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Research paper
Advanced countries: stagnation is not destiny for all of them!

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PANORAMA

MARCH 2015

Global Country Risk Outlook

COFACE ECONOMIC PUBLICATIONS

By Coface Group Economists

In this panorama we first set out a study examining how the advanced economies are facing up to the challenge of weak economic growth since the Lehman Brothers collapse, that isfor the past seven years now! Some observers are even talking of "secular stagnation". But, in our view, not all the advanced economies are facing the same challenges regarding this risk of long-term stagnation. We believe that five of them (Belgium, Germany, the Netherlands, South Korea and Switzerland) currently have sufficient strengths to succeed over the nextdecade, when measured according to the five indicators we selected (demographics, innovation, debt, income, inequality and international trade).

With this issue we are also publishing our quarterly barometer of worldwide trends in country risk. With regard to the development of the risks since the end of 2014, weexplain why we have upgraded our risk assessments for Belgium, Cambodia and the Netherlands and give a positive view on Tunisia's outlook. We also explain why we give a negative assessment for the prospects for Brazil and Ecuador and why we have downgraded our assessment for Sierra Leone. We have also revised our assessments of the business environment in Kuwait, Uganda, Russia and Togo.

Readers will find updated reports for some of these countries setting out their economic situation in more detail, at the end of the panorama. Readers will also find updated country analyses for Cyprus, Greece, India, Russia and Nigeria.

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RESEARCH PAPER

March 2015

ADVANCED COUNTRIES: STAGNATION IS NOT DESTINY FOR ALL OF THEM!

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INTRODUCTION

Almost seven years after the Lehman Brothers collapse, world growth is still much weaker than before the crisis: +2.8% in 2014 (+3.0% expected by Coface in 2015), against +4.3% in 2007. While the difficulties experienced by many emerging countries explain these figures, in part, the problems of growth in the advanced economies are also responsible. This poor growth observed since the crisis in the advanced economies is even, at times, seen as an irreversible phenomenon. Larry Summers, former US Treasury Secretary, notably talked of "secular stagnation" at a conference organised by the International Monetary Fund (IMF) in November 2013 as way of characterising this state of lasting stagnation into which the advanced economies are said to have fallen. It is argued that this stagnation is caused by a persistent lack of investment compared to saving together with the attendant negative interest rates. There are also several other explanations, such as the slowdown in technological progress or even weaker demographic growth.

But if growth is low in all the advanced economies, the pattern of growth differs from one region to another: the United States and the United Kingdom, for example, are doing better than Japan and the Eurozone. And even within the Eurozone itself, Spain and Germany are performing better than France and Italy. Cyclical factors, such as the fall in the oil price, currency fluctuations, and above all varying economic policies partly explain the recent disparities in growth. For example, after the Lehman Brothers shock, the US Federal Reserve was quicker to introduce monetary easing than its Eurozone counterpart. Equally, during the same period, the UK government acted more quickly than the Eurozone in implementing fiscal consolidation measures aimed at curbing the growth of the public debt. These austerity measures could then be stopped earlier so as not to hinder the recovery.

But beyond these differences in the short-term economic dynamics, we focus in this study on the longer term determinants of growth, in order to answer the following questions: are all the advanced economies doomed to this "secular stagnation"? Which among them have sufficient strengths not only to prevent slower growth, but quite the opposite, to allow faster growth in the next ten years?

In order to identify which of the OECD countries are least at risk of entering into a prolonged period of weak growth and even stagnation we have used five criteria. Two of these are traditional determinants of an economy's long-term growth: demographics and innovation (to measure technological process). This is because the prospects for long-term growth depend to a great extent on demographic growth and on growth in productivity (itself linked to an economy's capacity to innovate). The three other criteria chosen, however, relate more to the recent crisis. Effectively this has highlighted the negative consequences for economic activity of excess public and private sector debt (3re criterion). Increased levels of income inequality within the OECD countries is also one of the arguments increasingly put forward to explain the 2008-2009 crisis and then the weakness of the recovery (4th criterion), insofar as this leads to the long-term reduction in purchasing power for low-income households, which have the highest propensity to consume. Finally, the countries which have succeeded in improving the competitiveness of their export goods can expect to partly offset lower domestic demand through exports (5th criterion).

1 DEMOGRAPHICS

Growth in the economically active population slowing in the OECD countries

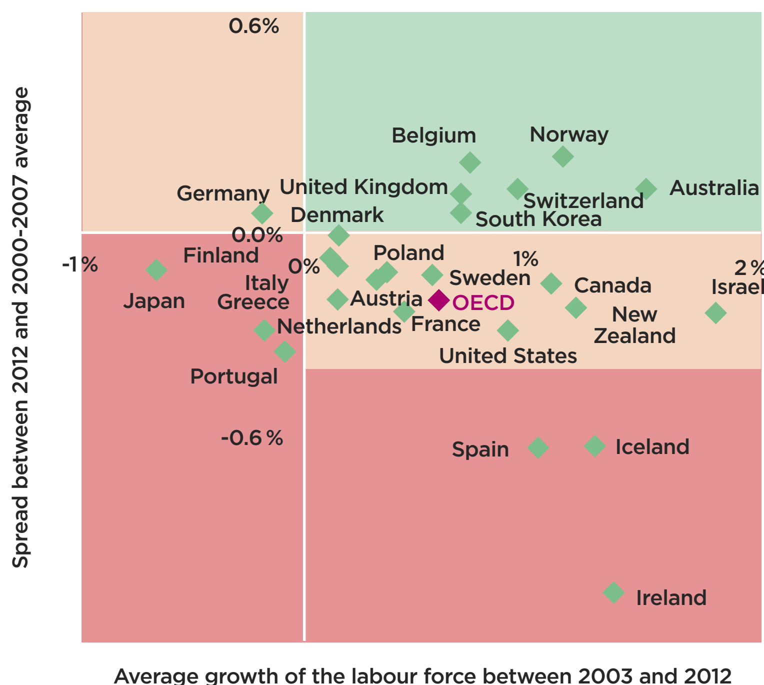
An economy's long-term growth depends in the first instance on the labour force available for production. How this available workforce evolves depends, in particular, on demographic growth, which in the OECD has been slowing since the early 1970s (annual population growth was 1.2% in 1972, against 0.7% in 2012. *See chart n° 1*). This trend in turns affects the growth of the economically active population in the OECD countries and increases the dependency ratio [(1)]. If in most OECD countries, the economically active population is still growing, few of these countries are seeing an acceleration in the growth of their assets. But, it is precisely this trend which can help improve growth prospects in the medium term. Here we are talking about Belgium, Norway, Switzerland, Australia, the United Kingdom and South Korea.

