Major Country Risk Developments
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By Byron Shoulton

Overview

Another cyber-attack in the U.S. on a major supplier; this time on JBS the world's largest beef, pork and poultry processor – interrupted operations at several plants in the U.S., Australia and Canada. The attack against JBS is the latest in a growing number to hit a range of businesses and institutions, including hospitals, the oil industry and local water supplies. The attack ratcheted up pressure on a food-supply chain already under strain from labor shortages, production constraints and high transportation costs. Plant closures from the JBS hack could lead to higher consumer prices, which have climbed this year because of high demand and a tight labor market.

Meanwhile, the economic rebound gathers momentum in the U.S., China, Europe, parts of Asia and Latin America. Lifting of restrictions on travel, social gatherings, instore shopping, eating-out and other outdoor activities are driving a steady return in demand for goods and services.

However, shortages of goods, raw material and workers continue to plague industry, manufacturing, and services; while causing slower deliveries of finished goods, driving prices higher and stoking inflation. Continued loose central bank policies and generous stimulus spending by governments has helped in flooding the financial system with liquidity. Some analysts now warn that U.S. Fed policies may be too relaxed amidst signs of growing inflationary pressures. Some nervously suggest that monthly Fed bond buying of $120 billion should be halted or at the least, the amounts should be reduced. However, a key measure of inflation expectations has slipped in recent days, raising the possibility that after this year's near-relentless climb, inflation may have peaked. The gauge known as the 10-year break-even rate suggests that the consumer-price index will rise by an annual average of 2.48% over the next decade. That was up from 2.01% at the end of 2020, but down from its recent high of 2.57% on May 12. The ups and downs of the break-even rate have come under scrutiny in recent months as investors have grown increasingly concerned about inflation. A leveling off or decline in the rate is good news for those worried that accelerating inflation could threaten investors' portfolios and overall confidence in the recovery.

The global shortages of semiconductors for example, which has affected global auto production and consumer electronics, is a vulnerability that may take years before being fully resolved. Remote work and study which has proliferated during the pandemic has led to explosive growth in the need for semiconductors which in turn is creating strains in global supply chains. Even while the industry has tried to address near term constraints, it will take longer for the system to overcome shortages in foundry capacity, raw material supplies and adequate availability of components used in semiconductor manufacturing. Planned expansions by Intel and others to boost advanced chip manufacturing by adding new plants in the U.S. and Europe are meant to ensure a more sustainable and secure global semiconductor supply chain. But these expansions will take time before additional production becomes available. Taiwanese and Korean companies which currently dominate the semiconductor manufacturing business have moved most of their production activity to Asia where more than two-thirds of advanced computer chips are now manufactured.

Rising global demand for raw materials, metals, minerals, rare earth, iron ore and a wide range of commodities, have spurred prices to record highs over the past few months. The rising pull for access to more essential materials and manufacturing components, in the face of expanded demand and ongoing delays, will help drive greater job creation globally and influence higher paying salaries. Nonetheless shortages persist. A backlog of orders across several sectors due to supply chain setbacks, remain an ironic reminder of the many challenges and the changing trajectory of the current recovery. The outlook for copper is for a sustained rally as Chinese demand stays high. Benchmark copper price hit a record high of $10,460 a ton in early May and remain above $10,000 per ton. The price of copper has not been near this threshold for a decade; and it has doubled over the past year.

China is the world's biggest copper importer, consuming half of all global output. The country's imports of unwrought copper and products rose 9.8% during January-April period compared with a year earlier. Investors see copper as an attractive commodity, especially as major countries push for decarbonization, which is expected to boost demand for electric vehicles as well as wind and solar power generation stations. Electric vehicles need plenty of copper wiring to propel themselves. Copper is mainly used to make electric cables and is also indispensable to infrastructure builders. Goldman Sachs estimates that copper demand will grow nearly 600%, to 5.4 million tons, by 2030 due to the focus on green transition. However, the market could face an 8.2 million ton supply gap by 2030. New mine development has been limited over the past decade, and mining companies remain cautious about doubling down on new developments and rising costs. Promising mines are located in places where it is difficult to deliver large equipment. A rise in environmental awareness is also causing an increase in environmental mitigation costs. Even if companies start exploring mines now, it will take at least five years before the additional yield comes to market.

