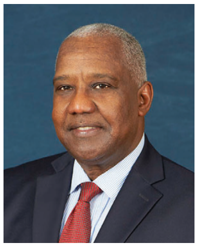
# Major Country Developments
# March 2019



*By Byron Shoulton*

## Overview

The U.S. and China are believed to be moving closer to a trade deal that will include China agreeing to buy more U.S. products, giving ground on auto-industry protections and intellectual property rights. Such an agreement would boost U.S. liquefied natural gas, agriculture and auto sales to China going forward. Whether those assurances are sufficient to get a deal done remains in doubt. How much China is willing to yield on questions of perceived unfair advantages that Chinese companies enjoy and concerns over Chinese state subsidies to cutting edge technology companies which are giants in their respective industries – remains unclear.  While the U.S. continues to aggressively object to China's Huawei Technologies Co. advanced presence in the global telecommunications space, other nations such as Germany, the UK and India have concluded that engaging with Huawei and having access to its equipment and technology will not pose a security threat to their countries. India with a population of 1.4 billion, is seen by technology leaders as a prime market for connectivity using advanced technologies including 5G networks, among others.

The initial losers in a U.S.-China trade deal would be Canada and Australia which are themselves big LNG and agricultural exporters. Australia is already a dominant LNG supplier to China and has been projecting rising exports to that country to offset falling coal revenues. Estimates of a likely U.S.-China deal suggest it would also hurt Asian trade with China [e.g. Japan could lose $28 billion annually, 3% of its exports; South Korea could lose $23 billion, 3.1% of total exports; and Taiwan could lose $20 billion, 3.2% of its exports].

The U.S. Administration continues its drive to shake up the global trading system, announcing that imports from India and Turkey will no longer qualify for preferential, tariff-free access to the U.S. market. The U.S. Trade Representative announced that Turkey and India no longer qualify as 'beneficiary developing countries' under the Generalized System of Preferences (GSP), which provides many low income and emerging economies with duty-free access to the U.S. market for some exports.

According to the U.S. Trade Representative, India has failed to assure the U.S. of equitable and reasonable access to its market. The move will likely stoke tensions between India and the U.S. India has been the largest beneficiary of the U.S. GSP program. In 2017, its duty-free exports to the U.S. under GSP were around $5.6 billion (or 11% of India's $48 billion in goods exported to the U.S. that year). Washington launched a review of India's preferential trade privileges in April 2018, complaining that the Indian government had not sufficiently opened up its market to justify duty-free access to the U.S. Instead, the U.S. said India had implemented a wide array of trade barriers that create serious negative effects on United States commerce.

Despite intensive engagement, the U.S. says India has failed to take the necessary steps to meet the GSP criterion. The American frustration with India's trade policies has been reflected in complaints by the Administration over high tariffs on U.S. Harley-Davidson motorcycles. That frustration has been felt among U.S. businesses, as India raised import duties on a wide range of goods over the past year. This formed part of Prime Minister Modi's campaign to promote domestic manufacturing, but which has negatively impacted U.S. companies such as Apple and Ford, among others.

In addition, India's price controls on drugs and medical devices, its intellectual property policies, and restrictions on agricultural commodity imports are sources of friction with the U.S. A recent overhaul of Indian regulations aimed at giving large local entities greater advantage has hurt foreign players such as Walmart and Amazon who have invested billions of dollars in the country.

The decision to remove preferential status for Turkish imports comes as tensions between Turkey's president Erdogan and President Trump remain volatile. The U.S. launched its review of Turkey's GSP status in August 2018, shortly after the eruption of strains between both countries over a detained U.S. pastor. While the pastor was released following the painful meltdown of the Turkish lira, relations between both countries have continued to be rocky, with disagreements over U.S. withdrawal from Syria and Turkey's plan to purchase an air defense system from Russia. U.S. imposition of high tariffs on Turkish steel and aluminum exports last year had already triggered Turkey's retaliation against U.S. exports of cotton which have been boycotted by Turkish mills. Previously, Turkey had been the fifth largest importer of U.S. cotton over many decades.

