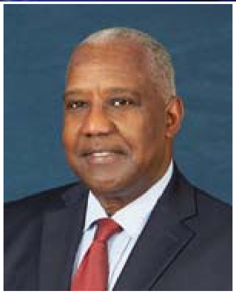
Major Country Developments

May 2019



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Overview

Despite weaker global demand, the **U.S**. economy experienced healthy growth during the first quarter of 2019, registering 3.2% GDP growth [at an annual rate], surprising many forecasters. Rising exports, falling imports and higher inventory investment drove much of the growth, helping to offset weaker gains in consumer spending and business investment. The strong first-quarter performance marked a turnaround from a gloomy start to the year when the economy appeared to be close to stalling. The U.S. economic outlook seem to brighten after the Federal Reserve reversed course in early 2019 and indicated that additional interest rate hikes would in all likelihood be withheld over the course of the year.

Meanwhile, new hiring has continued strong (unemployment at 3.6%), and inflation remains tame (trending below the 2% target set by the Fed). The strong U.S. dollar stimulated inflows of foreign funds seeking safer havens, causing portfolio investment to spike during the quarter. While most of the rest of the world struggles to regain economic growth momentum and euro-area activity appears stalled, U.S. economic expansion appears alive even after the ten-year anniversary since the recession ended. With the Fed on hold, the biggest remaining obstacle is U.S. trade policy. Uncertainty over whether tariffs will be lifted or if new ones will be imposed; uncertainty as to if and when bilateral trade accords will be reached between the U.S. and **China**, **Japan** or the **EU –** serve as hindrances to business investment sentiment while hampering medium-term planning decisions. These concerns not only weigh heavily on the welfare of U.S. farming and agricultural sectors specifically, but also hurt momentum in manufacturing while casting a pall over the auto sectors in Europe and Japan. U.S. labor has warned the Administration that it risks striking an "inferior agreement" with China in an effort to end the trade war, if it fails to rein in Beijing's use of industrial subsidies, thereby raising the pressure on U.S. negotiators. The AFL-CIO is insisting that a U.S.-China deal include binding commitments from China to prevent currency manipulation and to restrain the use of industrial subsidies. Labor's reservations are significant because they highlight the risk of a political backlash if a deal is reached with China but is viewed by Americans as being weak.

More broadly, global manufacturing activity has waned despite a recent pick-up reported in **China.** Chinese consumer spending, especially on cars, continues to underperform. Chinese stockpiles of raw materials, grain, copper et al. and weak domestic demand continue to place downward pressure on global commodity prices. China is under additional pressure due to the infestation of its domestic pig population

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by the African Swine fever. The epidemic has wiped out an estimated 30% of China's pig herd, forcing the country to resume buying U.S. pork despite a 62% tariff imposed by China in retaliation to U.S. tariffs on Chinese imports. The best estimate is that it will take "several years" for China to rid its pig population of the epidemic.

Leading global oil companies reported weaker first-quarter profits reflecting ongoing geopolitical tensions and weaker commodity prices. Oil refining, which has been a reliable profit center for the industry in recent years was especially hard hit. The oil companies' anemic results add to concerns over the direction of crude prices, where lackluster demand, excess gasoline and a build up of oil in storage facilities have led to fresh speculation that a predicted 2019 oil rally may fall short of expectations. At the moment the effects of U.S. removing waivers from sanctions against Iranian crude plus depressed production in Venezuela and Libya, will place upward pressure on global crude prices at least temporarily. Over time, the counter balance of stepped-up U.S. shale production will even out global demand and mollify prices in the coming months.

Separately, moving the U.S., Mexico and Canada trade pact [the so-called **USMCA** which will replace the Nafta treaty], to its final stages requiring ratification by the legislators in all three countries, is at a critical stage. The agreement is facing an uphill battle in the U.S. congress with trade unions citing lack of enforceable labor standards in Mexico as a barrier. Canada wants U.S. tariffs on its exports removed before it will sign on. Mexico is yet to sign on but recently passed legislation that allows Mexican pay raises, as required by the new agreement. It's still not certain if Mexican legislators will agree to the deal without seeking further compromise. Getting this agreement ratified soon is central to easing concerns over vital supply chains linking the three countries, whose economies are joined at the hip. The U.S. Administration is indicating a willingness to walk away without a deal, maybe to push for an early ratification. Moreover, sensitivity to the upcoming U.S. 2020 presidential race is playing its part in influencing opinions and adds pressure to the timing for ratifying this agreement.

Meanwhile, a decline in U.S. homebuilding and bad weather is causing a slump in the construction sector and hitting lumber prices. The slump comes a year after lumber prices reached record highs and were climbing higher amid a resurgent U.S. housing market, a boom in spending on home renovations and difficulties transporting wood from mills to building sites. Lumber prices are currently down nearly half to $344 from a high of $639 [per 1,000 board footage] reached on May 17, 2018. Prices collapsed right after that peak, and there has been little reason this spring for them to bounce back. Lumber producers are facing reduced residential construction, signs that remodeling work may slow, plus gains in output and efficiency at mills in the U.S. South.