China's recovery has triggered a price jump for many other commodities despite the pandemic. In just one year, iron ore prices jumped 78% and the benchmark price of lumber tripled. Prices for other metals such as nickel and aluminum have also risen.

Brazil

The outlook for Brazil's economic growth in 2021 has improved in recent weeks. Growth of Gross Domestic Product (GDP) expanded faster than expected in the first quarter. Latin America's largest economy is back to where it was before the onset of the pandemic at the end of 2019.

Officially released data showed that the economy grew 1.2% in Q1. This growth was surprising as some projections suggested that the economy would likely contract. The consensus now is for a faster recovery in Brazil. The stronger than expected results are being attributed to Brazil's booming agricultural exports, an uptick in fixed investment, and the loosening of pandemic restrictions. As a result, several banking and economic consultancies have revised their full 2021 growth forecasts upward to 4%, from 3% previously. Looking ahead, the economy is expected to pick up in the second half of 2021 as the vaccination campaign gathers pace and restrictions are lifted more effectively.

While the emphasis is definitely on strong agricultural exports as the main driver of renewed growth, several sectors showed positive growth (minerals, mining, manufacturing); a surprising outcome given Covid-19 restrictions. However, some scientists have warned of the potential for a third wave, which could slow the recovery. Much of the growth came from pent-up demand and an aggressive stimulus program, which saw the government spend the equivalent of 8.3% of GDP in 2020, most of it in cash payments to residents. Brazil's stimulus was the biggest of any major emerging market, almost double the percentage spent by China or India and compares with just 0.7% of GDP in Mexico.

The downside for Brazil is that the government piled up debt, which is now at 86.7% of GDP – a level considered unsustainable for developing economies that need to borrow.

Brazil's national statistics office has highlighted that although GDP growth in the first quarter returned to pre-pandemic levels, it was still 3.1% below the highest point of economic activity reached in the first quarter of 2014. The growing optimism has also been tempered by the dual threat of rising inflation and unemployment, which are fueling social discontent. Recently released data show 15 million Brazilians - or 14.7% of the working population- are unemployed. In northeastern Brazil, unemployment is at 18.6%. This means that the stronger GDP numbers – due to rising commodities exports, strengthening prices and higher inflation, do not necessarily reflect a better life for Brazilian families – as there was no increase in household income recorded. Meanwhile, the price of essential goods, such as food and energy, is increasing and taking a toll on income.

The Brazilian consumer price index increased 2.7% so far in 2021 and 6.7% over the last 12 months. The central bank has warned that inflation will increase further over 2021. Inflation remains in an upward spiral and international commodity prices remains the main source of price pressures. The momentum started with oil and iron ore and with the economic reopening in some countries and the subsequent resumption of demand. More recently, climate problems have also put pressure on international agricultural commodity prices. Inflation will be the challenge over the rest of 2021, eroding the purchasing power of salaries, while the labor market remains weak. In addition, there is the threat of problems in the supply of electricity because of a water crisis. According to a report from Banco Safra, there has been a risk of power supply problems during the drought. Rainfall at the beginning of the year was very scarce, which translated into low reservoirs at the end of the wet season in March, affecting Southeast/Central region and creating the worst hydrological crisis in 91 years.

The main threat according to the bank, is that eventual load peaks throughout the day cannot be responded to, which would generate instabilities and power outages. First, this situation puts even more pressure on inflation- electricity bills will be more expensive as of June, which will lead the Extended Consumer Price Index (IPCA) to exceed 8% in the 12 months to the middle of 2021. Obviously, it risks affecting the expansion of the economy. Also, a potential third wave of Covid-19 could slow down economic activity, if it requires more stringent social-distancing measures.