The U.S. Trade Representative concluded that Turkey has graduated from the GSP program due to its "increase in gross national income per capita, declining poverty rates, and export diversification." The removal of Turkey from the program will hit only a small part of the country's exports. The U.S. imported $1.66 billion under the GSP scheme in 2017, while Turkey's total global exports for the year were $157 billion. The Turkish Trade Ministry responding to the U.S. decision pointed out that the move conflicts with the mutual objective of both countries to increase bilateral trade to $75 billion per annum. The U.S. decision which will take effect in May 2019 will negatively affect U.S. small and medium sized enterprises and manufacturers.

Meanwhile, Turkey's GDP growth was cut by half due to weak domestic demand and the expensive costs to access credit which hurts investments. Chafing under strict fiscal constraints imposed in Turkey after the painful 2018 currency crisis, the Turkish government has been forced to resort to more creative attempts to stimulate the economy and give a morale boost to the electorate (who will vote in the presidential election later this year). The creative measures have ranged from leaning heavily on the country's state banks to make credit available; to pressing retailers to hold down prices. Some wonder if such an approach can last, or whether a nervous President Erdogan will eventually revert to more conventional spending tactics – to win reelection whatever the cost.

One way to stimulate the economy would be for Turkey's central bank to cut interest rates currently at 24%. But the bank is still rebuilding its shattered credibility after responding late to last year's currency woes. Investors have warned that cutting rates now, with annual inflation stuck at 20%, could trigger fresh market turmoil. The central bank has given assurances that it will not act prematurely.

## USA

The U.S. posted its widest monthly trade deficit since 2008 in December and a record annual deficit in goods as steady economic growth underpinned higher spending by U.S. consumers and businesses. The U.S. trade deficit with the rest of the world widened 19% in December from the prior month to $59.8 billion. During 2018 the U.S. imposed tariffs on a range of goods imported from other countries, particularly China, in hopes of giving American companies a competitive edge. Still the trade gap grew 12% from 2017 to $621 billion last year.

Tax cuts and spending increases which caused consumer and business demand to expand were the chief reasons for the wider trade deficit. U.S. imports grew 7.5%, while exports increased by 6.3% for the year. In addition to a jump in consumer goods, imports of industrial supplies were another driver of the trade gap. The goods deficit widened most with

China despite the imposition of high tariffs on Chinese exports to the U.S. The U.S. trade deficit in goods also widened with the European Union and Mexico.

Meanwhile, the two largest U.S. oil groups ExxonMobil and Chevron raised future production forecasts for U.S. shale in Texas and New Mexico (the so-called Permian Basin) by significant amounts. Both companies are expecting the boost in production to be profitable and to generate free cash flow, despite the shale industry's prior record of needing continued infusions of capital to finance drilling operations. The companies have become more confident of strong U.S. oil and gas production and are investing in pipelines and other infrastructure to address challenges created by the breakneck pace of development in the region. These include water shortages and a surplus of gas produced as a byproduct along with the crude. Exxon has lifted its projection from 650,000 barrels per day to 1 million b/d in 2024. Chevron revised upward its projections from 650,000 b/d to 900,000 b/d in 2023. These projections reflect a shift in the way the shale industry, pioneered by small and mid-sized companies, is increasingly being dominated by larger players. The growth plans mean that both Exxon and Chevron expect to triple their Permian Basin production from 2018 levels over the next five to six years.

North Korea and the U.S. failed to sign a much sought after deal when the leaders of both countries met recently for a two-day summit in Vietnam. The outcome was not a complete surprise. Statements from both sides following the meeting, while polite, suggest that if the gap between their positions does not narrow, the window of diplomatic opportunity for a deal may eventually close. Reports are that North Korea appears to have resumed rebuilding a nuclear site that it was in the process of dismantling following the first summit. It seems unlikely that tensions will escalate significantly over the short-term. North Korea's moratorium on missile testing is likely to be maintained provided both sides remain in open dialogue.