Immigration, basis for growth in the labour force

The countries in which the economically active population is growing more slowly or shrinking most significantly following the 2007 financial crisis are also those most affected by this growth shock: Ireland, Iceland, Greece, Portugal and Spain. The contraction can be explained by lower immigration during the years of the crisis and by the departure of national workers (brain drain) to countries offering better employment prospects. An OECD survey identified a net migration flow to Spain of 721,000 immigrants in 2007 compared with 16,000 in 2012. Over the five years, Spain would have had 2.7 million extra immigrants if the 2007 figure had been sustained. And, over the same period the number of economically active workers fell by 1.6 million. If one considers that 60% (average employment rate) of immigrants were economically active over the 2007-2012 period, the decline in the number of active workers could be explained by lower immigration. In contrast, Germany's net migration figure totalled 387,000 immigrants in 2012, compared with 99,000 in 2007. Over the same period, higher immigration meant that Germany's active workforce remained almost stable despite low fertility rates (1.38 children per woman in 2012). The 2007 economic crisis has, therefore, redistributed the demographic trends in the advanced countries by diverting part of the workforce to countries offering better job opportunities.

Chart n° 1
Labour force slowing in the OECD countries

Green zone interpretation, for example: countries where the labor force growth is positive between 2003 and 2012, and where this growth had been higher in 2012 than the average of 2000-2007 years.



Sources : OECD, Coface

(1) Dependency ratio: ratio of economically inactive workers compared to active workers

2 INNOVATION

The prospects for long-term growth also depend on an economy's capacity to innovate in order to realise productivity gains. Innovation manifests itself in different ways: rising employment in the key value-added sectors, development of export competitive advantage, investment attractiveness and phenomenal potential of so-called "innovation clusters" (2). It can be defined as the exploitation of new products, ideas and services, or of new economic and/or managerial models, based as much on technological concepts as on use. However, the technological aspects seem the most appropriate basis for measuring and comparing levels of innovation across different countries.

R&D, a proxy for measuring innovation

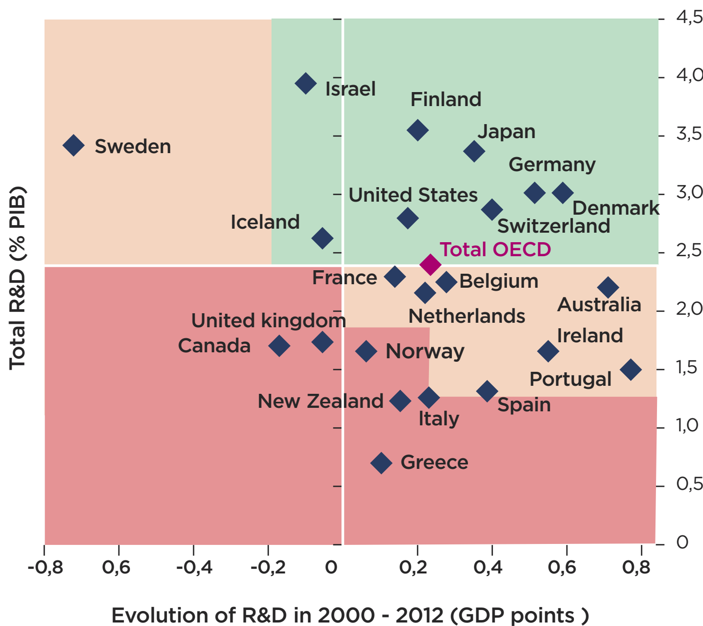
It is well known that research and development (R&D) underlies innovation. But some innovative companies do not spend on this type of activity. Nonetheless, this first standard indicator gives us a general overview of the respective position of each country in terms of innovation. The more GDP a country devotes to R&D spending, the more it is recognised as being close to its technological frontier, i.e. as being at the cutting edge of technological research and not at the catch-up stage.
Average R&D spending in the developed member countries of the OECD is 2.4% of GDP – up 0.2 points of GDP since 2000 *(see chart n° 2)*. A first set of countries exceeding these averages stands out: South Korea, Denmark, Japan, Germany, Switzerland, Austria, Finland and Israel. Other countries such as Ireland, Portugal or Australia spend less than the OECD average on R&D but spending growth since 2000 (being three times higher than the OECD average) is a sign of improvement.

The new technologies: a high value-added sector for exports

Thanks to a qualified workforce and a significant number of patents, some countries have managed to build on their innovation capacity to create comparative advantages internationally and can look forward to an upmarket shift in their exports. In the information and communication technology sectors (ICT), there is no significant correlation between R&D and ICT expenditure and ICT exports (a ratio of only 0.20), except in the case of Sweden, Finland and Ireland. The overall competitiveness of countries in the new technologies can thus be measured by the results of the Revealed Comparative Advantage Index (3) *(see chart n°3)*. For nanotechnologies, the annual pace of patent expansion was 5,2% between 2002 and 2012 in the OECD countries, whereas it was stable for biotechnologies. Only four countries (United States, Spain, Netherlands, Ireland) seem to stand out in both areas.

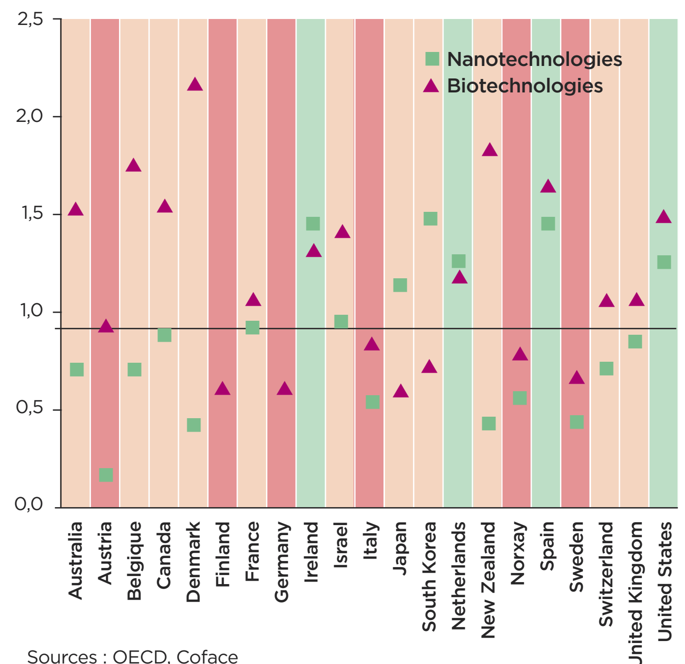
Chart n° 2
R&D performance of the developed countries

Green zone interpretation, for example: countries where the R&D spending are higher than OECD countries in average, and where the progression had been higher than -0.2 point of GDP between 2000 and 2012.



Sources : OECD, Coface

Chart n° 3
Revealed Technological Advantage Index for new technologies



Sources : OECD, Coface

(2) Business cycles", Schumpeter, 1939.
(3) Measuring the proportion of patents in an economy relating to a technological domain compared to the total number of patents. It is equal to 1 if the share of the economy in the sector is identical to its share in all areas and exceeds 1 in the case of specialisation.

Specialisation in new technologies and the drive to win market share in these areas is likely to increase still further in the years to come. Given their human capital endowments, the developed countries are fully able to exploit this resource to implement an effective policy to stimulate innovation. However, this is only possible if they also have physical capital endowments. It therefore seems to make sense to focus on the problems around how innovation is financed in order to identify which countries will be able to rely on innovation as their main source of growth.

