Major Country Risk Developments
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By Byron Shoulton

Overview

The global economy entered 2022 focused on a new surge of Covid-19 cases occurring around the world. The majority of new cases are reportedly the Omicron variant which appears by far the most contagious variant to date. New cases are at an all-time high in many countries, including the U.S. However, the number of people currently hospitalized or dying from Covid, appear smaller than with previous strains and spikes. This may be because more people are vaccinated today and the virus is less lethal; or that the Omicron variant is simply a less severe strain. Either way, it is reasonable to conclude that the interaction between the virus and humans means that the more people receive some protection against severe Covid-19 symptoms through vaccination or infection, the better the eventual outlook. The top priority remains getting more people vaccinated. Efforts so far to control the pandemic in the context of a global health emergency cannot continue indefinitely. The collateral damage – to mental health and wellbeing, social cohesion and the global economy is unsustainable.

Going forward, the world will need to build up resilience so that we can live with Covid-19 and its descendants, in a way that causes less disruption while still protecting the most vulnerable. Those efforts will have to include relying on the immunity provided by annual inoculations – preferably with a new generation of products that are effective against all variants of the virus. Governments and regulators [in partnership with researchers and the private sector] must look toward developing new vaccine technologies to supplement currently available regimens. Furthermore, more investment should be directed towards antiviral drugs that could play an important role in suppressing symptoms in those that are infected. The wide availability of quick tests that allow people to check whether they are infected or not, is also an urgent necessity that is yet to be achieved across the broad.

Recently, more countries have been forced to resort to stricter health safety policies; but (with the exception of China) most restrictions remain far short of full lockdown protocols seen earlier. More people have grown tired of stay-at-home restrictions, while employers and families are sensitive to the need for balance between appropriate health safety guidelines and the need for human contact in the workplace and in learning. At the end of the day, it appears that the option of remote work and learning will become permanent features across several sectors and institutions going forward.

The economic fallout continues to change. Just as some central banks prepare to gradually unwind and withdraw extra-ordinary support schemes for various economies -sparked by the onset of the pandemic-policymakers must ponder if moving too swiftly may stall the recovery.

Meanwhile, slower economic growth in China, dramatically higher prices across the globe, uncertain future global demand, amid worker shortages and further disruptions triggered by new Covid spikes - is affecting confidence, sparking fresh anxiety, and has clouded the economic outlook for 2022.

The European Central Bank [ECB] is expected to continue its net asset purchases for another two years – well after other major central banks begin to scale back their economic support programs that were triggered by the pandemic. A consensus expects the ECB to stop expanding its 4.6 trillion euro bond portfolio in 2023. Many central banks around the world

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have started to reduce their monetary stimulus in response to sharp rises in inflation as the global economy bounces back from the shock of the pandemic. The ECB is slower than most; in December its president said that its 1.85 trillion euros pandemic-response scheme would stop net bond purchases in March 2022, while an older asset purchase scheme would undergo a "step-by-step" reduction until at least October.

By contrast the U.S. Federal Reserve said in December it would accelerate the tapering of bond purchases to finish at the end of March 2022, while the Bank of England said after it raised interest rates in December that its net purchases would stop at the end of 2022.

USA

Two years after the pandemic brought much of the U.S. economy to a halt, public companies are reporting some of the best ever financial results. Profit growth among U.S. companies were mostly strong in 2021. Most companies recorded sales figures that are higher than where they were before Covid. The liquidity crunch that was anticipated once Covid hit never happened, leaving many companies with sizable cash cushions. The U.S. stock market ended 2021 near record highs and fewer public companies filed for bankruptcy in 2021 than in the years before the pandemic. Few could have predicted such an outcome.

Government support to households and funding for businesses kept consumer spending up, workers on payrolls and helped fuel revenue growth and profits among companies. The rebound has been good for smaller companies, but larger companies have done even better. The data shows that for large-capitalization companies profits and revenues were hurt less by the pandemic's initial economic slowdown. Larger companies also rebounded more quickly than smaller ones. Large companies have been able to navigate supply-chain disruptions a lot easier than their smaller counterparts. The larger companies have greater resources and market scale which gave them more clout and access than medium and small-sized players. Nonetheless, total sales in all three groups – in the most recently reported 2021 quarter were up from the comparable period in 2019. Profit growth for a majority of larger companies in 2021 were even stronger than 2019 figures.