Meanwhile, bad weather in key markets has hampered building and renovating new homes and limited orders. Nationwide, housing starts and building permits unexpectedly declined in March. Sales of existing homes also fell in March, the 13th consecutive month of year-over-year declines. That is problematic for lumber producers because home sales tend to spark demand from sellers making repairs before listing properties and from buyers who undertake renovations. Some builders are optimistic that lower lumber prices could boost profit margins after surging materials costs pushed home prices higher last year. Weyerhaeuser, the largest timberland owner in the U.S. and one of the largest lumber

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producers, is optimistic that housing will rebound in coming months due to lower mortgage rates, strong job growth and improving weather conditions.

UK

According to the latest manufacturing purchasing managers' index**, UK** manufacturing growth slowed in April as companies eased stockpiling following the delay of Brexit and new export orders declined. The index dropped to 53.1 in April from 55.1 the previous month. While stockpiling continued to support business activity, the UK PMI manufacturing index remained expansionary, in contrast to a prolonged malaise in the eurozone indices. Weaker global demand, particularly from the EU, the U.S. and China contributed to the fall in new export orders for UK manufacturers, together with overseas customers rerouting their supply chains away from the UK. Demand from overseas has been hit particularly hard with several overseas customers reducing their British supply chains to divest themselves of their reliance on the UK market.

Stockpiling by UK manufacturers continued in April, but eased significantly from the high recorded in March, when the proportion of companies reporting rising stocks had increased to the highest level in the history of the UK survey and by far the highest level across major economies. The record level of stockpiling suggest that companies were concerned about the risk of a no-deal Brexit disrupting supplies of goods and raw materials. But with the Brexit deadline now extended to the end of October 2019, the expectation is that the pace of stockpiling will keep falling. With large inventories relative to orders and weak global demand, UK manufacturing business activity will likely ease further. Housing market activity also slowed in the run-up to the initial March Brexit date and the prospect of a no-deal exit. The number of mortgage approvals for house purchases dipped to a 15-month low.

Meanwhile, Bombardier, the Canadian-based aerospace and rail manufacturer, is planning to sell its operations in **Northern Ireland**. The decision to dispose of the Belfast-based aerostructures business comes at a sensitive time, as the UK government continues to struggle with Brexit, in large part due to the impact on Northern Ireland of the planned departure from the EU. Bombardier is the province's biggest employer with a workforce of about 4,500 and had previously warned of "serious consequences" from a hard Brexit on its operations in Belfast.

The Canadian company has been present in Northern Ireland since the 1980's when it bought Shorts, one of the oldest names in aviation. The plant makes wings for what was previously known as the C-series jet, which was a huge cash drain on Bombardier. The troubled program was bailed out by Airbus, which took a 50.01% controlling stake in the project in 2017. It has since been renamed the Airbus A220. The Belfast operation is also responsible for the design and manufacture of large components for some of Bombardier's business jets, including parts of the fuselage for its range of Learjet, Challenger and Global families of aircraft.

Turkey

The Turkish economy is now in recession, even as annual inflation recently fell to 19.7% from a peak of 25.2% in October 2018. However, food prices have remained high, and renewed lira weakness this year and higher oil import prices have tempered hopes of a further steady decline in inflation. In March unemployment was above 16%. This helps to explain the plunge in

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President Erdogan's popularity and the loss of confidence in his government which hit all-time lows.

The Turkish lira was hit hard in 2018 after U.S. tariffs were imposed on Turkish steel and aluminum exports and the U.S. imposed additional sanctions on Turkey. The currency experienced renewed selling pressures in April which drove the value down further, while commercial lending rates picked-up steam, aided by domestic and international political uncertainties, tensions and doubts about economic policies. Then, the U.S. removed Turkey from the list of countries whose exports qualify for preferential treatment (access) to the U.S.

In late April the Turkish central bank maintained its repo lending interest rate of 24%. The rate (which is used for central bank lending to commercial banks) has remained unchanged since last September. The central bank acknowledged the continuing risk to price stability stemming from higher food and import prices, and the elevated course of inflation expectations, while it reiterated that it will maintain its tight monetary stance until the inflation outlook improves significantly. Turkey's corporate tax rate was raised from 20% to 22% in 2018. Personal income tax rates range between 15% and 35%. Reducing tax evasion was one of the elements of previous IMF programs, but compliance remains weak. Political instability and adverse market conditions will delay further privatization deals. Networks of patronage remain a constraint on the free market. Competition is still limited in several sectors. Attracting foreign direct investment remains a government priority, but macroeconomic instability and concerns about security, corruption and politicization of the judicial system will continue to curb inflows. Efforts to improve tax collection and prevent evasion is, so far, making only limited progress. In the banking sector asset quality is likely to deteriorate on the back of the financial market turmoil that began in 2018. However, the central bank is expected to lower rates gradually as inflation moderates in 2019-20.

