Major Country Risk Developments
May 2021

By Byron Shoulton

Overview

Parts of the global economy appear to be recovering faster than initially projected. In the U.S., China, UK, Israel, New Zealand, Australia and several countries in Asia, economic production is back at or close to pre-pandemic levels. The common thread appears to be those countries where delivery of vaccinations was most efficient, access to vaccines most successful or contact tracing and isolation most effective. Global trade flows have recovered from the early months of the pandemic and according to the Bureau for Economic Policy Analysis, trade flows are now at their pre-Covid levels, suggesting that despite ongoing geopolitical tensions, supply-chain disruptions and higher shipping costs, global manufacturing and logistics has managed to come back strong over the last three quarters.

Global semi-conductor shortages, as well as shortages of critical raw materials used in the design and manufacturing of certain high-tech components, continue to slow production of autos, smartphones, electric vehicles, etc. This is impacting a variety of high-tech equipment production lines causing some factory closures. Inadequate availability of critical parts and component supplies negatively affected factory operations in several countries, including **Germany, Taiwan, South Korea, Singapore, U.S., UK, Poland,** among others.

In addition, container shortages, various supply-chain disruptions, higher freight costs, and shortage of workers continue to add to strains in the delivery and availability of many products. Together with transportation and logistical bottlenecks, these have helped to fan inflationary concerns - given strong and growing global demand chasing fewer or scarce supplies. This is a recipe which pushes prices higher. Furthermore, higher costs for commodities, including crude oil, iron ore, industrial and base metals, in addition to other raw material price spikes, are likely to contribute to upward inflationary pressures over the coming quarters.

Prices for metals used in construction, including copper and aluminum, have jumped higher in recent months, after initially tumbling at the onset of the pandemic early in 2020. Demand for goods among consumers [unable to spend on travel or eating out], disruption in mining in South America due to Covid-19, and difficulties shipping material around the world are contributing to the rally in prices. The global economic rebound and expectations of infrastructure spending is likely to further lift demand for industrial commodities, helping boost revenues in commodity producing countries over the next 12-24 months.

India

Many governments continue to struggle to secure adequate vaccine supplies in order to put the pandemic under control. In **India, Brazil, Mexico, and South Africa** for example, covid cases continue to surge amidst more contagious variants and slow vaccination rollouts. Actual casualties resulting from covid are believed to be often three or four times higher than what has been officially reported in a number of countries. This is particularly true in India which has succumbed to a deadly second wave triggered by aggressive contagious variants and lax policies after the country mistakenly believed in February that it had beaten the virus. The combination of record high new infections, severe vaccine and oxygen shortages, overwhelmed hospitals, overstretched healthcare workers, and the need for medical equipment, have exposed India's fragile health-

care system, and the lethal nature of new variant strains. Pledged international help to India in the form of oxygen, medical equipment, vaccines, medicines and vital back-up supplies – has arrived too late to prevent the dramatic loss of lives. Help from abroad is just beginning to be released for delivery to affected communities.

Untimely international response notwithstanding, the unfolding tragedy is ironic since India had only recently been touted as the "pharmacy to the world", given its status as the leading producer of coronavirus vaccines sold globally. It is no wonder that as the daily rates of infections and deaths increased -forcing the expansion of domestic vaccination drive- India had to halt vaccine exports. Supplies of vaccines manufactured for export had to be diverted to help address the unfolding domestic catastrophe. India's Goa state, a popular tourist destination on the western coast, has the highest rate of infections in the country, with up to one in every two persons testing positive in recent weeks.

Although the Indian government has allocated funding to boost production capacity, supplies will remain tight for months. India accounts for 60% of the world's supply of covid vaccines, making the country and its factories central to global efforts to end the pandemic. The central bank has released $6.7 billion in funding for vaccine makers, hospitals and other health firms to counter the ongoing surge of infections. As of April 21, 2021 only 8% of the Indian population had received a single dose of a vaccine, even as daily cases exceed 400,000 and daily deaths reported at 4,000. The pace of inoculations has already slowed because of supply issues; and the forecast is that India will reach a 60% vaccination rate only late in 2022. More countries across the world are banning flights to or from India.