Sales at smaller companies recovered to 2019 levels less frequently than at large-cap companies. However, smaller companies displayed enormous agility and were able to switch to alternative supply sources et al. much quicker than their larger counterparts. Overall, 2021 results among U.S. companies have been surprisingly strong. According to the data, U.S. consumers returned to stores even while they have continued online shopping. With the recent dramatic spike in new Covid cases, new travel restrictions, etc., we can expect some dip in economic activity during the current period.

Meanwhile, South Korean semiconductor manufacturers are ramping up their lobbying presence in the U.S. to navigate U.S.-China tensions and win critical export licenses to supply Chinese companies targeted by U.S. trade sanctions.

Samsung, Hyundai, SK Group and LG, South Korea's four leading conglomerates are leading efforts to pressure U.S. authorities to allow them to produce strategically sensitive goods such as semiconductors and electric vehicle batteries in the U.S. LG will open a lobbying office in the U.S. this year, after its battery-making unit LG Energy Solution was embroiled in a multibillion-dollar legal dispute with domestic rival SK innovation that threatened to disrupt Ford's electric car plans in the U.S. LG also had to reimburse General Motors after a costly electric vehicle recall over battery flaws.

The South Korean groups are seeking export licenses to supply U.S. blacklisted Chinese companies, including technology group Huawei and chipmaker Semiconductor Manufacturing International Corp (SMIC). The Koreans aim to strengthen their access to the U.S. government and Capitol Hill out of a need to respond quickly to a changing global agenda and to minimize business risks in global supply chains amid the worsening U.S.-China relations. Also, the changing international trade order and ESG [environmental, social and governance] requirements have driven the need for an effective channel to reach decision-makers in the U.S.

SK Hynix, the world's second-largest memory chipmaker, set up an internal unit in December to manage its U.S. business as it works to complete a $9 billion acquisition of Intel's Nand flash memory business. Reports are that the company may consider building a wafer plant in the U.S. after struggling to upgrade its Dram facility in Wuxi, China.

The U.S. is opposed to exporting advance equipment to China. The Korean campaign has coincided with efforts by rival regional chipmakers to increase their U.S. presence. Taiwan Semiconductor Manufacturing Company, the world's largest contract chipmaker, has raised its profile markedly in Washington. It is building a $12 billion chip factory in Arizona and competing for $52 billion in chip subsidies announced by the U.S. Administration.

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Africa will likely continue to suffer from the lingering effects of the pandemic and new waves of infection, especially given the low vaccination rates across much of the continent. While economic growth is forecast to gain some momentum in 2022, it promises to be modest and follows a very difficult 2021. Economic performance across the continent will likely be patchy, with major economies once again underperforming.

Africa's recovery can be best described as a patchwork of varying performance. In particular, the region's oil producers will gain from a further increase in international oil prices, while non-oil commodity exporters will receive an uplift from rising food and industrial raw materials prices (after even bigger gains in 2021). Although economic growth in China (Africa's most important trade partner) is expected to moderate in 2022, a forecast 5% expansion in China's real GDP will still be sufficient to support continuing firm demand for Africa's exports. The region's commodity exporters will receive a boost from strong global demand and high prices for oil & gas, metals, minerals, timber, and some food exports in 2022.

Meanwhile, the region's travel and tourism will likely experience another difficult, albeit a slightly better year in 2022, with major tourist destinations desperate to see an increase in arrivals while grappling with year three of the pandemic. Economies with large tourism sectors – for example Botswana, Mauritius, Namibia, Kenya, South Africa, and Seychelles – will continue to be negatively affected by ongoing restrictions on international travel. As the uptake of vaccines gradually makes international travel safer, tourism will start to pick up. However, given current vaccination trends and the spread of Omicron, it could be 2024 before visitor arrivals fully recover.

Conflict hotspots will pose a substantial risk to security and stability on the continent. These include civil war in Ethiopia, a recent coup in Sudan, long running conflicts in Libya, South Sudan and the Central African Republic and Somalia; extremist-fueled conflict across the Sahel and northern Mozambique;

and violence between government forces and separatists in Cameroon's Anglophone region.

By mid- December 2021 only a handful of African countries had vaccinated more than 40% of their populations and of concern is the fact that some of the largest African economies and most populous countries namely – Cameroon, Congo-Brazzaville, Ivory Coast, the Democratic Republic of Congo (DRC), Ethiopia, Ghana, Kenya, Nigeria, Senegal, Sudan, Tanzania, Uganda, and Zambia- had vaccinated less than 15% of their populations. North Africa and Southern Africa will continue to lead the way on vaccine rollouts in 2022, which reflects the development of vaccine production and distribution sites in Egypt, Algeria, Morocco and South Africa, and access to global supply chains as international vaccine diplomacy intensifies.