Deepening economic malaise, frustration with government policy and resentment toward Syrian refugees have been growing steadily in Turkey. In recent municipal elections, in which the opposition defeated the ruling Justice and Development (AKP) party in most of the country's big cities, including Istanbul and Ankara, much of that frustration came to the fore. Opposition politicians regularly played the refugee card (promising to send Syrian refugees home). Many believe that for Turkey to come to grips with its economic demise and begin to dig itself out of recession, it must first develop a strategy to deal with getting approximately 3.6 million Syrians living in Turkey to return to their homes. Some politicians claim that the Syrians pose a threat to security and public order while President Erdogan himself has proposed resettling at least some of the refugees in a safe zone he wants set up in northern Syria. Syrian workers undermine wages in Turkey because their desperate situations allow them to accept work at much lower wages than Turkish nationals are paid. In reality, the ongoing war in Syria and the poor conditions in that country would likely prevent a majority of Syrian refugees from returning home any time soon. Nonetheless, there is a consensus that the current policy toward the refugees is unsustainable, despite financial assistance which Turkey has received to help it deal with this problem.

An intense migration of Turkish capital, wealth and expertise abroad in recent years, as the business and professional classes fled the country for greener pastures, will make it more

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difficult to turn the economy around. The brain and talent drain over the past decade, combined with accelerated capital flight over the last few years, won't be easily replaced.

Meanwhile, Turkey's relationship with the U.S. took a turn for the worse when Washington warned that Turkey's purchase of a Russian missile defense system would jeopardize Turkey's role in building parts for U.S. F35 jet fighters. The recent removal of waivers to countries buying Iranian oil is a direct hit to Turkey (a buyer of Iranian crude).

Argentina

The probability that the sitting Macri government won't be re-elected in upcoming October presidential elections seemed more likely as Argentine asset values plunged in April and the currency faced renewed depreciation pressures. As the currency has slumped further the country risk premium has skyrocketed.

Former leftist President Cristina Fernandez leads in the polls against President Macri, a major reason why the credit default swap rate rose to 1,257 basis points in April, implying a very high risk of default.

Annual inflation rose to 54.1% in March. Investors are evidently penciling a victory by Ms. Fernandez as a high-likelihood event. The damaging opinion polls come amid a domestic crisis in confidence in the sitting government's ability to stem the upward drift of inflation.

Data from Argentina's statistics institute show that the trade account posted a surplus of $1.2 billion in March 2019. The result represents a significant turnaround from a deficit of $554 million for March 2018. The principal driver of the trade surplus continued to be strong import compression, with domestic demand yet to pick up following the economic crisis which dominated 2018. Imports fell by one-third in March compared to the same period last year. Imports of capital goods and accessories for capital goods were hit the hardest; both fell by two-fifths as extremely tight monetary and fiscal policy continued to dampen investment spending. Consumer goods imports also declined sharply, reflecting the deterioration in households' purchasing power. Imports of durable and semi-durable goods were affected the most, as these are most responsive to income declines. By contrast, imports of necessities such as medicines and basic food items fell modestly.

Export earnings also fell modestly in March, by 5% year-on-year. However, the effects are due mostly to price swings, as export volumes rose across all major categories. Energy exports performed the best, reflecting higher volumes of and prices for oil exports. The outlook for fuel exports is encouraging given recent investment in the sector. In February, YPF, the State-owned oil company, made its first export of oil obtained from the large Vaca Muerta shale deposits, and shipments are slated to increase in the months ahead. Exports of primary products and of agricultural goods also increased in volume terms; however, subdued prices for agricultural commodities meant that earnings from these exports actually fell in year-to-year terms.

More concerning is the decline in exports of industrial manufacturers. In particular, automotive exports (which have knock-on effects on exports of aluminum, rubber, plastic and related products) have weakened as a result of recently reinstated export taxes as well as a weaker outlook in Brazilian demand (the Brazilian market accounts for 65% of Argentine auto exports). There should be good economic data to come as this year's bumper harvest

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boosts activity, with some positive effects for consumers.

While expectations are for Argentina's economic conditions to experience a turnaround, this will be a very gradual process, and imports are likely to remain in the red for most (if not all) of 2019. Meanwhile, the economy remains in recession and while some polls give President Macri a competitive chance to remain in power, Argentines are not pleased with the effects of the IMF bailout on domestic living conditions. Reports of more people slipping into poverty than has been the case in over a decade, is sufficient to turn voters away from the Macri government and back into the clutches of the Fernandez' leftist, state-dominated economic model.

The private sector has many bad memories of the past under two successive intrusive Fernandez administrations during the 1990's. A Fernandez return will be a bitter pill for private businesses and entrepreneurs to swallow. Unless President Macri can rein in inflation, his re-election bid is at risk. Peso volatility will remain the major concern. Combined with Treasury sales of IMF dollars, the imminent inflow of dollars from this year's bumper harvest will be supportive of the peso in the coming months. But the country is under the microscope, and short-term currency volatility remains a real threat to confidence and to economic recovery.

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

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