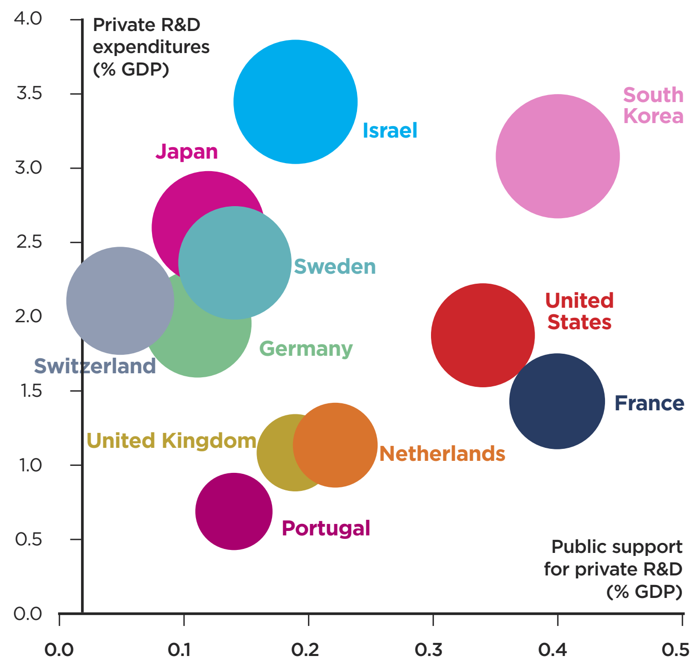
Public support, bank credit: main channels for financing innovation

There are different ways in which the public sector promotes innovation. As we have already seen, public support for training and research plays a key role. The public authorities have other more or less direct tools, in particular for stimulating private R&D: research subsidies, government loans (very widespread in the environment sector to encourage "green growth"), as well as tax incentives (like the research tax credit in France). It is then as much about providing funds as creating a favourable tax environment for private investors which incentivises them to meet the needs of start-ups (as in France, Switzerland or Australia).

France, South Korea and the United States devote the most significant proportion of GDP to this kind of support (0.36% of their GDP on average for these three countries compared with 0.14% in the other developed countries) *(see chart n° 4)*. Other countries, like Portugal, the Netherlands or Belgium also show interesting potential. However, there is no evident correlation between public support and a high level of private R&D. Some countries, like Switzerland, Germany, or above all Israel, manage to stimulate R&D spending by private businesses without them particularly benefiting from significant state aid. By contrast, France's results are only average given the public sector efforts. If the tax support is too targeted, it can create niche markets, in which businesses do not necessarily try to grow in order to continue benefiting from the favourable tax system. However, In Germany and in the United Kingdom, the ability to transform a small innovative enterprise into an intermediate enterprise is often cited as an indicator for measuring innovation. On the other hand, public support tends to favour innovation research based on purely technological considerations, whereas most innovations (for example: Google, Facebook, smartphone applications) are based on economic considerations, which are more about bringing together innovation and profitability.

SMEs in Sweden, Switzerland, South Korea but also Portugal, stand out from those in other developed countries because they have fewer difficulties in accessing bank credit (the percentage of loans to SMEs amounted to over 75% of total loans, compared with less than 40% in most other OECD countries). All young innovative organisations find it hard to access bank credit, especially during the start-up phase, as much because of their risk profile and because the banking institutions find it difficult to assess the scope and performance of their project, as because of their lack of guarantees. This phenomenon has been all the more marked during the crisis in recent years, despite the low interest rates. According to the OECD [4], SMEs as a whole have found the last few years harder than between 2000 and 2008.

Chart n° 4
Impact of public and private R&D spending on the level of R&D (size of bubbles)



Sources : OECD, Coface

Private equity : the future of funding innovation

Private Equity funds are playing an increasingly important role in funding innovation, especially in meeting the needs of small structures at various stages of development by providing equity through a direct investment.

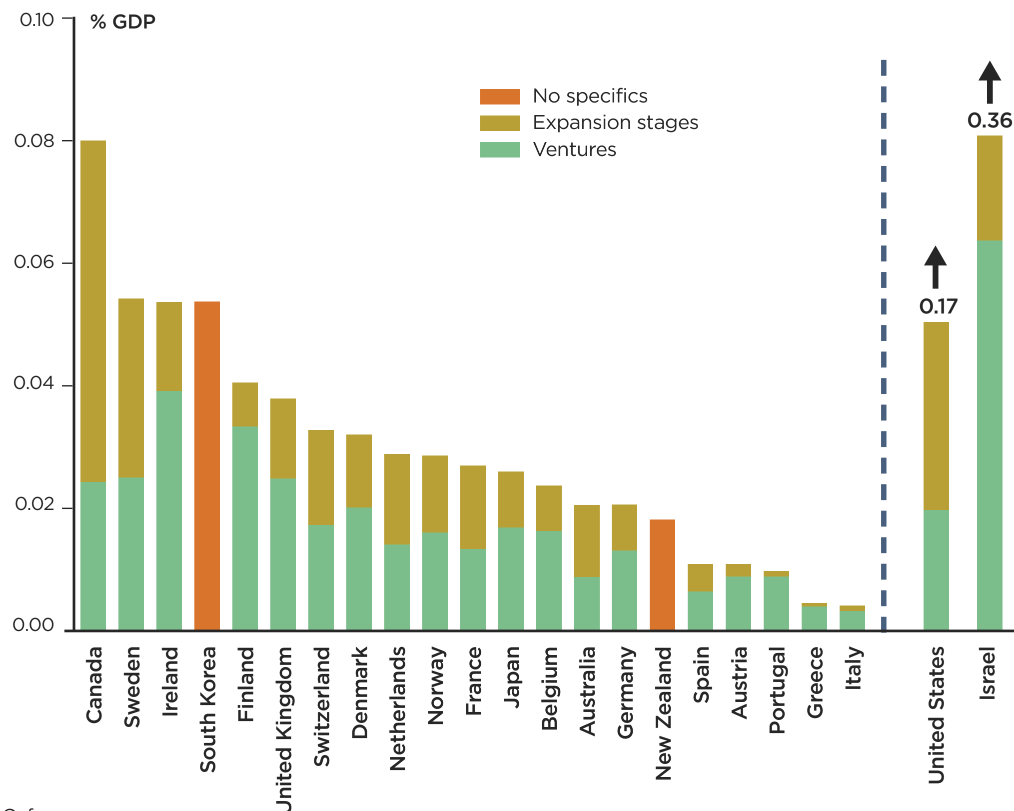
(4) OECD Science, Technology and Industry Scoreboard 2013

Investment in private equity is particularly high in Israel (0.36% of GDP) and in the United States (0.17% of GDP, see *chart n° 5*), for several reasons. Israel manages to stand out from other countries in terms of innovation, especially thanks to the international exposure of its businesses. As it has a limited internal market, the country has succeeded in making itself attractive by developing high added value products for the international market in several high tech sectors (health, software) and by attracting foreign capital (47% of the finance for its R&D, against 10% on average for other countries). In the United States, the amounts allocated are higher than anywhere else and the financing of innovative companies is facilitated by pension funds eager to diversify their portfolio risks by placing some US household savings in high-yield, innovative projects. In this process, the role of Business Angels (individuals, or groups of individuals, who invest their personal money and who advise and guide the innovative companies) is key. It is a process which enables substantial investments to be made, while mutualising risk and there is a track record and expertise with regard to innovative projects, and unlike the banks (Basel III) or insurers (Solvency 2) is not constrained by changes in regulation. There were 263,400 Business Angels in the United States in 2012, compared with 25,000 in the United Kingdom, second highest number). Funds which provide 90% of the invested risk capital (or ventures, start-up or early-stage).