The road to recovery across most of Africa since the crisis year of 2020 has been slow and fragile owing to lingering fiscal pressures, elevated debt levels, high unemployment, and limited access to vaccines. The Delta and Omicron variants have prompted a tightening of domestic containment measures in some countries and the reimposition on international travel restrictions by foreign and African governments. Successive waves of infection will ebb and flow across the continent in 2022 and the risks associated with an escalation of the public health crisis are elevated by the fact that most parts of Africa lag far behind other major regions of the world in terms of vaccine rollout.

Most of the region's more developed economies – namely Algeria, Angola, Ethiopia, Nigeria, South Africa, Sudan, and Zambia – will once again underperform; while smaller more dynamic trading economies- especially Senegal, Ivory Coast and Ghana in West Africa and Uganda, Rwanda, Tanzania, and Kenya in East Africa – will lead the way in terms of GDP growth in 2022.

The commodities bull-run is expected to continue (albeit at a slower pace) in 2022, which bodes well for corporate revenue and share prices among energy, metals, materials, and food producers. Strong demand and high prices will provide a timely, albeit temporary, financial windfall and some financial breathing space for Africa's natural resource exporters. The countries most affected by commodity price swings are the energy majors of Algeria, Angola, Egypt, Libya, and Nigeria, as well as large-scale mining states of Botswana, the DRC, Ghana, Mauritania, Morocco, Namibia, Niger, Sierra Leone, South Africa, Zambia, and Zimbabwe.

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Nigeria

Among key trends to watch in Nigeria in 2022 are forthcoming party primaries ahead of the 2023 presidential election, the growing path of ungoverned spaces in the country, action on fuel subsidies, planned tax increases and an expected court ruling on the vexed issue of who can collect value- added tax [VAT] in Nigeria.

Regarding economic policy, the authorities plan to remove fuel subsidies in early 2022. The logic in doing so is powerful. Not only is cheap fuel becoming a heavy fiscal burden against high global oil prices, but a new mega refinery will be starting up in Nigeria during 2022, with the potential to eliminate the country's entire fuel import requirement. To ensure that the facility can supply the local market – and not the export market – local pump prices will need to reflect the refinery production costs. Currently, gasoline is being sold locally at less than half the market price.

Ending the import bill for fuel would shave between 15%- 20% from total imports, delivering a major victory to the central bank in its years long ambition to protect the value of the currency, the naira, through import substitution. The government plans to distribute cash through a monthly "transportation allowance" to the lowest income Nigerians as a way of compensating for costlier fuel. However, the poorest Nigerians are not those most likely to be affected by higher pump prices in a country with 0.06 cars per head. It will be relatively more affluent Nigerians – those ineligible for compensation – that stand to lose out the most. As past attempts to increase gasoline prices have demonstrated, the political reaction can be intense. The government was forced to backpedal on an attempt to increase prices in 2020 after mass protests, and any repeat so close to elections would prompt a similar drift in policy.

On the financial front, banks will move to boost their capital levels this year as forbearance by the Central Bank of Nigeria on restructured bad loans may well be extended beyond the March 2022 expiration date. Implementation of Basel III capital rules and a new banking law will be a major focus for Nigeria's commercial banks in 2022 – with the process to be completed by May. It may be extended until August.

It will be a tricky time for banks' capital positions, as forbearance measures that were introduced in 2020 in response to the pandemic shock, which directed banks to restructure problem loans, will expire in March 2022. The forbearance directive could be extended depending on the situation with Omicron, but if expiry goes ahead as planned a sharp uptick in non-performing loans will almost certainly result.

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The impact on the real economy will be muted by regulations that compel banks to lend, notably a loan to deposit minimum of 65%. This stands to prevent banks from derisking their loan portfolios and also from meeting capital requirements. Undercapitalized banks, mostly Tier 2 institutions at present, will need to raise equity and/or pursue mergers, with several likely to issue Eurobonds, to raise the necessary funds.

The same issue will affect tax policy, with only small adjustments likely ahead of the poll. There is no question that sizable tax increases will be needed over the medium term. The Ministry of Finance has already stated that Nigerians should prepare for higher rates and levies, and the country's finance law is due for an update by mid-2022, when changes to the tax code will be outlined. With the Omicron variant spreading globally, creating uncertainty abroad and at home, Nigeria's government is unlikely to alter corporation tax (currently at 20%-30%) or VAT, especially so close to elections.

