years, banks made easy money by stuffing cash into high-yielding government debt. However, with the central bank's benchmark Selic rate at 2.75%, recently raised from an all-time low of 2%, that model has come under strain. The pandemic delivered a serious dent to earnings in 2020. Although lenders remained in the black, considerable provisions to cover bad loans contributed to the biggest percentage drop in two decades with sector-wide profits down almost a quarter, according to data provided by Economatica.

Many Brazilian companies have sourced lending at much lower interest rates outside Brazil over the years, often in dollars or euros. Portions of existing foreign currency debt owed by Brazilian entities will be refinanced as some debtors negotiate for longer repayment terms. Some workouts have been agreed and registered; others are currently being discussed. The confluence of competitive forces and regulatory changes have raised questions about the long-term trajectory of the banking sector. Despite a downward trend over the past few years, borrowing costs in Brazil rank among the highest in the world. The average annual interest on loans has crept up to 22% for households and 11.3% for businesses, according to central bank data. Some in the Brazilian banking sector believe lower rates will be the trend for sometime and will eventually feed through into credit growth.

The jolt to the traditional banks and their comfortable ways of operating has come from a band of homegrown fintech's with low overheads and no branches. Leading the pack is Nubank, which boasts almost 35 million customers in Brazil [out of a population of 213 million]. After a $400 million fundraising this year, it reportedly has a valuation of $25 billion. Other rising brands include Neon and C6.

While the traditional banks have adapted their investment products, they remain behind the fintechs on the lending side. They will need to become nimble to be competitive as the fintechs have credit operations that are easier to use and offer more attractive fees. Still, there are some skepticism about how much of the lending pie the fintechs can grab away from the traditional banks. At the end of the day, the new entrants in digital credit do not have the balance sheets to keep all of the loans on their books. For the time being, incumbent banks still have the advantage of scale, brand power and physical presence to remain a force to be reckoned with.

Although low interest rates tend to squeeze bank earnings, they provide the conditions to expand lending in a country such as Brazil, with a weak level of credit penetration. Brazil has never had a time like this in terms of low rates to stimulate mortgages and lending to households. Publicly-owned Caixa Economica Federal is seeking to boost financial inclusion for the poorest one-third of Brazilians. Already the biggest lender by the number of customers, Caixa created 35 million new accounts in 2020 to facilitate payment of government Covid-19 benefits to people who were previously unbanked. The bank is now opening new branches and promoting its digital arm. The direction taken as the country seeks recovery from recession and the pandemic, will have to bring more of the populace into the formal economy and part of the financial system. Brazil is a diversified economy with global manufacturing, engineering, mining, mineral, and raw material supply- chain linkages. Its important agri-business & thriving agricultural exports to China, Europe and Asia will provide vitally needed economic boosts during this medium-term recovery process.

Future growth will be dependent on investment boosts [post-pandemic], aimed at combining government, private and foreign investments; aided by future technology enhancements to modernize industry and better support the domestic economy while boosting exports and imports. Government debt was 102% of GDP in 2020 [up from 89% in 2019]. However, Brazil's healthy foreign exchange reserves, strong export momentum and independent central bank policies provide the basis for medium-term optimism. A recovery is forecast over four years.

South Africa

The central bank held its main interest rate at an historic low of 3.5% in March [breaking with several of its emerging market peers that have increased rates following a surge in U.S. Treasury yields]. The rate hold was anticipated in view of South Africa's moderate inflation and relative currency stability. No further interest rate moves are anticipated this year. Maintaining the current low rate will help support a post-pandemic recovery.

Companies in South Africa's construction and building sector confirm that low interest rates remain the biggest driver of activity. A decline in consumer price inflation to 2.9% in February also supports economic activity and low interest rates, although inflation is forecast to head higher during 2021 in view of rising oil prices and a prospective double-digit hike in electricity tariffs. Pressure from energy costs will, however, be partly offset by a favorable outlook for food prices because of a second consecutive bumper harvest this year. A comparison with interest rate and inflation trends in another emerging market, Turkey, underlines the benefits to South Africa from having an independent central bank with an inflation-targeting mandate, alongside a flexible exchange rate.