Brazil's mass vaccination campaign [in one town Serrana] between February and mid-May saw cases fall by 80%, and hospitalizations down by 86%. The campaign has curbed transmission of the disease in the town, also reducing cases and deaths. More than 95% of the town's eligible adults agreed to take the Chinese CoronaVac vaccine as part of the experiment. The study's results show that it is possible to control the pandemic by vaccinating about 75% of the population.

Meanwhile, thousands of Brazilians took to the streets at the end of May to protest against President Bolsonaro, who had played down the gravity of Covid-19, which has killed more that 460,000 people in Brazil. A congressional probe into the crisis has shown the Bolsonaro administration failed to take up an offer from Pfizer last year to supply as many as 70 million vaccine doses, among other failures. More than four months into its vaccination campaign, Brazil has immunized only about 10% of its population, mostly with CoronaVac doses secured by the Sao Paulo's state government (not the national government). Banco Itaú is projecting that that the progress of vaccination should allow a return to economic normality in the fourth quarter of 2021, with the prospect that the entire population over 18 years old will get the first shot by November. Overall, the economy is showing greater resilience than was expected a few months ago. Still there are risks to the scenario, and a firmer recovery in not yet assured.

China's Sinovac's covid vaccine is being rolled out across other Latin American countries such as Colombia, and in dozens of other developing nations from Egypt to the Philippines.

Egypt

The IMF published its second and final review of Egypt's progress under the country's 2020-21 $5.2 billion standby arrangement (SBA). Acute financial and external liquidity concerns at the outbreak of the crisis resulted in Egypt tapping the IMF for $2.8 billion from its pandemic emergency rapid financing instrument, which followed soon after the SBA. The SBA set further targets relating to structural reforms begun under the 2016-19 $12 billion extended fund facility with the IMF. The IMF financing helped Egypt to stabilize foreign reserves and to maintain exchange rate flexibility for the Egyptian pound. Investor confidence in Egypt has since been restored and the sovereign has been able to tap international bond markets several times since mid-2020.

The IMF remains broadly positive regarding Egypt's macroeconomic stability and the country's adherence to goals set in the most recent IMF program. It suggests that the third and final $1.6 billion tranche of funding will be released on time in mid-year 2021. The IMF reports that Egypt complied with objectives outlined in the agreement on improving fiscal transparency and governance. The authorities have also proceeded cautiously during the pandemic in terms of additional government support, wary of putting too much pressure on fiscal finances after years of tough reforms.

Egypt recorded a primary surplus (excluding interest payments) in 2020 and kept the overall deficit broadly stable at about 8% of GDP, despite pandemic pressures. The economy grew by 3.6% overall in 2020 and is on course to grow modestly in 2021.

The private sector remains constrained by institutional weaknesses, with trade and investment regulation requiring further reform in order to support private-sector development. Some rationalization and small-scale privatization of some state assets is proceeding. However, despite a pledge to sell-off some military-run enterprises on the stock market, the government is unlikely to reduce the role of the army in the economy, particularly in larger industrial and infrastructure projects, given its dependence on the loyalty of the security forces.

Egypt's regional strategic importance was on display through its mediation efforts conducted via its intelligence services to bring about a cease fire to a recent flare up in the conflict in Gaza between Israel and Hamas-led forces. The U.S. acknowledged those efforts in calls between Presidents Biden and Sisi as well as the visit of the U.S. Secretary of State to Cairo.

On May 27th President Sisi made a state visit to Djibouti that was aimed at enhancing security, military and economic relations. The visit to the East African nation is part of a series of initiatives that Egypt has taken to bolster military ties with African countries in the Nile Basin and Horn of Africa. This forms part of President Sisi's plan to raise Egypt's strategic profile. It is also aimed at bringing pressure to bear on Ethiopia with regard to the contentious Grand Ethiopian Renaissance Dam (GERD) issue, as the filling of the dam is set to continue, raising concerns over Nile water supplies.