The president, Muhammadu Buhari, who is stepping down after two terms, has not signaled a favorite to succeed him. And has not revealed his true position on a shift of power to the predominantly Christian south, in line with a customary power-sharing agreement, after the north's (majority Muslim) eight years in power during his presidency.

The expectation is that the two leading political parties [PDP and APC] will both field southern presidential candidates. This was tried and tested in the last election in 2019, when both of the PDP candidates were from the north and low voter turnout in the party's southern heartland cost them the election. For the ruling APC, the final decision is more uncertain, but ditching the power-sharing custom would risk an internecine feud that the party cannot afford, given that it will already be trying to defend a dismal term in office.

The security situation in large parts of Northern Nigeria will remain abysmal as overwhelmed armed forces battle multiple and contending threats by well armed groups motivated by criminal opportunism and extremist ideology. Boko Haram and the Islamic State West Africa Province (ISWAP) continue to extend their influence over the country's northeast and are increasingly forming linkages with Fulani bandits in the northwest. Although initially motivated by economic goals, bandit networks are becoming increasingly ambitious, to the extent of imposing levies on local populations. There is not much the government can do before the elections to restore order from such a dismal starting point.

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There will be increased security and economic cooperation between Nigeria and its international partners, especially the U.S., which signaled intent for a stronger relationship when it removed Nigeria from a religious freedom watchlist in November last year. The U.S. has been an important arms supplier for the Nigerian military, and Nigeria's delisting, against the recommendations of a federal committee on religious freedom, could be a step towards the increased weapons sales that are needed for the Nigerian military to check the advance of Islamist militants, which have encamped just a few hundred miles from the capital, Abuja.

Military aid and sales between Nigeria and the U.S. could mark the beginning of a turn in Nigeria's war against militants, with the army often being outgunned at present.

The implementation of the Petroleum Industry Act will face challenges as sub nationals insist on their full rights and oil producing host communities demand more compensation. There will also be a crucial court ruling this year on whether local authorities or the federal government are allowed to collect value-added tax in state jurisdictions.

South Africa

South Africa is Sub-Saharan Africa's largest economy, underpinned by a wealth of natural resources and a diversified industrial base. But persistent structural constraints, such as high unemployment, limited skills, and power shortages, will hamper economic expansion. Flight bans imposed by several countries on Southern Africa following the emergence of the Omicron variant will damage the tourism sector and delay the normalization of international travel, at least for the first few months of 2022. The duration of the curbs will depend on emerging evidence about the level of the threat posed by Omicron.

The government's main policy challenges, after a severe, pandemic-induced recession in 2020, are to sustain the economic rebound that is currently underway and to guard against a return to sluggish pre-pandemic growth rates. An immediate goal is to restore confidence via a $2.7 billion emergency relief package. Accelerating covid-19 vaccinations is another priority, with the number of people inoculated reaching 43.7% of adults as of December.

GDP growth in 2021 reached an estimated 4.8% - a multi-year high, following a severe pandemic-induced recession in 2020. Growth is projected to slow to 2.1% in 2022 – in line with a concurrent global slowdown. Over the next year, the government will implement a further relaxation of capital controls on outward investments and other flows. Despite tough fiscal conditions, the government is committed to avoid major tax increases in order to shield households and companies – as the country begins its recovery from the pandemic.

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Looking ahead, among some key policies that will impact private enterprise and competition in South Africa in 2022-23 include a post-pandemic investment drive focused on infrastructure that's meant to facilitate public-private partnerships (PPPs). However, challenges to this initiative includes tighter competition laws and stricter black economic empowerment rules.

Meanwhile, a reworked mining charter offers some concessions to businesses. Separately, a new foreign investment law will limit access to international arbitration by giving local courts the primary responsibility for handling disputes. Regulatory reforms will likely boost investment in transport and electricity by private firms and PPPs over 2022-24.

The domestic financial sector remains sound with banks continuing to be a major source of corporate financing, helped by a strengthening economic recovery and profits. Meanwhile, interest rates will edge upwards, in line with global trends and adding to financing costs. The continued independence of the South African Reserve Bank (the central bank) will help to preserve financial system stability. The country's market-determined exchange rate means that inflation risks are lower than in many emerging markets (example Turkey), although growth lags behind its emerging-market peers because of domestic structural constraints. Being commodity dependent, widely traded and an emerging market proxy, the rand is vulnerable to adverse shifts in global sentiment.