A shortfall in global vaccine supplies means western vaccine manufacturers are looking for alternative production hubs, but these will take months to reach full capacity. Meanwhile, the Indian government has allocated grants to the country's two major vaccine producers to boost their respective capacities. India's government is under growing pressure to impose a nationwide lockdown to stem the current devastating surge. India's Supreme Court ordered the government to submit a plan to meet New Delhi's 40 hospitals' oxygen needs.

India is likely to breach its fiscal deficit target in the [April 2021-March 2022] year due mainly to revenue shortfalls. A deficit target of 6.8% of GDP was revised to 8.3%. The IMF now expects the health crisis will damage economic growth. Previous forecasts of 10.1% GDP growth during 2021 and 2022 fiscal years was revised down to 7%.

Separately, the pandemic crisis enveloping India is reportedly spreading to Laos, Thailand, Bhutan and Nepal where infection surges have been reported. Similarly, the heath authorities in Kenya and Uganda reported that the presence of the variant first diagnosed in India has infected people in both countries. This underlines calls for widening access to vaccines to foster global economic recovery.

USA

The U.S. has entered a new, more hopeful phase as new pandemic cases are at their lowest in six months, while hospitalizations have decreased, helping to improve sentiment and the medium-term outlook. As more people get vaccinated, businesses reopen, outdoor activity resumes, and the services sector returns to more normal activity, spending has improved and will likely stay elevated. Meanwhile, travel (both domestic and to foreign destinations) has resumed, with hotel reservations, car rentals and affiliated services registering an uptick over recent months. Contributing to the increasing activity are the 56% of American adults who have been vaccinated, as well as a strong desire to get back to business, including travel. Once vaccinated, folks are emboldened and more confident venturing away from home both for work and leisure. Convincing those who remain reluctant to get the vaccine is a lingering

challenge as the pace of vaccinations has slowed in recent weeks.

A recent cyber-attack on the main U.S. oil pipeline that carries 45% of fuel supplies to the country's east coast, will immediately boost prices for gasoline, diesel and jet fuel and other refined petroleum products. An emergency waiver that allows fuel to be transported by road, is unlikely to sufficiently replace the supplies which have been cut-off when the pipeline was shut down. The disruption of fuel supplies could affect some businesses, households, and travel at this crucial juncture of the economy's reopening. The extent and length of the disruption is still too early to predict, but it sends a powerful message on how vulnerable the economy is to these types of attacks. Protecting U.S. infrastructure, security and critical supply lines from hostile forces determined to degrade them, remain among the highest national security priorities.

The construction, transportation, auto, manufacturing, online retailing, and service sectors have experienced expanded demand, sometimes surpassing projections made at the beginning of the year. However, the labor market added only 266,000 jobs in April compared to 770,000 in March, marking an unexpected deceleration in job creation. There remain 8.2 million fewer Americans currently employed compared to February 2020 at the onset of the pandemic. The April 2021 jobs report was a disappointment as forecasters had projected that around 750,000, or one million new positions would be added for the month.

While leisure and hospitality added 331,00 jobs, there were losses in other sectors, including car manufacturing, temporary help and retailing. There continues to be reported shortages of workers to fill positions left vacant by the pandemic, or due to retirements and other career changes. These include workers in food processing, long-haul truck drivers, on-line delivery, big city bus drivers, transit workers, plumbers, electricians, welders, and some construction workers. It is suspected that some workers are unable to return to work due to childcare constraints; while generous stimulus checks and extended unemployment benefits may have played a role in unemployed persons choosing to "collect" government benefits instead of seeking work.

A booming U.S. housing market and strengthened consumer demand are helping to feed booming commodity prices. Soaring lumber and freight costs and higher costs for hiring (earnings have increased by 8.4% at an annual rate, and more for lower-income jobs), carry the risk that such pay increases will become embedded into expectations, leading to more inflation. Recent inflation data indicates that U.S. consumer prices spiked 2.6% in the year ended March. This may reflect temporary factors as well as a revival in spending on a wide range of goods and services. Surveys of manufacturers show they are struggling to keep pace with demand amid shortages of basic materials, parts and components, in addition to rising commodity prices. Viewed in the context of continued high demand for more goods and services, the trend is unmistakable: inflation will be on the rise over coming quarters.