Sisi's visit to Djibouti came days after Egypt's signing of a technical military accord with Kenya. Similar military agreements have been signed with Uganda, Sudan and Burundi since March, encompassing intelligence sharing, joint exercises and military training.

Colombia

Social unrest has roiled Colombia over the past month following a misjudged tax reform bill. The government sought to raise funds needed to make pandemic-related cash transfers permanent; and to narrow the fiscal deficit which would have eliminated creditworthiness concerns. The bill also would have placed more of the fiscal burden on those more able to pay.

However, the tax reform bill focused mainly on taxing individuals rather than corporates, making it unacceptable to struggling consumers and to politicians eyeing re-election next year. A month-long general strike against the tax reform initiative saw businesses closed, factory production halted and thousands not reporting for work. The tax bill was withdrawn in an unsuccessful attempt to stop the violence. The protests continued. For the government, it must now return to the fiscal drawing board. Other Latin American governments must be viewing the Colombian case as a lesson learned.

The Colombian president Ivan Duque suffers from low levels of popularity, and strong anti-incumbent sentiment. The impact on some right-wing candidates who aligned themselves with President Duque is expected to be negative. This could affect governability as right-wing parties in Congress seek to distance themselves from Mr. Duque. It is too early to predict the likely outcome of the May 2022 presidential election, but the expectation is that this will be a polarized campaign. Protesters are seething over police brutality, inequality, corruption, lack of opportunities and a host of other issues. Dislike for President Duque's conservative government is palpable. The government blames terrorists, criminal groups, and left wing guerillas, who it says have infiltrated the protests. One worrying aspect of the violence has been the appearance of armed civilians who have opened fire on protesters. Despite all this, most protests have been peaceful.

The economy grew by 2.9% in January-March quarter, driven by recoveries in household consumption and investment. Although the pace of growth has slowed compared with the second half of 2020, the result was positive (the forecast was for an expansion of 1.2%). Estimates of damage and economic disruption from the protests run a wide range and, without certainty on how long these protests will continue, it is difficult to arrive at an accurate number. Estimates of the damage to the economy from lost output range from $1.6 billion to $2.7 billion (0.5% to 0.9% of GDP).

The construction sector was a major engine for GDP growth in the first quarter. Growth in the sector was driven principally by government subsidies to boost demand for low and middle income housing; permits for new housing developments jumped by 28.4% in January-March and the total area approved for new housing developments exceeded levels for the same period in the two prior years. Mining and quarrying also expanded on account of a rebound in the production of key commodities (including coal, oil and ferro-nickel), although output remains below pre-pandemic levels.

The recent wave of protests caused disruptions to urban and intermunicipal mobility and supply chains – principally agriculture- which will take a toll on economic activity.

S&P downgraded its rating for Colombia from BBB-Negative to BB+ Stable, citing the withdrawal of the tax reform as the impetus. Many Colombian bankers and economists had expected a downgrade if fiscal reform failed to materialize.

Looking ahead, the recovery will depend mostly on how the pandemic evolves and whether any new restrictions would slow activity. The vaccine rollout has been slow, and the second quarter is expected to register an economic contraction amid soaring Covid-19 infections, new targeted lockdowns and the effects of the wave of social unrest in April-May that has hit economic activity.

Colombia's outlook for the rest of 2021 is also vulnerable to developments in fiscal policy. The country's investment grade rating hinged on the government's ability to signal to markets and investors that it is taking the necessary steps to bring down the debt burden over the medium term via tax reform. Having failed to do so, the economic outlook is likely to be hit by a rise in interest rates and inflation.

Growing downside risks for the economy this year and in the medium term stem from Colombia's fiscal woes. The President retracted the tax reform proposals to appease protesters, but this move has raised concerns among investors, as the lack of a tax reform complicates the government's ability to manage the public debt burden, which has risen significantly since the pandemic began. The forecast is for non-financial public sector debt/GDP ratio to reach 77% in 2021. Some believe that the Congress will pass a reform in the second half of this year to generate additional recurrent revenue streams from 2022, which should help reassure the markets, at least to some extent.