In the Nordic countries (Sweden, Denmark, Norway), or again in the United Kingdom and France private equity is also relatively important. Nonetheless, the funds are partly devoted to financing companies at the development phase or spent on takeovers/acquisitions (49% of companies in France and in the United Kingdom, compared with 29% on average in Europe). They do not, therefore, necessarily foster the creation of start-ups or their transformation, which is admittedly the stage involving the highest risk for an investor, but also the most crucial for a young innovative enterprise. In Austria and Ireland, where the share of private equity as a percentage of GDP is low, the amounts are mostly devoted to risk capital (over 61% of companies compared to 46% on average in Europe). The innovative companies in these countries, or again of the small Irish and Israeli businesses are highly attractive, which helps strengthen these countries' attractiveness for high tech companies.

The innovation challenge for the developed countries is based therefore on their ability to finance it, especially at the earliest stage. To address the chronic difficulty young innovative enterprises have in accessing bank credit, the development of private equity seems more than necessary and needs to be based on effective public policy (as in South Korea, Sweden or Canada) so as to provide a framework that will enable its development.

Chart n° 5
Investment in private equity by country in 2012 (or latest available data)



Sources : OECD, Coface

3 INEQUALITIES

Income inequality has been rising since the crisis

Income inequalities in many OECD countries have increased over the past 30 years regardless of their initial level. This trend has accelerated since the 2008 crisis as shown by the evolution of the Gini coefficient *(see chart n° 7 page 10)*. Sweden, which today is still one of the most egalitarian countries in the world, has, for example seen a rapid rise in inequalities. The same goes for the United States, France, Denmark and Australia.
Inequalities between generations are on the rise: while the crisis affects all age groups of the economically active population, young people have been first in line. Their unemployment rate in fact rose from 11.8% in 2007 to 15.6% in 2013 in the OECD countries (+3.8 percentage points). Over the same period, it rose 2.2% (5.3% to 7.5%). According to the OECD [5], young peoples' real disposable income within the Eurozone countries fell by 1% a year, whereas the income of those aged over 65 continued to grow by 0.9%.

Inequality and growth: an ambiguous relationship

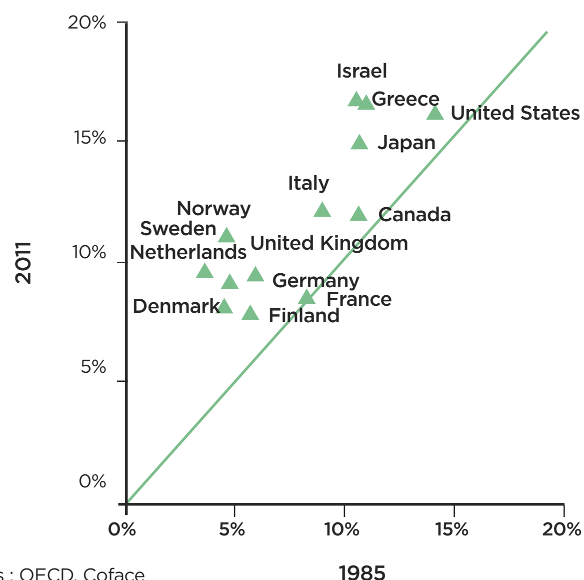
There is plenty of economic literature which looks at the link between inequalities and growth, stressing first that the former fosters the latter. Arthur Okun declared, for example, in 1975 that reducing inequality impairs efficient economic growth [6]. Behind this lies the theory of incentives: lower income inequality in a country reduces the incentive to work and to invest. Long-term growth is thus penalised. Moreover, the economist said that redistribution via the tax system and a minimum wage could also be costly for the economy as a whole. He pointed out that transferring some of the income from the rich to the poorest in society led to a net loss associated with the administrative cost of doing so.

But from the early 2000s, the conclusions of several studies contest Okun's findings. According to Alesina and Perotti [7] (1996), inequality generates political tensions and economic instability which qui ultimately reduces investment. Further, according to Rodrik [8] (1999), it prevents the social consensus needed to absorb economic shocks. Since the Lehman Brothers collapse, there has been an increase in the number of empirical studies measuring the effect of inequality on growth. According to the Director of the Employment, Labour and Social Affairs Directorate at the OECD [9], Stefano Scarpetta, the level of inequality reached in the rich countries is such that it is impacting negatively on economic growth.

Inequality limits the development of human capital

In 2014, in a Working Paper by Frederico Cingano, the OECD quantified the growth lost due to rising inequality. He showed that, actually, lowering inequality leads to an increase in growth. The reduction in inequality is more pronounced in countries where income inequalities are falling than in those where they are increasing. The economy of the United States, the most unequal country in the OECD in 2011, could have grown 20% faster between 1990 and 2010 if income disparities had not increased between 1985 and 2005. The authors highlight the consequences of the relative impoverishment of low-income households. This limits the development of human capital constrained by the financial cost of accessing good quality education. According to the OECD, contrary to Arthur Okun's thesis, redistribution does not hurt growth. Targeted redistribution does not prejudice the accumulation of human capital, thus the possibilities of educating oneself, so fostering social mobility and the development of skills. The IMF [10] backs this position. According to their calculations carried out in 2014, increasing redistribution to the 60% less well-off, rather than to the 50% less well-off (+10 percentiles), has an almost zero direct impact on growth, but reduces inequalities which, in itself, positively affects growth by an estimated 0.5 percentage points. The impoverishment that has been observed among the working population (aged 18-65) over the past 30 years is undermining the accumulation of human capital which relies on the ability of the poorest households to borrow *(see chart n° 6)*.

Chart n° 6
Poverty rates [11] in 1985 and 2011..



