Major Country Risk Developments
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By Byron Shoulton

Overview

Oil prices have risen by 50% since January 2021. With continued strong global demand forecast, crude prices are expected to rise higher over the next 12 months. Opec and its allies failed to secure a new deal that would raise oil production now. As a result, crude prices hit their highest levels in three years. Brent, the international benchmark, reached $77.84 a barrel, the highest since 2018. The U.S. benchmark, West Texas intermediate hit $76.98 – the highest since 2014. The request was designed to ease rising prices and extend an existing supply deal to ensure stability as the world embarks upon a fragile recovery out of the pandemic.

OPEC members know that there is a need to raise oil production levels, as global demand has started to outstrip supply. But the UAE, one of the most powerful members of the group after Saudi Arabia and Russia, has objected to extending an agreement first forged in April 2020- when oil prices fell – unless the group agrees to revisit how UAE production target is calculated. The UAE has invested billions of dollars in increasing its production capacity. It feels the so-called baseline used to calculate its production target is outdated and does not reflect that new capacity, meaning it is cutting proportionally more supply than other members. The UAE has a point. But if OPEC agreed to review one country's baseline it would get pressured to do this for every other member of the alliance, and some would not like the result.

Russia, not an OPEC member, has been cooperating with the group since 2016. But it is among the countries whose production target would likely fall under such a review. In addition, tension between Saudi Arabia and UAE are growing. Both countries increasingly view each other as competitors in the Gulf region. The staunchest of allies not so long ago, the two Middle East nations now have diverging views on a number of issues: the Yemen war, the relationship with Israel or Qatar and the Saudi intention to compete with the UAE as a regional business and tourist hub.

OPEC planned to raise production by 400,000 barrels per day each month until at least the end of 2021. That would add two million barrels a day (or roughly 2% of pre-pandemic demand) back to the market, gradually unwinding the huge 10 million b/d cuts agreed to in the midst of the pandemic shock last year. The forecast is that crude prices will comfortably rise above $80 per barrel – up more than 50% since January 2021- and above where they traded before the pandemic. Higher crude prices are a boost to the appeal of electric vehicles. Production, sales and orders for electric vehicles have increased steadily in the U.S., China and around the world during the past year.

Without a new agreement Opec's default option is to leave production unchanged, which means a tighter oil market during the second half of 2021 into 2022 as global demand picks up.

Separately, the surge in cyber threats from spies and crooks is alarming. As the global economy confronts a new age in frequent cyber-attacks [aka ransomware assaults], the realization is sinking in that these could potentially cripple whole networks supplying water, electricity, hospitals, airflights, ground transportation, banking, tele-communications, and military intelligence, among others– if preventative steps are not taken. The implications are national and global in scope. All countries have vulnerable physical assets such as oil pipelines, power plants, ports, airports, railways and highways, cellular towers, etc., – whose failure could bring much economic activity to a

standstill and disrupt normal lifestyles. The financial industry is another growing focus of cyber-crime. Regulators in the U.S., China, Europe, Russia, across Asia and elsewhere have begun to examine, anticipate (and are seeking to prevent) possible attacks that could cause bank failure or financial sector collapse.

Further focus is centered on data collection using cutting edge technologies. For example, computers which are built into cars, homes and factories, which create an industrial internet. Regulators worry about the collection of data via a collection of such sources and networks. The vast amounts of information contained and the potential to use that data to harm, influence or blackmail a company, an organization or a country have become paramount concerns for regulators, companies, infrastructure operators and to national security interests. Cyber-insecurity has geo-political implications as well. In conventional warfare and cross-border crime, norms of behavior exist which help to contain risks. In the cyber-domain however, confusion and blurred lines are dominant features. Questions such as: does a cyber-attack from criminals tolerated by a foreign adversary warrant retaliation? When does a virtual intrusion require a real-world response? These are questions that policy makers are repeatedly asking.

At the recent summits of the G7 and NATO, western countries promised to work together to contain cyber-attacks. However, confronting countries like China and Russia are crucially relevant and remain elephants in the room. An increasingly digital global economy has become equally vulnerable to cyber-crime without a definable difference between hostile state actors and private for-profit cyber-crime syndicates.

China now seeks to tighten the rules for Chinese companies listing on overseas stock markets or seeking to sell shares abroad. The shift comes as Chinese [and U.S.] regulators intensify scrutiny into technology companies, their power, market influence and the threat of monopolistic practices. China's move toward restricting such listings also highlights the diverging visions in Beijing and Washington surrounding the future of technology, data protection and security concerns. Given the widening distrust on both sides on a range of issues, there are more Chinese and U.S. companies that are getting caught-up in the midst of rising tensions, mistrust and ongoing efforts at state-control, protection and dominance over sensitive sectors and rising suspicions over the role of the technology giants at the center of processes.