Pandemic induced job losses will oblige trade unions in South Africa to accept a mild relaxation of currently inflexible labor laws. New Covid-19 cases are rising quickly, as Omicron seems more infectious, but early signs point to fewer serious cases (and deaths), which could obviate the need for tighter domestic restrictions if confirmed. Unemployment remained at 34.9% at year- end of 2021. Higher social welfare payments provided some relief and are likely to be extended past the planned March 2022 end date, adding to fiscal strains.

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The central bank raised the benchmark repo interest rate to 3.75% in November, ending a loosening cycle and heralding further rises in line with global monetary trends (for which precise timing is uncertain). Total external debt is expected to remain close to $170 billion (42% of GDP), as higher public sector borrowing offsets a smaller private-sector appetite for new loans. Despite domestic challenges, South Africa will continue to attract international companies, including from the U.S., Europe, and Asia, owing to strong institutions, a sound banking sector, and its role as the continental gateway.

South Africa's investment in other African markets will remain broad-based, with a particular focus on banking and telecommunications. The pandemic is temporarily disrupting regional relations because of periodic border closures and flight bans, but regional access for South African-based firms will improve in 2022, helped by vaccine rollouts.

Over 2022-23 the rollout of domestic fiber-optic cables is expected to boost telecommunications capacity and cut costs. Investment in digital technology is set to gather momentum, including in 5G, cloud computing and high-end data analysis.

The political climate is set to heat up ahead of the 2024 general election. The vote share of the ruling ANC fell below 50% in last November's nationwide municipal elections, a record low, exacerbated by low turnout. President Cyril Ramaphosa is expected to expedite reforms – including moves to boost power supplies and fight corruption – ahead of the 2024 election. His tightening grip on the government is positive for socioeconomic reform, but South Africa faces a race against time to curb the risk of civil disorder fueled by poverty, unemployment, and inequality.

Brazil

Brazil's successful auction of deep sea oil prospects in December is being hailed as a sign of oil majors' appetite for crude. For the Brazilian government the auction is a watershed event for its program of concessions for infrastructure and natural resources development.

Previous attempts to execute the complex auction flopped in 2019. The country's Minister of Mining and Energy is celebrating the $2 billion in fees [raised via the recent auction concession] for the cash-strapped government and a further $35 billion in investments to be made by oil majors Shell and Total Energies in Brazil's oil and gas sector.

Compared to government's plans for structural economic reforms, which have been stalled for years in Congress, the program to attract private companies to invest in -and operate- major infrastructure projects have boomed. Since coming to office in 2019 President Jair Bolsonaro's administration has auctioned 131 concessions, generating over $145 billion in investments and $26 billion in fees for the government. In the previous 2.5 years-since the investment program began in 2016 – the figures were $44 billion and $8 billion respectively.

The government predicts expected auctions of more than 150 concessions and the generation of $70 billion in investment during 2022 as investors, mostly local, seize the opportunity. This is a rare bright spot in President's Bolsonaro's economic agenda, generating billions in sorely needed investments in the nation's road, rail logistics and sanitation systems. The investment program will serve as an engine for an economy that has struggled to grow for almost a decade. Despite a strong bounce back from the initial impact of the pandemic, many forecasters expect Latin America's largest economy will again contract in 2022, under the combined impact of soaring inflation (19%), very high interest rates and weak consumer confidence.

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The projects to be auctioned are already well advanced and promise to intensify activity in years to come. Among the projects lined up are 26 airports, 25 ports, 10 highways and nine national parks and forests. In addition, the government expects to host 10 auctions for mineral rights this year. Independent analysts point out that although Brazil has attracted some international companies, the investments are predominantly from local interests. They point to President Bolsonaro's controversial rhetoric which often alarms foreign investors.

The finance minister predicts that the new investments could propel economic growth of 2% in 2022, despite growing threat from double-digit inflation, soaring interest rates and persistently high unemployment.

One caution is this year's October election which will likely pit Bolsonaro against former president Luiz Inacio Lula da Silva – which could impact investor sentiment. With the business community's and market sentiment lack of confidence in both candidates, some investment decisions will likely be put on hold.

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Still, the government's special secretary for the Investment Partnerships Program cited reasons for the program's success to date, as being due to the structuring of the projects and a more "investor friendly" approach in a country historically riven by bureaucracy. This contrasts with the government's failure to pass headline economic reforms, including a simplification of Brazil's outdated and confusing tax system and an administrative reform of the state. While the government has made some progress of late with recent successful concessions and expected investments, there is much more that needs to be done to reassure foreign investors that Brazil is a reliable investment destination.

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