Sources : OECD, Coface

(5) "Rising inequality: youth and poor fall further behind", OECD, 2014
(6) A. Okun (1975): "Equality and Efficiency: the Big Tradeoff", Brookings Institution Press.
(7) A. Alesina and R Perotti (1996) : "Income distribution, political instability, and investment"
(8) D. Rodrik (1999): "Where Did All the Growth Go? External Shocks, Social Conflict, and Growth Collapses" Journal of Economic Growth
(9) F. Cingano (2014): "Trends in income inequality, and its impact on economic growth", 2014, OECD Working Papers, N° 163
(10) Jonathan D. Ostry, Andrew Berg, and Charalambos G. Tsangarides (2014): "Redistribution, Inequality and Growth", IMF
(11) The poverty rate corresponds to the proportion of people whose income is below the poverty threshold. i.e. half the median household income

Inequality also increases the risks of a financial crisis

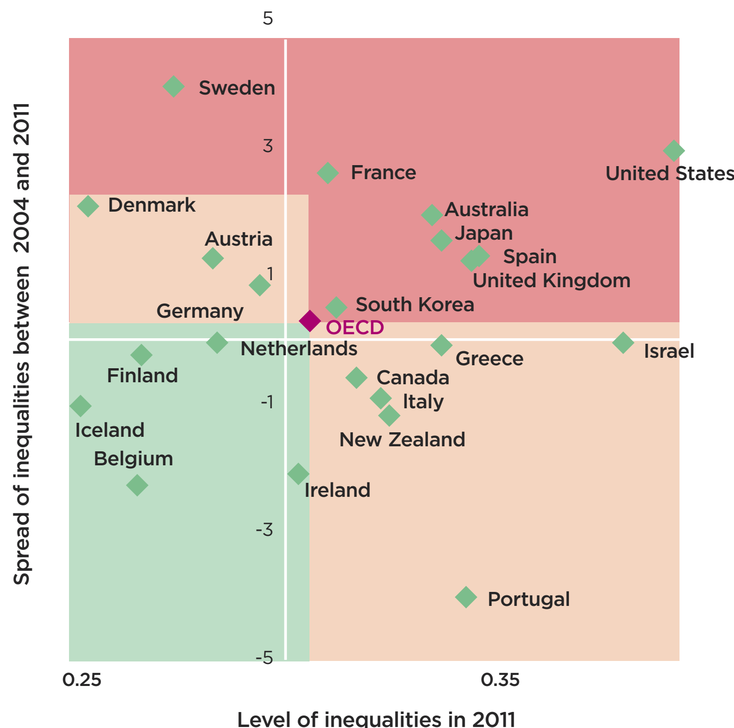
According to the IMF [12], the richest in society lend to the poorest when wealth inequality is high. According to the authors, in 1983 the debt/income ratio [13] for the richest 5% of US households was 80%. For the remaining 95% it was 60%. In 2008, the ratio is dramatically reversed with a ratio of 65% for the richest 5% and 140% for the remaining 95%. Faced with incomes that are hardly rising if at all, the middle classes and the poor resort to borrowing in order to maintain their consumption levels. Consumption inequality increases less, therefore, than income inequality. Nevertheless, this disjointed development means that lenders cover themselves more, generating demand for financial intermediation and financial services resulting in the two-fold growth of the financial industry. Since 1981, the ratio of private credit to GDP in the USE has risen from 90% to 210% and the share of the financial industry in GDP has doubled from 4% to 8%. According to Raghuram Rajan [14], over and above the accommodating monetary policy which led to the subprime crisis in the United States, it was actually inequality which weakened the financial system as a whole. According to him, increased inequality led the authorities towards growing laxity with regard to financial regulation in a bid to support demand and job creation.

The Lehman Brothers collapse, the changes in bank regulations (Basel II, Basel III, Dodd Frank Act in the United States) and the weight of total accumulated debt (private and public) are hampering the ability of the financial players to finance their investments and thus limiting production in the medium term.

The countries in which income inequality is particularly high in terms of the GINI coefficient [15] are the United States, Israel, Spain, the United Kingdom and Japan. The coefficient for these countries ranged between 0.39 and 0.34 in 2011 compared with an average of 0.30 for the OECD countries. But, as well as the level, it is important to analyse the trends in inequalities *(see chart n° 7)*. According to an OECD study published in 2014 [5] the United States, France and finally Sweden, still the more egalitarian than the OECD average, have lost potential growth points because of rising inequality. In contrast, growth in some countries seems to have benefited from a recent reduction in inequality: this is the case for Belgium, Iceland, Ireland and finally Portugal.

Chart n° 7
Dynamic of inequality, variations of the GINI Index in the OECD countries.

Green zone interpretation, for example: countries where the inequality level is lower than OECD countries in average, and where this level had been reduced between 2004 and 2011.



Sources : OECD, Coface

(12) M. Kumhof and R. Rancière (2010): "Inequality, Leverage and Crises", IMF Working Paper 10/268
(13) The debt represents household debt and income represent pre-tax income.
(14) R. Rajan (2006) : "Fault Line, How Hidden Fractures Still Threaten the World Economy" (introduction)
(15) GINI: an index which measures the inequality of income distribution in a country. If the index value is 1, then income is going to only one person and there is extreme inequality. If the index value is 0, there is no inequality and all income is identical.

4 TOTAL DEBT

Growing debt in the advanced economies boosted activity between 2000 and 2008

Debt in the advanced economies has risen significantly since the early 2000s. To a large extent, this trend first concerned the private sector *(see chart n° 8)*, the rise in public debt being less marked.
There are several reasons for this growing pre-crisis debt in the advanced economies: relatively expansionary monetary policies in a low-inflation environment, long-term interest rates weakened by the purchase of government bonds by central banks in countries with current account surpluses (China, Japan, the rest of Asia, the Middle East and other oil-exporting countries, in particular), financial liberalisation and shortcomings in prudential regulations (notably regarding new financial products) and also greater income inequality *(see part 3)*.

This rise in debt initially favoured growth in the OECD countries. If an economic player (State, household or business) is able to borrow, this actually boosts activity insofar as such borrowing enables more investment and/or consumption.

Debt also helps offset fluctuations in activity. For example, a household whose income is falling can maintain the same level of purchasing power and consumption by making use of credit. In the same way, a business can continue to invest despite falling profits thanks to a loan. And a State borrows in order to keep public spending stable at a time of falling tax receipts.
But beyond a certain threshold, debt seems to have a negative rather than positive effect on economic activity.

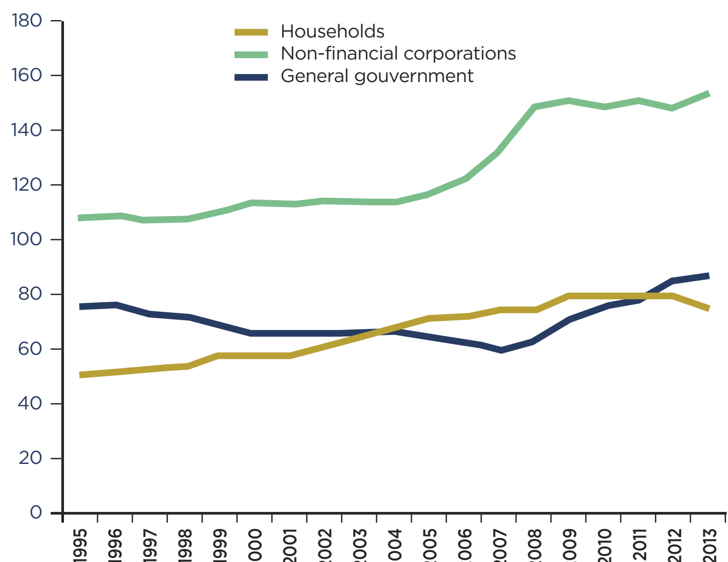
However, excessive debt impairs borrowers' balance sheets and makes them vulnerable to asset price fluctuations

Debt increases the financial vulnerability of debtor businesses, households and States. Generally speaking, it exposes borrowers to the risk of insolvency or bankruptcy when it reaches excessive levels. Secondly, debt exposes them to liquidity risk: when some of this debt matures and new debt needs to be issued, interest rates may rise and accordingly increase the interest charge for the borrower. Finally, the value of the debt can suddenly skid out of control if it is partially expressed in a foreign currency and if the local currency depreciates against it. For example, if a borrower's total debt is expressed in US dollars and the local currency depreciates by 50% against the dollar, the value of the debt doubles.