Separately, housing prices are rising across the world at a brisk pace: in the U.S. at the fastest pace in over three decades. In the UK housing prices are experiencing the quickest growth rate in 17 years. Prices in Germany, which missed much of the past four decades of rising house prices, have surged. Even in Italy and Japan, where house prices have been mostly stagnant for decades, house prices have moved up.

The causes are a combination of a lockdown-induced shift in priorities; richer workers, saving money staying at home and desiring something different. The possibility of remote or hybrid working has led plenty of urban office workers to imagine the possibility of living somewhere with more outdoor space. Prices have risen fastest in areas that offer larger gardens or access to more scenic vistas. Central bankers have played a role by lowering interest rates and buying up assets in a bid to keep financial markets functioning and workers employed. Many homeowners have been relieved to see house prices hold up, as falling house prices hurt consumer confidence and developers' appetite to build, as well as banks' balance sheets.

Now the surge in prices is feeding other challenges, including higher inflation and institutional investors overpaying and squeezing out ordinary buyers – a concern shared by anti-gentrification activists.

Shipping prices have continued to surge as well. Prices to ship containers from Asia to the U.S. and Europe are rising at an historic pace as cargo owners

bid rates up in search of ocean transportation capacity. Industry leaders expect capacity to remain tight for the rest of 2021. The average price for shipping a 40-foot container has more than quadrupled over the past year. Since May the price is up 53%. Shipping experts say the rising rates are a result of disruptions across supply chains that triggered delays in ports and inland distribution networks as retailers and manufacturers rush to restock inventories that were depleted during the pandemic. Ocean shipping rates started edging upwards last summer as consumer demand began rising with easing of lockdown measures.

The pricing surge has accelerated as events including the Suez Canal blockage in March and bottlenecks at gateways in Southern California and China's Yantian port have tied up ships at sea for weeks at a time. The backups have rippled across supply chains and left containers in short supply. The high shipping rates have left many shippers, particularly those with relatively low-value goods facing a choice: They can pay the prices and try to pass the costs on to their customers or retreat from overseas markets. Last year many companies delayed shipping in the hope that the cost would come down. Now there are no choices left, they pay the costs or lose the sale to a competitor.

USA

In June Federal Reserve officials vigorously debated whether the economic rebound in the U.S. would soon be strong enough to start dialing back the Fed's pandemic-era stimulus more quickly than expected. Minutes from the June meeting of the Federal Open Market Committee meeting showed wrangling over whether the economy was ready for a speedier reduction of the $120 billion bond asset purchase program. Fed officials hinted that tapering of bond purchases may start earlier than previously expected given the stronger economic outlook, buoyed by the fast U.S. vaccination rollout, but a majority concluded that conditions were not quite ripe yet. The debate is expected to take center stage over the coming months.

The Fed decided to keep its main interest rate on hold and close to zero, but officials forecast that they would increase rates in 2023. According to the minutes, a few officials indicated they expected the economy to be ready for interest rate rises "somewhat earlier" than previously thought, but others pushed back. Some investors interpreted the new interest rate projections as an indication that the Fed may prove more responsive to inflationary pressures than previously expected, prompting a sharp rally in U.S. government bond prices since the meeting.

U.S. job recovery is gaining momentum as evidenced by 850,000 jobs added in June, the biggest gain over ten months. This was accompanied by rising wages and continued strong demand for workers. Meanwhile, workers are rejoining the workforce at a faster rate, as employers hire from sometimes scarce supply of qualified candidates, to serve a flood of customers who returned as fears of the pandemic ease. Employers are offering hiring bonuses and other incentives to attract workers, while the number of people who say they are prevented from looking for work because of the pandemic fell in June by 900,000 to 1.6 million.

Despite the positive movement in the latest labor market figures, there remains 6.8 million fewer jobs in the economy than in February 2020; and the unemployment rate currently at 5.9% - is well above the pre-pandemic rate of 3.5%. A full 25% of new jobs created in June were in the leisure and hospitality sector where hourly wages were up 7.9% from their pre-pandemic levels.

Employment opportunities in retail, demand for teachers, positions in national delivery, ride-sharing companies, confectionery makers and various manufacturing companies suggest that companies are primed to hire additional staff. They report varying degrees of worker availability for open positions. The tighter labor market has given workers greater leverage to seek not just higher wages but more worker-friendly conditions and more flexibility, such as remote work and other incentives. The conditions for new job creation in the U.S. appear good over the

next year.