Turkey's benchmark rate soared from a recent low of 8.25% in May 2020 to 19% in March 2021, for example, and year-on-year inflation jumped to 15.6% in February 2021. South Africa's main drawback is a persistently low rate of economic growth due to a raft of structural constraints.

South Africa's vaccine rollout is off to a slow start and frequent power blackouts have returned to hobble economic activity. GDP growth of 3.8% is projected for 2021. Expectations for getting back to pre-pandemic output levels is unlikely before 2022-23. Getting vaccines to populations of poorer South Africans and people living in rural and remote villages will take time.

Government debt reached 82% of GDP in 2020 raising concerns of fiscal instability. South Africa spent 18.6% of public revenues on debt service last year. This compares with an average of 10% for emerging markets. Inflation is expected to stay at the low end of 3%-6% targeted by the central bank for 2021.

South Africa recorded a rare current-account surplus in 2020, of 2.2% of GDP. The surplus of $6.7 billion in 2020 exceeded expectations. The switch to a surplus for the first time since 2002, stems from a large rise in the merchandise trade surplus and a moderate decline in the deficit on invisible trade (comprising services, income and current transfers).

Exports were resilient in 2020 despite the pandemic, rising by 7% to $85.5 billion. Imports declined sharply by 20% due to cheaper oil and slackened demand. Despite the current-account surplus, the balance of payments moved into deficit in 2020 because of net financial outflows.

India

According to trade data from India's Ministry of Commerce and Industry, merchandise exports grew by 58.2% year-on-year in March, after remaining almost flat in the previous month; meanwhile imports rose by 52.9%. The increases reflect how much trade flows had plummeted amid the global and domestic shutdowns of economic activity in efforts to curb the spread of the pandemic.

Exports touched $34 billion in March 2021 and were 21.3% higher than in February, the highest value ever recorded in a month, pointing to some recovery in demand in India's export destinations. Growth in exports was broad-based, with nearly all categories of goods recording positive year-on-year increases. Excluding the volatile categories of oil products and gems and jewelry, merchandise exports posted an even stronger year-on -year growth of 60.7% in March.

The upswing in merchandise imports (cost, shipping and freight included) was 18.7% higher than in February. It was led by a 584.2% year-on-year jump in gold imports. Despite a surge in global oil prices, overall value of crude oil imports rose by just 1.2% year-on-year, which reflects continued subdued demand for domestic use and points to a weakness in export demand for petroleum products. Nevertheless, non-oil and non-gem and jewelry import values were 44.5% higher than the year earlier, indicating further improvement in domestic demand conditions because of normalizing activities. The expectation is for goods exports and imports to record continued growth in 2021 amid an improved domestic economic outlook. This trend is expected to be strengthened by a broad surge in global commodity prices, which will expand India's import bill.

However, one year after the onset of the pandemic India recorded 103,558 new cases on April 5, its highest daily record to date. This forced the reimposition of lockdowns amidst warnings that hospitals were running out of beds. This is true in even small Indian cities. These worrisome developments are reminiscent of earlier waves in the pandemic; and comes even as India continues to vaccinate more than three million people every day, one of the largest efforts in the world.

After several months of declines, daily infections have surged tenfold since mid-February. More than half of the new infections were traced to the western state of Maharashtra, which includes Mumbai, India's financial capital. The state government ordered all shops, movie theaters, markets, and restaurants to close and imposed a nighttime curfew, exempting only essential services.

With 12.6 million confirmed covid-19 cases, India's caseload is the world's third highest after the U.S. and Brazil. Officials attribute the recent spike to a relaxed attitude among Indians when it comes to wearing masks and maintaining social distancing.

The government is criticized for sending mixed messages: allowing large crowds to gather for a major Hindu holiday – where hundreds of infections were reported. Prime Minister Modi's party has held crowded rallies in several states where local elections have begun. At the inception of the pandemic Mr. Modi enacted a severe lockdown. As India's already ailing economy contracted even further, the government began lifting restrictions last May, and infections started to explode.