Substantial debt can also trigger increased macroeconomic risks insofar as it makes the borrower depending on the price fluctuations of financial assets or property. For borrowers using financial assets or property as collateral, the ability to borrow reduces as the price of these assets falls.

Moreover, a high level of debt increases the magnitude of the wealth effects: a financial asset and/or property price shock will impact more significantly on household net wealth where households are very indebted. The problem is the same for businesses and the State.
Finally, high private and/or public sector debt restricts central bank monetary policy. This is down to the fact that tightening monetary policy can lead to higher debt interest for borrowers and thus impair the solvency of the State, trigger company insolvencies and/or household bankruptcies by making the most vulnerable of them even more vulnerable in the short term. But on the other hand, the effect of long-term expansionary policies is also to ease borrowing conditions for those whose debts are already too high. Finally, the central bank's ability to intervene is limited in a similar environment.

Chart n° 8
OECD countries: debts (% GDP, simple average, source: OECD)



Source : OECD

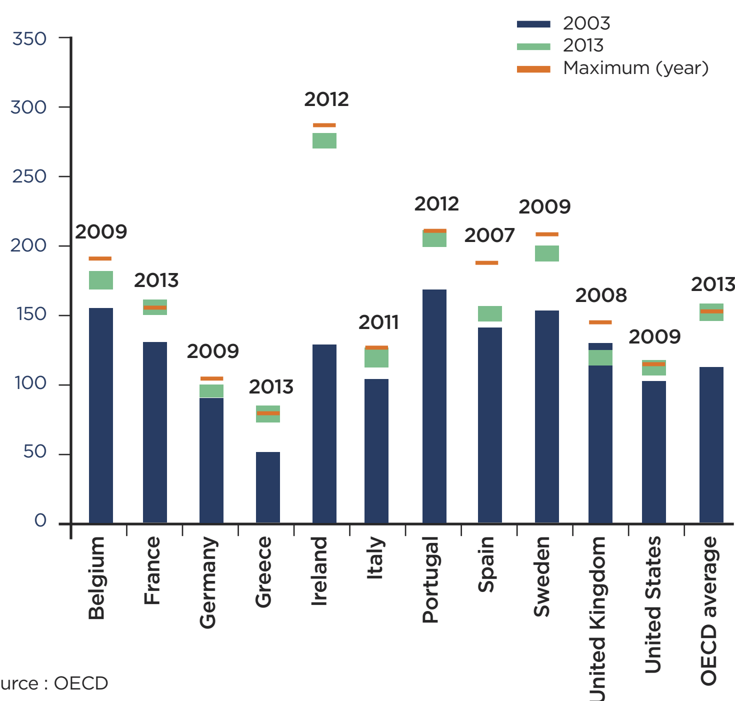
The 2008-2009 global crisis illustrates the risk associated with excessive debt. The countries in which private debt rose most significantly before 2008 are, moreover, also those which subsequently recorded the deepest recession (Spain, United States, United Kingdom). Apart from this very recent period, other episodes in the contemporary economic history of the advanced economies have confirmed the negative consequences of excessive debt (banking crises in the Scandinavian countries in the early 1990s...).

Finally, without going as far as triggering a recession, other episodes confirm the negative impact of private debt on growth when it exceeds a certain threshold. For example, the structural slowdown in Japanese growth in the early 1990s coincided with the rise in Japanese business and household debt [16].

This is confirmed by the economic literature. According to Gourinchas and Obstfeld [17], the expansion of private sector credit (together with an appreciation of the real exchange rate) is the factor most likely to account for the financial crises occurring between 1973 and 2010 in the advanced and emerging economies.

After cataloguing all these recessions preceded by excessive debt, the IMF[18] observed that this makes the recession deeper and the recovery slower than is the case for typical crises.

Chart n° 9
Company debt in OECD countries (% of GDP)



Source : OECD

The IMF goes into some detail, noting that the total increase in debt observed before the crisis in the boom period was eroded in the case of households. As far as corporate indebtedness is concerned, the post-crisis adjustment was a little less significant: it corresponds to two thirds of the increase recorded during the period of expansion.

In this context, the countries where indebtedness has increased the most in the past ten years are particularly vulnerable, especially as the deleveraging process has hardly begun *(see charts n° 8 page 9 and 9 below).*

Interactions between household, business and government debt increase the risks

All these fairly recent episodes also highlight the way the debts from the different sectors interact: When their level of debt starts to put stress on their purchasing power, households consume less, which reduces the State's tax revenues. Likewise, lower tax revenues can affect the State's budget when businesses record lower profits due to reduced investment capacity associated with high debt. Conversely, a State whose debt is considered too high tends to limit its spending and/or raise taxes. Such decisions can impair the solvency of businesses and households.

Germany, South Korea, Australia, Switzerland and Finland are among the least indebted

We have selected two indicators in order to identify the countries most at risk in this regard. We first measured the total indebtedness by country relative to GDP in 2013 [19]. As well as the total aggregated public sector, corporate and household debt, we also take into account the number of sectors with excessive debt (i.e. the point at which it depresses growth). The alert thresholds we fixed are 85% of GDP for households and 90% for businesses and government debt (see BIS [20] for reason behind the threshold for private debt).

(16) On this topic, see the Coface panorama of December 2014: http://www.coface.com/News-Publications/Publications/Panorama-Should-we-be-afraid-of-low-flation
(17) Gourinchas P.O et Obstfeld M. (2011): "Stories of the Twentieth Century for the Twenty-First", NBER Working Paper N° 17252, July.
(18) Bornhorst F. and Ruiz Arranz M. (2011): "Growth and the Importance of Sequencing Debt Reduction across Sectors", Jobs and Growth: Supporting the European Recovery, Chapter 2, International Monetary Fund.
(19) Namely, the sum of household, business and public debt.
(20) Cecchetti, S.G., M.S. Mohanty and F. Zampolli (2011): "The Real Effects of Debt," Working paper, Bank of International Settlements N° 352.