Peru

The country faces run-off elections on June 6th and panic has seized the Peruvian elite at the prospect that Pedro Castillo, a rural primary school teacher turned hard-left populist could emerge the winner. Mr. Castillo's political party Free Peru is led by a Marxist advocating widespread nationalization, higher taxes, a new "peoples' constitution" and import substitution policies in the world's number two copper producer. A strict lockdown last year resulted in the economy contracting by 11%, the second worst contraction in Latin America after Venezuela.

Described by many observers as a choice between the lesser of two evils, the second run-off elections pits Pedro Castillo against Keiko Fujimori, the widely disliked daughter of an authoritarian former president who ruled in the 1990's. The currency, the sol fell to an historic low of 3.85:US$1 at the end of May, as wealthier Peruvians rushed to dump the currency and move their savings abroad. Local bankers and business leaders confess to not seeing this level of capital flight in Peru for more than two decades.

The root of the current crisis goes back years. Hailed as a success story for more than 15 years, not enough of Peru's economic growth has trickled down to the poor. Successive corruption scandals help destroy faith in the political and business classes and created chronic instability. This led to Peru having three presidents in just over a week in 2020. When the pandemic hit, the health services collapsed amid a shortage of beds and medical oxygen. Data show that Peru was one of the hardest hit countries, suffering more than double its normal death rate during the pandemic. A strict lockdown imposed in 2020 plunged the economy into a deep recession but failed to curb the spread of the virus, fueling indignation among most of the public. Almost one-third of Peruvians now live in poverty, according to official figures, an increase of 10 percentage points since the start of the pandemic. A growing number of Peru's downtrodden millions see in Mr. Castillo a ray of hope. His slogan, "no more poor people in a rich country" has sent a powerful message to audiences in left-behind communities across Peru.

The task of trying to stop Castillo from winning the presidency has fallen to Fujimori, a conservative who was the runner-up in a chaotic first-round election with 18 candidates, none of whom proved popular. Castillo won with 18.9% and Fujimori's tally of 13.4% was smaller than the number of blank and spoiled ballots. Polling data showed that Fujimori had among the highest rejection rates of the first-round candidates. She was forced to abandon campaigning in the historic city of Cusco recently, after being pelted with plastic bottles and garbage by a hostile crowd. Already tarnished by corruption allegations, Fujimori's unpopularity is amplified by a record as a confrontational leader in a previous parliament and from past conflicts with her family. Nonetheless, the panic of the business class is such that they are endorsing her unconditionally.

The latest opinion polls show a tight race, with a wide early Castillo lead narrowing significantly; but since the polls failed to forecast Peru's first round accurately, few people are making bets on the outcome. Local journalists complain of heavy pressure from media owners to demonize Castillo and play up the idea that he represents a Marxist menace, something the candidate's supporters say is untrue. Some say that instead of being representative of the Cuban or Venezuelan model, Castillo is more in the image of former Bolivian president, Evo Morales.

Assessment of what a Castillo government might be like is complicated by the candidate's aversion to interviews and uncertainty over the role of Vladimir Cerron, the Marxist leader of the Free Peru party. Mr. Cerron, a former regional governor under investigation for corruption, has been a shadowy figure throughout the campaign. Optimists believe Castillo might soften his tone once he's elected, citing the example of Ollanta Humala, a leftist who governed more moderately when in power from 2011 to 2016. But in the final stages of the campaign, Castillo is not giving any signal of moderation. With the election drawing near, Peru's professional classes express the sinking feeling that neither candidate is remotely suited to tackling the country's huge challenges. According to a local political analyst, this is a contest between failures. The one who fails the least will be the winner.

Among the business elite in the capital Lima and in boardrooms of mining companies that generate much of Peru's wealth, no one is amused. For them Castillo's party Peru Libre (Free Peru), wants nothing short of revolution in Latin America's fifth most populous country, aiming to overturn the free-market model that has governed the country for a generation. In its manifesto, the party says foreign mining companies should be forced to pay 80% of their profits to the state rather than the "miserable" 10%, 20% or 30% that they pay now. Copper, gold, silver, zinc and crude oil are among Peru's strongest exports.