Meanwhile, the Federal Reserve once again reiterated its commitment to maintaining ultra-low interest rates while continuing its monthly bond buying program until the U.S. recovery is sufficiently assured. The Fed's 2% inflation target range will be maintained and even with inflation rising above 2%, the current plan is for the Fed to first ensure economic stability before moving to raise rates. The lackluster April jobs report weakens pressure on the Federal Reserve to consider a first step toward withdrawing its monetary support for the recovery.

As the overall economic outlook improved in recent months, U.S. banks and credit card issuers have reportedly begun easing lending criteria and moving toward pre-pandemic credit standards. Financial institutions are seeking loan growth following more than a year-long stagnation/contraction in new consumer and business lending. Industrial loans, autos, large and medium-sized companies, and small

businesses are among the categories being targeted and marketed to for granting new loans. Banks have been reversing larger loan- loss provisions that were put in place in anticipation of a surge in loan write-offs that have not occurred. Federal relief payments to businesses and households during the pandemic were effective in preventing an avalanche of defaults and more business closures. The upshot: a renewed willingness to support lending for new investments as entrepreneurs hunt for new opportunities to expand; while households invest in real estate and home improvements while considering other investments. The U.S. economy is set to also benefit from strong global demand for agricultural products in 2021-22. This will include a fairly robust bump in exports of grain, soy, pork products and nuts to China.

Proposed Federal outlays for post-pandemic recovery spending on infrastructure face opposition as concerns remain over how the U.S. will pay for stimulus measures; and what will be the impact of corporate tax increases on future economic growth. However, whichever version of pending proposals for infrastructure outlays are eventually implemented, these will make an important difference in moving the U.S. forward in achieving long-term economic competitiveness, while aiding future job creation. Tax increases to pay for infrastructure upgrades will become a necessary price for bringing U.S. competitive readiness up to par over the next decade.

Europe

The European economic recovery fund worth 750-800 billion euros, is beginning to take form and is being channeled to EU member states with lower living standards and those hardest hit by the pandemic. The fund, known as Next Generation EU, is expected to increase fiscal space in highly leveraged countries and is a landmark step for the currency block, as it establishes a precedent for the EU to issue debt to fund common needs. The program is pegged at a maximum 800 billion euros, of which half will be in the form of grants. The total size will depend on recipients take up of loans from the commission, which may not appeal to some countries that have lower borrowing costs. This is on top of the EU's normal seven-year long term 2021-27 budget, which weighs in at 1.2 trillion euros.

Disbursements from the fund are expected to stimulate new economic activity following the covid-led EU economic contraction last year, which continued into first quarter 2021. The boost to Europe's pandemic-stricken economy (which contracted by 6.2% in 2020) from as much as 800 billion euros of EU funding over the next five years is on track to help the region rebound close to its pre-crisis growth path. Projections anticipate an extra boost in eurozone GDP by an average of 3.5% over the next five years, depending on how much of the funds are actually spent and how well they are used. Several countries plan on supplementing the money from the EU with additional funds from their national budgets, including 60 billion euros in France and over 30 billion euros in Italy. Some 14 countries have already submitted their spending plans to the EU. The IMF has lauded the program and opined that if the funds are well spent and accompanied by needed structural reforms, the boost to the region's GDP will be strong.

Greece's plan, which won praise from the EU for its coherent design, is predicted to result in a 7% boost to GDP by 2026. Other private forecasts estimate that Greece would experience an uplift close to 12%, the highest of any EU member state. The biggest uncertainty over the program includes how effectively and how much of the money would be spent. In the six years to 2020, EU member countries spent on average only half of funds they were allocated. However, the absorption rate of EU funding was closer to 90% in the six years after the 2008 financial crisis, suggesting countries are better at putting funds to work in downturns similar to the current one.

After shrinking 6.2% last year, and with GDP falling by 10% in both Greece and Spain, the region has been lagging behind its main trading partners in the U.S. and China. The eurozone regional economic outlook

has brightened lately, partly due to an expected spillover from the $1.9 trillion fiscal stimulus program in the U.S.