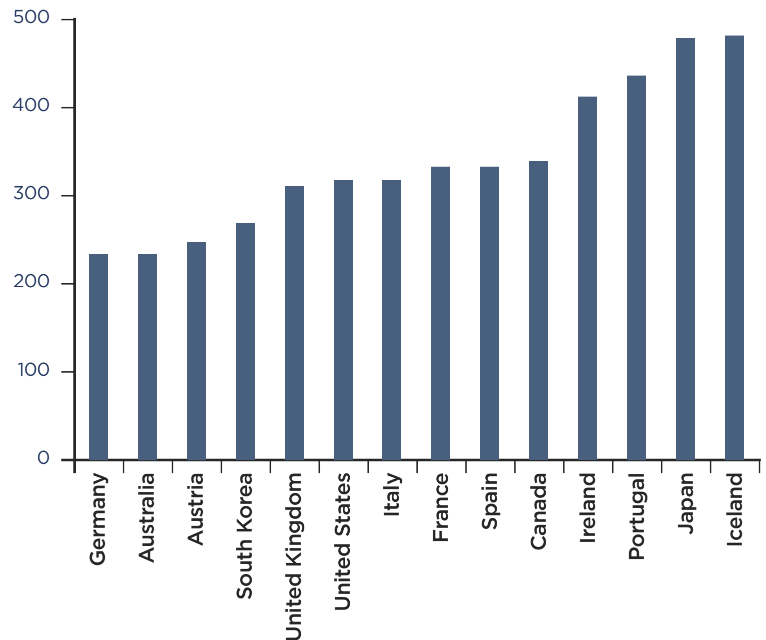
Finally, this analysis shows that economic growth in Germany, South Korea, Switzerland, Finland and Australia is unlikely to be constrained by excessive debt in the near future. These three countries do not have more than one sector with excessive debt, while their total debt is at a relatively low level (between 250 and 270% of GDP) [21].

Tangible signs of this advantage can meanwhile already be seen: the German housing market being one of the only ones to have avoided the excesses of the decade leading up to the 2008-2009 crisis, it is now expanding. Investment in construction contributed positively to growth in 2014, in contrast to most Eurozone economies.

At the other end of the scale, Ireland, Portugal, Iceland and Japan have very high levels of total debt, representing over four times GDP. As regards the total debt of the United Kingdom and of Canada, this is slightly lower but the debt in each of the three sectors exceeds the critical threshold.

In all the other OECD countries, total debt has reached relatively high levels (between 300% and 350% of GDP in most cases) but the debt in at least one of the three sectors is below the limit threshold fixed.

Chart n° 10
Total debt of OECD countries (2013, % of GDP)



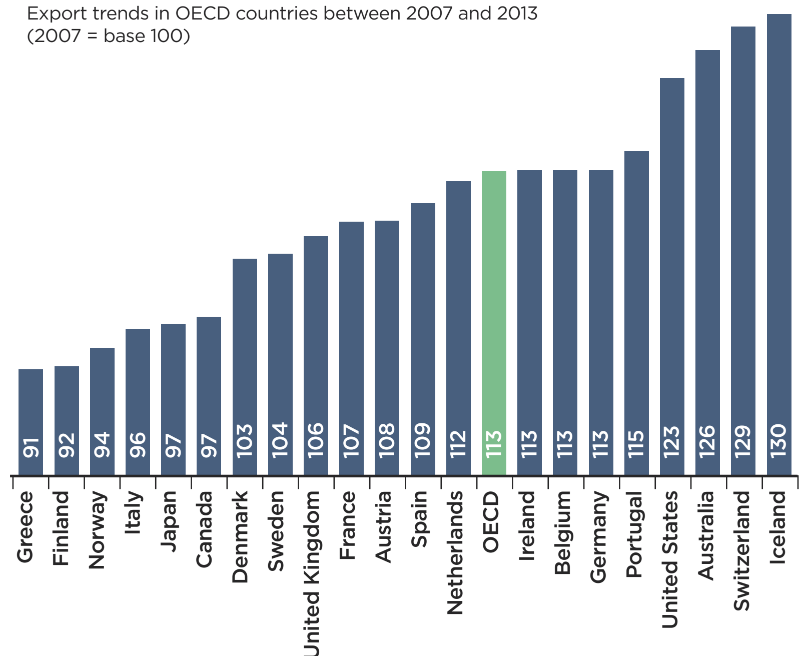
Source : OECD

5 EXTERNAL TRADE

In a context of domestic demand dampened by numerous obstacles such as those detailed above, the advanced economies can take advantage of strong competitiveness in order to gain export market share. They must first have an open economy [22] and then see a favourable trend for their exports. The most open countries are Ireland (105% of GDP), the Netherlands (83%), Belgium (82%) and Switzerland (72%). Taken together, exports from the OECD countries rose 13% in volume terms between 2007 and 2013 compared to the region's GDP *(see chart n° 11)*. Accordingly exports from Iceland (+30% compared with 2007), Switzerland (+29%), Australia (+26%), the United States (+23%) and Portugal (+15%) have increased. In contrast, exports from Greece (-9%), Finland (-8%), Norway (-6%) and Italy (-4%) contracted.

There are different possible explanations for this export performance, such as price competitiveness and non-price competitiveness.

Chart n° 11
Export trends in OECD countries between 2007 and 2013
(2007 = base 100)



Sources : OECD, Coface

(21) Several of the European countries which have recently joined the OECD also belong to this category: Slovakia, Czech Republic, Hungary and Slovenia.
(22) The rate of openness is measured by the weight of exports of goods and services in GDP

Southern Europe's price competitiveness has increased

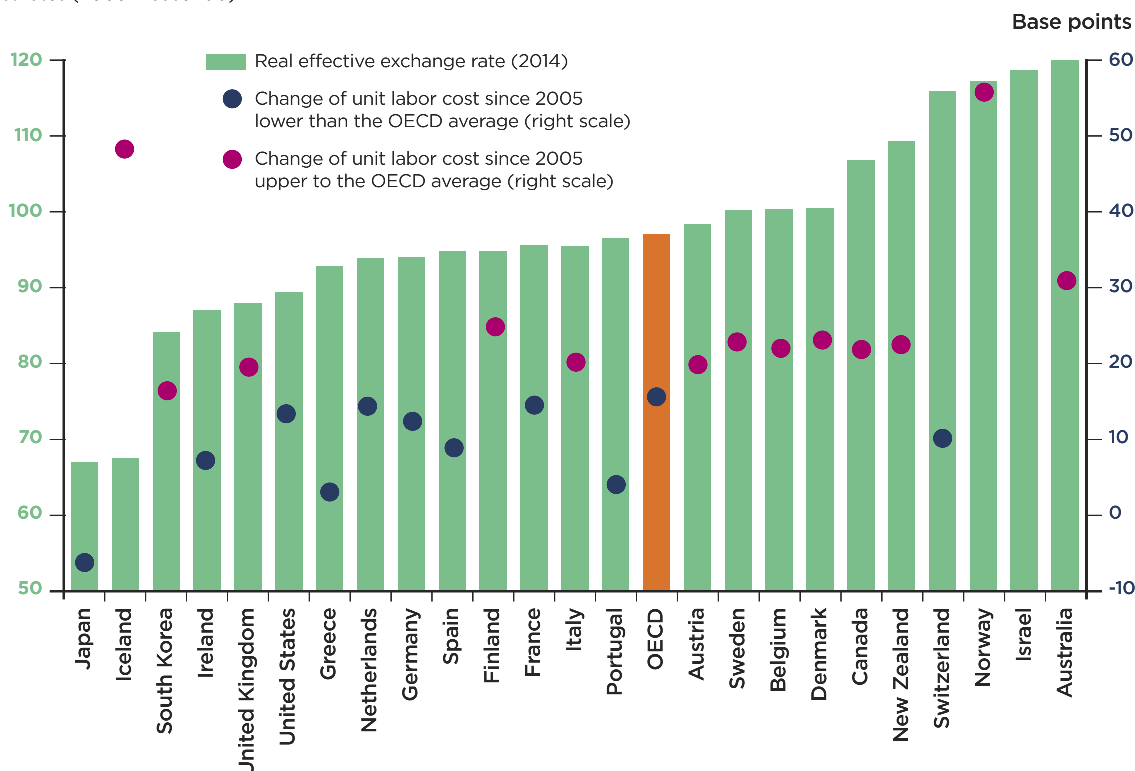
Movements in real effective exchange rates (REER [23]) illustrate the price competitiveness of the OECD economies *(see chart n° 12)*. Accordingly, Australia, Israel, Switzerland and Norway have been hit by rising REER. Conversely, Japan has put on strong gains in competitiveness compared with 2005 as the real effective exchange rate has fallen sharply. Two other countries also stand out: the United States and Ireland.