Financial markets are unsurprisingly rattled – not only by Castillo's ample first-round victory but by subsequent polls that suggest he enjoys a strong lead over Fujimori. In addition to the fall in the value of the currency, the stock exchange has shed over 12%. The spread between 10-year sovereign bonds and U.S. Treasuries widened by over 71 basis points and the cost of insuring against default shot up, with five year credit defaults swaps hitting their highest level this year following the first round. One recent business survey found 75% of Peruvian companies have put their investment plans on hold until after the election.

For those worried about a Castillo presidency, there is solace in the math of Peru's fractured political landscape. In the next congress, Peru Libre will be the largest party with just 37 out of 130 seats. Even with support of other leftists it will struggle to muster the one-third of parliamentary votes Castillo would need to avoid impeachment, let alone the two-thirds he would need to change the constitution.

Zambia

President Edgar Lungu and the ruling Patriotic Front party is expected to win the August 2021 elections. Crackdown on the opposition will risk triggering social unrest during and after the election campaign, compounding existing public dissatisfaction with Zambia's poor economic performance.

The incumbent's victory would be hard-won, and the ruling party will probably emerge with a thinner majority in the National Assembly (it currently holds 90 seats out of 166). The consensus is that the sitting government will seek to further restrict the political space to gain an edge over the main opposition party. The police have been denying permission to leading opposition party, the UPND, to hold public rallies using as an excuse the fact that the president was campaigning in the same province. Other efforts to frustrate the UPND are expected to surface in the run up to the vote, and it is speculated that the party's leader could be arrested. There is precedence. The opposition leader was jailed for four months on charges of treason after the 2016 elections. Moreover, support for the Patriotic Front is likely to remain strong in areas which have benefitted from infrastructure development under the Lungu administration.

The outlook is for inflation to average 14.9% in 2021, while GDP growth will be a muted 2.4% following an estimated 2.5% contraction in 2020. Given population growth of 2.9%, the economic growth forecast implies that per capita GDP will continue to fall in 2021, after two years of declines. This will likely exacerbate risks to social stability over the short term. Protests are likely to meet violent responses from police forces, and potentially the introduction of additional security powers as in the aftermath of the 2016 elections, which will serve to further entrench social tensions.

Meanwhile, the regulatory environment for the mining sector remains highly volatile. The government has adopted a an increasingly confrontational stance towards foreign mining firms since the forced liquidation of Vedanta Resources local copper unit in May 2019, and has vowed to increase its role in the management of the country's copper resources. Local communities affected by mining activities have shown support for the government's hostile stance, which gives the government incentive to retain this approach, at least until the election. Moreover, lobby group Zambia Chamber of Mines has recently made clear that $2 billion in investments have been halted due to higher taxes imposed on the sector since 2019.

Some believe that the constrained state of government finances will leave mining companies facing a burdensome tax regime over the coming year – as the government seeks to bolster its revenue intake. The effect is likely to be a dampening of investments and output in the sector. Furthermore, progress on fiscal reform will remain elusive in 2021. The anticipation is for lengthy and complex debt restructuring negotiations between the government and foreign creditors, following missed Eurobond coupon payments in November 2020 and in January 2021. This is due to both to Zambia's varied group of foreign creditors (comprising bilateral lenders and multiple private sector bondholders) and the perceived lack of transparency over the scale and terms of Chinese debts. The government has also resumed discussions with the IMF over a financial program, and the Fund is currently reviewing the authorities' plans to achieve fiscal and debt sustainability as part of the Economic Recovery Program (2020-23).

While an IMF program would increase investor confidence and speed up debt negotiations, the government will likely avoid imposing harsh austerity measures that the program would entail in an election year. This means that compliance with the program, which is unlikely to be agreed in the coming months, would probably remain limited in the near term.

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