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Russia has pulled out of a key bilateral cold war era nuclear arms treaty with the U.S. This follows American withdrawal from the Intermediate Nuclear Forces treaty in February. Russia said it would suspend its obligations under the treaty until the U.S. ends its violations or until the treaty expires. This means the treaty will expire in August 2019 unless both sides return to compliance. The U.S. wants to replace the existing agreement with a new or revised agreement to include other countries, particularly China. The moves have stoked fears of a new arms race.

## Venezuela

Venezuela slips deeper into an economic and political quagmire from which it will take the country many years to recover. For now, the challenge is how to get sitting President Nicolas Muduro to step aside; and thereafter organizing a credible election process that would allow free and fair voting for a new representative government chosen by the Venezuelan people.

The economic meltdown which has unfolded slowly over many years, saw the gradual but dramatic deterioration of Venezuelan society, while oil prices fell at the same time as Venezuelan crude output shrunk to all-time lows. Decades of under-investment in the oil sector, severe mismanagement of the country's resources by the State, (including hijacking the revenues of the national oil company while firing of thousands of PdVSA workers), and the mass exodus of millions of Venezuelans, have seriously undermined the Muduro regime's credibility.

The persistent shortages of basic necessities, inflation currently at over a million percent, and the consistent lack of foreign exchange, have reduced Venezuela to a status equivalent to that of a failed state. The decision to prevent any payments for Venezuelan crude sold to the U.S. from getting to the Muduro government, would have major negative consequences for the sitting government, which is completely dependent on revenues from crude exports to pay for vitally needed imports. The government must find alternative means to sell crude if it is to have access to hard currency while U.S. sanctions remain in place. One unconfirmed report is that Russia has taken possession of some Venezuelan gold reserves, which it would eventually exchange for cash to keep the Muduro regime afloat.

The Opposition leader Juan Guaido who has claimed the position of interim president (and who is recognized by the U.S. and other countries in the region as well as European governments), has his work cut out for him.

The military leadership which by all appearances continue to support Muduro, forms the basis for the regime's continued existence and hence its survival. Until and unless the military abandons him, it is difficult to foresee Muduro stepping aside, even with tough U.S. sanctions already in place and more promised. Both Russia and China who are owed millions in unpaid loans to Venezuela publicly support Muduro, while China has reached out to Mr. Guaido – to establish lines of communication….just in case. The way forward in Venezuela is paved with uncertainty. Despite Muduro's unpopularity and the extremely desperate country conditions, the military leadership continue to hold most of the cards.

## China

A rare public disagreement has erupted between Chinese Premier Li Keqiang and the central bank over record credit expansion in January, resulting from monetary stimulus intended to support China's flagging economic growth. The premier and President Xi Jinping have been consistent critics of large-scale stimulus programs that their predecessors launched in response to the 2008 financial crisis, which is criticized for encouraging wasteful investment and leading to a dangerous increase in debt.

A crackdown on excessive debt and financial risk since 2017 led to a sharp slowdown in credit growth in 2018, helping push GDP growth to a nearly three-decade low. In response, policymakers have enacted a series of monetary and fiscal stimulus measures since the summer of 2018, with a particular focus on boosting lending to small, privately owned companies, which suffered disproportionally in the debt crackdown. For months, policy loosening failed to boost credit flows, as banks remained cautious on lending into a slowing economy, while the U.S. trade war battered business confidence, reducing companies' appetite for capital expenditure. That began to change in January, as data shows that banks and bond investors unleashed a record monthly volume of new credit. In response, Premier Li warned of risks from this deluge of credit.

The concern is that investors are obtaining low-interest, short-term loans and re-investing the proceeds in high-yielding wealth management products, earning virtually risk-free profits on the spread. Mr. Li warned that the fundamental path to solving China's long-term development problems was structural reform and a focus on high-quality growth. The central bank has responded that the focus on assisting small businesses with short-term loans was a necessity to help companies worst hit by the slowing economy.

Officially, the Chinese economy grew at a slower 6.4% pace in 2018 (down from 6.8%) and is forecast to slow further in 2019 to around 6%. Some independent sources are forecasting GDP growth closer to 5%.