Spending by tourists visiting Europe declined by 64% in 2020 compared to the previous year, while the overall contribution of travel and tourism to the region's GDP declined by half. Across the continent 3.6 million people have lost jobs in the tourism/hospitality sector, equivalent to 10% of the 2019 workforce. The pandemic exposed the heightened dependency on tourism in economies such as **Spain, Italy, Portugal, Greece and Cyprus**. Businesses in southern Europe are preparing for a post-pandemic recovery beginning in the second half of 2021.

The eurozone stumbled in its vaccination rollout during the early months of 2021, but now appears to be turning the corner toward a rebound. The key determinant for opening up business and travel remains the rate of vaccinations in both source and destination countries. The European Commission has moved up the date when 70% of the EU adult population will be vaccinated to July (from September previously). EU officials plan to relax lockdown measures affecting outdoor dining and retail, before opening to tourism in time for most summer travel.

As European vaccination campaigns accelerate and lockdowns ease in some countries, surveys have found confidence among EU businesses and households rebounding to well above pre-pandemic levels. As a result, there is an expectation that the European Commission will upgrade its forecast for EU growth to 3.7% in 2021 and 3.9% in 2022. Eurozone exports, manufacturing and the anticipated return of tourism have helped in lifting business and consumer confidence, while credit growth is projected to begin to strengthen during the second half of 2021 and continuing into 2022. A spike in visitor bookings across southern Europe indicates strong demand for sun, sea and relaxation from visitors in Germany, the UK and elsewhere in northern Europe. Airlines project business to reach 80% of 2019's volumes over the coming summer months. Bookings improved three fold after Cyprus and Greece announced plans in March to reopen for the summer.

Italy

Italy announced ambitious investment outlays, using its share of funds from the European Union's stimulus program. The government announced it will focus on improving the sustainability of Italy's tourism sector as it prepares to reopen. The National Recovery & Resilience Plan (NRRP) has been approved by parliament and its implementation will be closely monitored by the European Commission, Italy's finance ministry and a steering group attached to Prime Minister Mario Draghi's office. However, local authorities will play a crucial role as the government emphasized the need for close and effective coordination between central and local governments to ensure the successful delivery of investments.

The main pillars of the announced plan aim to accelerate digitalization of Italy's public administration and the broader economy, boost investment in the environment, reduce gender and income inequality, strengthen healthcare system and services, and improve the outlook/opportunities for Italy's younger generation. Past experience suggests that two of the biggest challenges that the new plan will face are to improve coordination and enhance the capacity and effectiveness of local governments. If approved by the European Commission, the plan could release a total of up to 248 billion euros in EU grants and loans and national budget allocations in the coming years.

On an annual basis Italy's real GDP fell by 1.4% during first quarter 2021, after having contracted by 8.9% in 2020. The quarter-on- quarter contraction in January-March was expected, given the negative impact on activity of restrictive measures introduced to control the second wave of covid in Italy and most of its trading partners since October 2020. The authorities began easing restrictions in most regions of the country, which is contributing to a recent uptick in economic activity. Manufacturing and construction

activity both improved in March and April while the purchasing managers' indices (PMI's) have both been firmly in expansionary territory (over the 50-point mark) in recent months. However, the services sector, which typically accounts for almost 70% of GDP, remained below 50 in March at 48.6. The expectation is for a moderate initial pick-up in economy activity, to be followed by an improving trend over the coming months.

While Prime Minister Draghi's recovery plan is bold, it may be hard to implement, given political and societal resistance to reforms. A boost to economic activity is likely but may not last as the political environment is likely to deteriorate ahead of the next general election due by March 2023. Only limited progress on reforms to improve competition is likely. The government is under pressure from some of its coalition partners to ease pandemic restrictions more rapidly to revive the economy as new infections have been declining since mid-March. The forecast is for relatively modest GDP growth of 3.4% this year and 3.5% in 2022. A premature reopening of the economy could lead to another severe wave, hitting growth.

Industrial activity has rebounded from the depths it reached during the lockdown following the Covid-19 outbreak in March 2020, but both manufacturing and construction output remain below pre-crisis levels. Supply-chain disruptions have eased. A gradual pick-up in demand is projected in 2021, reflecting the slow start to the vaccination program.