The new lockdowns in Mumbai have been met with resistance by opposition politicians and business leaders. Representatives of the hotel industry appealed to the Maharashtra state government for financial support and tax waivers, projecting that the latest lockdowns would bring economic ruin.

India's vaccination drive has been a rare bright spot domestically, but at a cost to other nations: the government has curtailed exports of vaccines manufactured by its huge pharmaceutical industry, dealing a setback to poorer countries that had been relying on India for vaccine supplies.

Kenya

After a steady growth trend in foreign capital inflows, foreign direct investment (FDI) to Kenya fell in 2019 amid U.S.-China trade tensions and again in 2020 amid the pandemic. FDI to Kenya in 2020 amounted to $1.1 billion (down from $1.3 billion in 2019 and $1.6 billion in 2018). The forecast is for foreign capital inflows to increase steadily over the next four years, averaging $1.6 billion per year for 2022-25, as the pandemic is more contained and economic recovery takes root.

FDI growth in recent years has been driven by Chinese investments in mega-projects, and investments in housing, information and communications technology, chemicals, manufacturing, and the oil-and-gas industries.

Kenya is considered as the top destination for impact investors in East Africa and the second in the continent behind South Africa. According to the Global Steering Group for Impact Investment, a nonprofit organization based in the UK, in 2005-15 (latest available) impact investors brought more than $4 billion into Kenya, accounting for almost a half of FDI during that period. The 2020 drop in FDI brought on by the pandemic is expected to hit service industries such as aviation, hospitality, tourism and leisure the hardest.
The top country sources of FDI into Kenya include the UK, the Netherlands, Belgium, China and South Africa. Last September lawmakers proposed the Start-up Bill 202 for introduction to the senate. If passed, the legislation would make Kenya the latest African country to have specific legislation for start-ups. Kenya is considered one of Africa's "big four" for start-ups and innovation, alongside Nigeria, Egypt and South Africa.

Foreign investment is welcomed in most sectors, but restrictions apply in telecoms and insurance and on the Nairobi Securities Exchange. There are no restrictions on the repatriation of profits or capital. The Companies Act 2015 contained a controversial clause that required all foreign companies registering in Kenya to cede a third of their shareholding to Kenyan citizens, though a 2016 amendment ultimately abolished the provision.

Public utilities are legally open to foreign investment, though a foreign takeover would probably provoke political and public resistance. Foreign investment of more than $100,000 require an investment certificate from the Kenyan Investment Authority.

The government imposes some restrictions on foreign investment in postal services and telecommunications- in part to protect state-owned entities with monopolies in these sectors. Restrictions also apply to the media, notably radio. Kenya Reinsurance Corporation enjoys a guaranteed 20% share of reinsurance policies from local insurers.

The discovery of oil reserves in 2012 sparked foreign investor interest and led to aggressive competition for petroleum blocks. Until 2019, exploration activities were governed by an outdated 1986 statute that deterred investors, which the government had long been trying to update. After multiple failed attempts, the Petroleum (Exploration, Development and Production) Bill 2017 was signed into law in 2019.

Because of agricultural deregulation over the past two decades, farmers no longer have to sell their coffee, maize or tea to Kenyan marketing boards, but the results of deregulation have been disappointing, and farmers lack crucial resources. Farmers have struggled to establish strong alternative marketing channels and are vulnerable to climate irregularities and fluctuations in commodity prices and exchange rates.

In December 2020 Kenya passed the Tea Act, which states that only those licensed by the Tea Board of Kenya can manufacture tea for sale. It also institutes direct settlement schemes for farmers, so they are paid immediately after the sale of their tea; and requires factories to pay 50% of sales to farmers. A proposed Coffee Bill (under review as of end-February 2021) is similarly aimed at boosting income for Kenya's coffee farmers. It would allow for factories to register autonomously rather than as collectives.

The Ministry of Industry, Trade and Cooperatives has identified a number of sectors that need immediate intervention to save them from collapse, including textiles, construction, poultry and paper. The Trade Remedies Act of 2017 is aimed at stopping unfair competition from imports.

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