Meanwhile, the U.S. trade deficit continues to widen as American consumers and businesses step-up purchases of imported products and materials - reflecting a brisk and broad based economic recovery.

Germany

German carmakers will continue to suffer from acute semiconductor shortages over the medium term, industry lobby groups warn. Auto production for 2021 is forecast at 400,000 units, following the fifth consecutive month of falling vehicle production. At the same time, overall industrial production fell 0.3% in June from the previous month, largely because of supply problems with crucial materials such as steel, copper, wood and plastics, leaving production levels 5% below pre-pandemic level in February 2020.

The biggest drag on German industrial output was the 3.4% drop in capital goods production. This was mainly due to a 7.2% fall in vehicle output, which has shrunk every month of this year and in May was 28% below its pre-pandemic level. The 2021 growth forecast for domestic production was lowered by 10 percentage points with the expectation that 3.6 million cars will be produced, rather than 4 million passenger cars to be built by German brands by the end of December. In 2019, the last pre-pandemic year, German companies built 4.6 million cars. The head of the industry lobby group considers the semiconductor shortage a self-imposed problem caused by poor planning, but that there had been an "exponential" rise in demand in many areas.

The industry has concluded that in the short to medium term, it will be hard to find solutions, but have urged politicians to back the building of new chipmaking facilities in Europe. There is strong demand in Germany for electric cars and premium gasoline-powered cars; both of which require more semiconductors than the average vehicle.

German manufacturer BMW, which has generally fared better than its rivals in procuring crucial chips, disclosed that sales in the first six months of 2021 were up 40% over 2020 and more than 7% higher than in the pre-crisis year of 2019. The company also overtook its arch-rival Daimler on sales, selling almost 1.18 million BMW brand vehicles in the period, compared with Daimler's 1.16 million Mercedes brand cars. However, BMW warned that it expected the supply situation for semiconductor components to remain difficult and said it cannot rule out the possibility of this impacting sales during the rest of the year. IHS Markit calculated that 1.4 million fewer vehicles had been produced worldwide in the first three months of 2021 as a result of the shortages, and estimated that capacity will only begin to keep up with demand from carmakers in 2022.

Malaysia

The largest party in Malaysia's ruling coalition has withdrawn its support for the sitting Prime Minister and has called for his resignation. This is occurring just as the country faces one of the worst Covid-19 outbreaks in south-east Asia. UMNO the political party that has dominated Malaysian politics for decades withdrew its support because it says the Prime Minister had failed to address the country's economic slowdown or to fight the pandemic.

The UMNO decision is the latest upset in Malaysia's tumultuous politics that risks plunging the country into chaos at a time when authorities are faced with one of the worst waves of covid infections. With 800,000 cases Malaysia is fighting the largest outbreak in the region after Indonesia and the Philippines. The daily number of infections has surged sevenfold since the end of March, with 7,000 cases reported in one day reported recently. The ongoing political crisis continues to weigh heavily on the economic recovery and is also a distraction from dealing with the severe covid outbreak.

The Prime Minister now could face a vote of no confi-

dence when parliament reconvenes at the end of July after a seven-month hiatus following a state of emergency. There remains a lot of backroom negotiations over keeping the prime minister in power or trying to find an alternative PM.

Malaysia's king declared a state of emergency in January, the country's first since deadly race riots in 1969, at the behest of the government. The monarch said the order, which runs until August, was necessary to fight the pandemic. But it also followed the loss of the government's thin parliamentary majority after two members of the coalition defected. The prime minister, who in the past few months has restored his narrow majority, has been accused by his opponents of exploiting the pandemic to cling to power.

As of May 17th travel between Malaysia and its neighbor Singapore was allowed for family visits to the seriously ill or for family funerals. Both countries depend on cross-border commuters for survival. Over the past year about 300,000 people who usually travel on a daily basis over the Johor Strait from Malaysia to Singapore have not been able to work.
In August of 2020, in response to requests from companies and workers, officials allowed cross-border commuters to enter the country on condition that the stay for 90 days or longer.

In many cases, companies in Singapore have set up new housing arrangements for their Malaysian employees. Such measures are expensive, but it is difficult to hire manufacturing employees in Singapore, leaving companies with little choice. The situation highlights the interdependent relationship. Singapore, a highly developed city-state, and Malaysia, a country with abundant land and resources, form a loosely integrated economic zone. The two countries account for more than 10% of each other's exports and imports and are each other's second-largest trading partner after China.