Guatemala

The economy contracted by 1.5% in 2020, the smallest decline in the Americas (excluding Paraguay). The relatively shallow contraction is explained by strong exports and increased remittances from nationals living overseas. The outlook is for the economy to rebound in 2021, with GDP growth projected at 3.9%, converging towards medium-term growth of 3.5% in 2022-23. While the pandemic had a relatively mild impact on GDP thus far, a surge of infections would pose risks, given that vaccinations are proceeding slowly and healthcare provision is sparse.

During the first half of 2020 the central bank lowered its key lending rate by 100 basis points to 1.75%. Average inflation currently is 5.7%, above the central bank's target of 4%. However, above target inflation is being driven by the base effect from lower prices in first quarter 2020 and higher energy prices. Guatemala's current-account surplus increased to 5.5% of GDP in 2020 from 2.3% the previous year, contrary to expectations. The unexpected expansion of the surplus had three main causes: growth in merchandise exports, lower imports, and resilient remittances. Remittance growth in 2020 (7.9%) was lower than annual average between 2015 and 2019 of 13.6%. The current account surplus is expected to trend lower as imports recover.

International reserves reached $18.5 billion (23.8% of GDP) at the end of 2020; equivalent to 10 months' worth of external payments (and more than double similar rated countries of 4.3 months). Reserves increased by $3.6 billion in 2020 supported by the government's external issuance and net purchases due to exchange rate interventions of $.3 billion. The accumulation of reserves has made Guatemala a net external creditor. In 2020 credit grew by 5.8%, a similar rate before the pandemic. Banking system liquidity at 17.5% in February 2021 is similar to a year earlier, and the capital adequacy ratio of 16.4% is well above the 10% requirement. Non-performing loans fell to 2% from 2.2% in 2020.

The country's long-term foreign currency issuer default rating of BB- was recently confirmed by Fitch. The rating is supported by Guatemala's track record of macroeconomic stability and conservative fiscal policies which have minimized the government's borrowing. In November 2020 congress passed the 2021 budget but suspended its approval after violent demonstrations including an attack on congress. This was the second year in a row that congress did not pass a budget. The suspension of the 2021 budget removed the approval of two external loans: $594

million from the IMF and $20 million from the World Bank.

The country's fiscal deficit reached 4.9% in 2020 as the government spending increased by 17.2% while revenue fell by 3.8%. That deficit compared favorably with other BB rated countries with the average at 7.8% of GDP. Spending in 2020 by the government in response to the pandemic amounted to 2.3% of GDP, including grants to companies, food security initiatives and loans.

The 2021 fiscal deficit is projected at 3.5% of GDP as revenues are expected to increase by 7.7% and spending to fall by 2.1%. The fiscal deficits are expected to narrow after 2021 trending closer to pre-pandemic levels of around 2% of GDP. However, a slowly declining revenue -to-GDP ratio and the lack of the political will to address it remains a medium-term fiscal risk for the country.

Government debt-to-GDP increased to 29.2% in 2020 from 24.1% the previous year. This compares favorably to other countries with similar ratings. The average for countries with similar rating is around 59.3%. However, debt to revenue in 2020 was 273%, higher than the average of 230% for similar rated sovereigns.

The government financed the 2020 deficit mostly by issuing local debt, including bonds sold to the central bank worth $1.5 billion (equivalent to 1.8% of GDP). The constitution authorizes the government to monetize parts of the deficit when there is a national disaster. Externally, the government issued $1.25 billion in Eurobonds (or 1.5% of GDP) and received $541 million in concessionary lending from multilateral institutions.

Financing needs in 2021 are estimated at 4.8% of GDP. This year the government can issue up to $4 billion in new debt, either locally or abroad. The government is expecting more disbursements from the multilateral loans approved last year that total $1.25 billion.

Chad

The sudden death of the president of Chad, Idriss Deby on April 20, 2021 after more than three decades in power and only a day after he won re-election, has thrown the country into political and security uncertainty. His death casts doubt not only on Chad's future stability but that of the region.

Chad's military which is regarded as one of the strongest in the region, has come under immense domestic pressure to fight a Libyan backed rebel group (FACT) that has been launching attacks in the north of the country. With the army struggling to contain the rebels, opposition-led forces and other challenges on the domestic front, the country may have to scale back regional military commitments, which will likely worsen the already dire security situation in neighboring countries.