Separately, China has indicated that it is open to slash the cost and size of Malaysia's $20 billion East Coast Rail Link (ECRL) to save its keystone Belt and Road project in the country. Official discussions between the two countries has yielded this stark reversal by China. Work on the project was suspended soon after Prime Minister Mahathir was returned to power last year. In January the Malaysians cancelled the project. It was put back on the table after Beijing asked to continue the talks. China's willingness to meet Malaysia's demands [including cutting the price tag for the project] comes amid a strong push-back against the Belt and Road Initiative across the region. The world's largest infrastructure undertaking has prompted opposition, for example, in Sri Lanka and Pakistan, with critics raising fears over Chinese hegemony and countries' inability to repay large Chinese loans that were offered to pay for the projects.

## Algeria

Demonstrations continue in Algeria following the announcement by supporters of the decades-serving and ailing 82 year-old President Bouteflika - that he intends to seek a fifth term as president. Despite having suffered a stroke six years ago, not communicating to Algerians, and currently receiving treatment in a Swiss hospital, Bouteflika is being presented as the best candidate to continue leading the country. It appears a powerful group of Algerian special interests – whose wealth and influence are tied to the president – are keen to maintain the status quo. The head of the business lobby, a construction tycoon has been a close ally of the president over many years and is behind the drive for Bouteflika to run again.

However some leading entrepreneurs are reportedly defecting from Algeria's main business association [Forum des Chefs d'Enterprises or FCE], which is the main organ being used to advance Bouteflika's fifth term run. This division among the business elite is significant, sending the message that growing numbers of Algerians fear that their near-invisible president is being used as a façade by an opaque group of power brokers to maintain control and protect their political and economic interests. The vice chair of FCE recently quit the organization, stressing that it was wrong to use the business lobby group to go against the wishes of the majority of Algerian citizens (who are clearly frustrated by this attempt to deny them freedom to choose new leadership). Other senior business leaders and academics have joined in the narrative that it's time for a change in Algeria.

The Algerian economy is state-dominated but Mr. Bouteflika has sponsored an emerging private sector, parts of which have grown rich as a result of the billions of petrodollars poured into a massive public works program. This has transformed the face of the oil-rich country of 40 million people with new roads, ports and new houses, even though it has failed to create a diversified economy capable of keeping up with the demand for jobs from a predominantly young population.

As oil prices fell in 2014, squeezing Algeria's public finances, the government curtailed imports, while boosting the domestic private sector. Protections extended to local industries includes tax holidays, access to foreign currency at the official rate, subsidized energy and credit from state-owned banks. Business figures supportive of another term for the president are seeking to preserve the advantages they have enjoyed, which have led some to speedy success and big fortunes. Those critical of the president have run into problems and face ongoing complications, hurdles and delays in conducting business– placed in their path by the authorities.

These individuals have joined the popular demonstrations voicing opposition to Bouteflika's bid for a fifth term. Their voices are gaining traction especially as the outside world begins to look closer at what has been until now an obscure, and almost closed society. With the government's firm control in the allocation of foreign exchange in Algeria, payment delays have been experienced in servicing external debt coming due. These delays appear mostly bureaucratic and at times seem subject to influence peddling [i.e. shorter waiting periods depending on closeness of principals at Algerian entities to the government's political machinery].

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## FCIA's Deals Of the Month

**Pay-As-You-Go Policy:**
$90 million limit of liability, providing nonpayment coverage on sales to North American equipment rental sector

**Bank's Receivable Purchased Policy:** $36 million limit of liability, nonpayment coverage on A/R Purchased in the North American automotive sector

### *What is Trade Credit Insurance?*

*If you are a company selling products or services on credit terms, or a financial institution financing those sales, you are providing trade credit. When you provide trade credit, non-payment by your buyer or borrower is always a possibility. FCIA's Trade Credit Insurance products protect you against loss resulting from that non-payment.*

**  **Non-Cancelable Limits:** Subject to policy terms and conditions, after issuing the policy, the insurer may not unilaterally reduce any country or buyer limits.*