A cross-border high-speed rail project, which had been under development since 2010, was expected to further accelerate that economic integration. But on January 1, 2021, the two governments announced the termination of the project. At the end of March, Malaysia paid $77 million in compensation to Singapore. The two countries had agreed in 2013 on a plan to connect Kuala Lumpur and Singapore, 350 kilometers apart, with a train service that would make the trip in 90 minutes. The project, however, fell prey to political turmoil in Malaysia. Statements from government officials and media reports suggest that it was the Malaysian side that reneged on terms of the deal.

The agreement was to pick a company responsible for providing the rolling stock, laying the tracks and designing and operating the system through an international bidding process. However, Malaysia insisted on dropping this provision during negotiations to review the agreement. The government wanted to fast-track the process to make up for the two-year delay. It also saw an opportunity to use the project to stimulate the economy after the pandemic. The Malaysians must have figured that if foreign investment was kept out of the project, local businesses would benefit.

Singapore found the new terms unacceptable. Singapore wanted to choose a company through an international bidding process to ensure that the interests of both countries were protected; and saw the removal of that clause as a fundamental departure from the bilateral agreement. The rail project would have further unified the economic zone, but its failure brought into sharp relief the gap between the two countries' ideas of transparency and rationality.

Egypt

In late June, the Central Bank of Egypt published external sector data for the first quarter of 2021 showing a marked widening of the country's current-account deficit in both year-on-year and quarter-on-quarter terms to its highest quarterly level of $5.7 billion.

The sharp widening in the current-account deficit was driven by an 18.5% surge in import costs to $19 billion in January-March 2021 – as international commodity prices rose sharply. Earnings from exported goods also increased strongly (14.1%); as global demand picked up, it has kept pace with growth in the larger import bill. As a result, the trade deficit reached $11.4 billion in the first quarter of 2021, some $2 billion higher than a year earlier.

The services surplus, which is normally a significant offsetting factor in keeping the current account deficit manageable, has started to widen but remains sharply down on pre-pandemic levels. Although transportation earnings were at similar levels to pre-pandemic levels despite the temporary closure of the Suez Canal in March, services receipts from tourism were only about 35-40% of their pre-pandemic highs. More recent waves of the pandemic have led to renewed international travel restrictions in key markets.

At the same time, with the surge in goods import costs, services debits have returned to pre-pandemic levels, leaving the services surplus at about half its pre-pandemic level. While the current transfer surplus, including remittances, has been relatively stable, the smaller income deficit has widened. Overall, Egypt's current-account deficit was more than double its year-earlier level in January-March.

External sector pressures have stayed manageable owing to financial account inflows that have helped to prevent the depletion of net foreign exchange reserves, which averaged about $40 billion in January-May 2021 (six months' worth of import cover). Foreign direct investment (FDI) inflows were comfortably above their year-earlier level at $1.4 billion but were well below the pre-pandemic quarterly average. However, financial inflows remain exceptionally high at $5.8 billion, driven by purchases of government securities, including a $3.75 billion sovereign bond issue in February.

The forecast for the 2021-22 trade deficit and the current-account deficit has been increased. However, given strong capital inflows there is no expectation of external payment difficulties in the short term. Nevertheless, reliance on volatile portfolio inflows presents a significant risk.

India

In June India's merchandise exports grew by 47.3% year-on- year, to stand at $32.5 billion, while imports rose 96.3% to $41.9 billion. Trade flows in June remain higher than pre-pandemic levels, signaling that the external sector is broadly healthy. Robust imports in June further indicate that domestic demand remains strong. Looking ahead over coming months, the expectation is that both exports and imports will continue to rise. Export growth will be bolstered by anticipated recovery in India's key export markets, like China and the U.S. The country's import bill will continue to inflate on the back of recovering domestic demand and elevated energy and commodity prices.

The main downside risk to the forecast is a slower than anticipated economic recovery (posed by a more severe containment measures prompted by further waves of covid-19 infections). This would weaken trade flows broadly, but the negative impact on imports will be more pronounced.

Growth in the value of outbound shipments was fairly broad-based. Excluding the more volatile categories of oil products and gems and jewelry, merchandise exports posted large double-digit gains not only in annual terms but also compared with the levels in 2019. The increase in imports was led by almost doubling of the value of inbound shipments of crude oil and petroleum products, which to some extent have been pushed up by higher global oil prices. Excluding the volatile components of gems, jewelry, and oil, import values were 12.5% higher than in 2019.

On account of quicker import growth, the shortfall of

the merchandise trade account widened to $9.4 billion in June, compared with $6.3 billion in May and a modest surplus recorded in the year-end period.

The latest data supports the view that both merchandise exports and imports will register substantial growth in 2021. The trade deficit is expected to widen substantially in 2021 (to $159 billion from $95.2 billion in the previous year], as growth in imports continues to outpace exports.

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

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