The swift appointment of Deby's son, Mahamat Deby, as the new head of state was meant to send a signal of continuity and stability, with the establishment of a transitional military council (CMT) to oversee an 18-month transition. However, the disregard for the country's constitution, which calls for an election to be held within 90 days in case the president's position is vacated, has fueled suspicion that the military takeover was an institutional coup.

The CMT has drawn criticism from the opposition, and to appease it, the military junta appointed a civilian, Albert Padacke, as the country's new prime minister to lead the transition. However, this will be most likely insufficient to resolve the crisis, even within the military, where some members are already contesting the absence of collective decision making on key matters for the transition. Since then, rebel leaders from the FACT have vowed to head to the capital to re-establish democracy. Popular protests have broken out throughout the country, and deadly clashes with the army continue, as the opposition rejected the legitimacy of the military council. These multiple

episodes of violence amount to increased instability, to which the CMT will have to dedicate considerable effort to overcome.

The implications of Idriss Deby's death go further than Chad's borders, and the future of the Sahel region hangs in the balance. Having a powerful military, Chad played a key role in the G5 Sahel (a military alliance of Burkina Faso. Mali, Mauritania, Chad and Niger to fight terrorism in the region) and promised extra troops at the latest G5 Sahel meeting in Mid-February. Moreover Mr. Deby was the president of the G5 alliance, and Chad contributed the most troops to the grouping. However, given the recent rebel incursion in Chad and broader instability expected in the country, the government had already started to recall some of its troops to Chad to defend the country's capital. A move which is likely to be reinforced by the military junta. If confirmed, Chad would not be in a position to continue to provide strong regional support to the G5 on the same scale, at least not in the near term.

This would represent a blow for the G5, throwing an already volatile region into uncertainty. Burkina Faso is facing regular terrorist attacks in the north and the east of the country. In Niger, it was reported that some Chadian rebel leaders sought refuge at the border and could use it as a base to attack the Chadian military junta in the future. Mali is struggling with Islamist attacks in the northern and central parts of the country.

Moreover, Chad also contributes to the Multinational Joint Task Force, which comprises troops from armies of Chad, Niger, Nigeria, Cameroon and Benin; the joint force aims to fight against Boko Haram, an Islamist terror group that operates in the Lake Chad region. Nigeria announced its plans to beef up security at the border with Chad at the end of April, with the aim of preventing an influx of people from Chad in the wake of social unrest in the country and attacks from Boko Haram in the border region. Boko Haram has also stepped up attacks in the far north region of Cameroon in recent weeks. Cameroon's military announced that it has killed several fighters and freed civilians who had been abducted by the militants. The expectation is that the militants will continue to exploit the vacuum created by Chadian forces, which will now focus on internal security issues, possibly for as long as the 18-month transition period lasts.

France and the U.S. have been key allies for Chad, supporting Idriss Deby's stay in power multiple times over the years in the name of regional stability. International actors have lost a strategic partner in the fight against terrorism in the region. French President Macron was the only western leader to attend Deby's funeral, demonstrating French support for the military council as a means to ensure immediate stability. Although Mr. Macron condemned the violence that erupted after opposition-led protests against the CMT, the initial unconditional support fueled criticism for its disregard of the existing constitution and highlighted the instrumental role that France still plays in Chadian politics.

Chad will likely remain at a crossroads in the near term. It is facing major security challenges both at home and in the regional fights against various terrorist groups. Mahamat Deby's transition is risky, not only in terms of political legitimacy, but also the risk that it creates in terms of affecting the region as a whole.

By Byron Shoulton, FCIA's International Economist
For questions / comments please contact Byron at bshoulton@fcia.com

Although FCIA has made every effort to insure the accuracy of this publication we do not accept any responsibility whatsoever for - including but not limited to - errors, omissions, opinions or advice given. This publication is not a substitute for professional advice and all information is for guidance only. Coverage descriptions in this brochure are summarized. Consult the policy declarations and policy form for a full description of the applicable terms, conditions, limits and exclusions. Policies are underwritten by Great American Insurance Company, which is an authorized insurer in 50 states and the District of Columbia © Copyright 2021 by FCIA Management Company, Inc. FCIA logo (letters and design) are registered service marks of Great American Insurance Company. All rights reserved.