Germany, the United Kingdom, Switzerland and Japan and benefiting from their non-price competitiveness

But another aspect needs to be considered, as the Japanese export performance has not improved despite steep gains in price competitiveness. In fact, non-price competitiveness (quality, innovation, design, branding, distribution networks...) are also key to evaluating an economy's export positioning. A study by the European Commission in 2010 [24] stresses the fact that price competitiveness explains less than 40% of the variation in Eurozone countries' export performance over 1998-2008. Another study [25], carried out by the French Treasury and Economic Policy General Directorate in 2014 concluded that exports from Japan, Germany, the United Kingdom and Switzerland were the least sensitive to price factors than their OECD counterparts. Conversely, Spain, Portugal and Greece positioned on low-end or mid-range products are highly sensitive to price variations [26].

To conclude, many OECD countries are benefiting from their positioning. First, Belgium and the Netherlands are situated at the heart of the Eurozone and benefit from their geographic position. Second, Germany, Switzerland, Japan and South Korea are benefitting from the impact of their non-price competitiveness. Lastly, Spain, Portugal and Iceland are exploiting an adjustment to their price competitiveness, while their products are subject to fiercer competition due to the positioning of their range. Conversely, exports from Northern European countries are suffering because of the difficulties they are experiencing in adjusting their costs to levels in the main European economies. Equally, in Italy unit wage costs have continued to rise since 2007, thus generating a fall in exports.

Chart n° 12
Real effective interest rates (2005 = base 100)



Sources : Datastream, OECD, Coface

(23) The REER measures in an economy's nominal exchange rates with its trading partners adjusted by variations in price.
(24) "The impact of the global crisis on competitiveness and current account divergences in the euro area", European Commission, 2010, Vol. 9 N° 1
(25) R. Sautard, A Tazi, C Thubin: "quel positionnement hors prix de la France dans les économies avancées?", 2014, Trésor-éco, n°122 (What is the non-price-competitiveness positioning of France among advanced economies?)
(26) To arrive at these results, the authors calculated the average quality of a country's runs a quantity surplus for a product whose export price exceeds its import price, then the sale of the product depends more on quality than on price. They were thus able to rank traded products by sensitivity to unit price and so determine their quality.

CONCLUSION

The 2008-2009 global crisis highlighted the advanced economies' vulnerabilities. This study shows that they are not all identically exposed to the risk of protracted economic stagnation. They do not necessarily have the highest potential level of growth according to conventional approaches - these do not take into account some of the criteria used to measure long-term growth in this study.
We selected five criteria to assess a country's ability to benefit from stronger growth potential over the next ten years. We then assessed each country's level of risk with regard to these 5 indicators. More specifically, for each of the criteria, the country whose risk is deemed to be relatively weak (green dots in the table below) satisfy the following conditions:

- **Demographics:** positive and accelerating growth of economically active population (*see chart n° 1 page 3,* countries in green region);
- **Innovation:** countries where R&D (as % of GDP) is higher than the OECD average and increasing (*see chart n° 2 page 4*, countries in green region), and which have an effective system of financing innovation and which have comparative advantages in the high tech sector;
- **Inequalities:** lower than the OECD inequality average and declining levels *(see chart n°7 page 8,* countries in green region);
- **Debt:** relatively low total debt level (between 250 and 270% of GDP) and debt held by at least one of the 3 sectors (households, businesses, government) below the limit threshold *(see part 4)*;
- **Trade:** countries whose export performance has been equal to or above the OECD average since 2007 as well as those satisfying the following two conditions;
  - good non-price competitiveness;
  - specialisation in mid-range products with depreciation in real effective exchange rate since 2005.

In the end, five economies were identified: they are the best positioned to succeed in this environment of long-term weaker growth. They are Belgium, Germany, the Netherlands, South Korea and Switzerland. These countries share the fact that they do not have major vulnerabilities when it comes to the five criteria, namely demographics, innovation, debt, trade and inequalities. Germany, South Korea and Switzerland enjoy a moderate level of total debt (which includes government, household and non-financial businesses), which makes them less exposed to the risk of deleveraging. They are also in the leading group when it comes to innovation, a key factor in realising long-term productivity gains. As regards Belgium, the country enjoys positive, accelerating demographic growth as well as strengths in the area of inequalities and satisfactory external trade performances. Finally, the Netherlands is similar to Belgium.

	Demographics	Innovation	Inequalities	Debt	Trade
Australia	green	yellow	orange	green	yellow
Austria	yellow	yellow	yellow	green	yellow
Belgium	green	yellow	green	yellow	green
Canada	yellow	yellow	yellow	orange	yellow
Denmark	yellow	green	yellow	yellow	yellow
Finland	yellow	yellow	green	yellow	orange
France	yellow	yellow	orange	yellow	yellow
Germany	yellow	green	yellow	green	green
Greece	orange	orange	yellow	yellow	yellow
Iceland	orange	yellow	green	orange	green
Ireland	orange	yellow	green	orange	yellow
Israel	yellow	green	yellow	yellow	yellow
Italy	yellow	orange	yellow	yellow	orange
Japan	yellow	green	orange	orange	green
Netherlands	yellow	yellow	green	yellow	green
Norway	green	yellow	green	yellow	orange
Portugal	orange	orange	yellow	orange	green
South Korea	green	green	orange	green	green
Spain	orange	yellow	yellow	yellow	green
Sweden	yellow	yellow	orange	yellow	orange
Switzerland	green	green	yellow	yellow	green
United Kingdom	green	yellow	orange	orange	yellow
United States	yellow	green	orange	yellow	yellow

BAROMETER

March 2015

COUNTRY RISK AND BUSINESS CLIMATE ASSESSMENTS CHANGES

ASSESSMENT UPGRADED, REMOVED FROM NEGATIVE WATCH LIST, OR PLACED UNDER POSITIVE WATCH LIST

Country	Country risk previous	Country risk new
Belgium	A3↗	A2
Netherlands	A3↗	A2
Tunisia	B	B↗
Cambodia	D↗	C
Lebanon	C↘	C

	Business climate previous	Business climate new
Togo	D	C

• **Country risk assessment** assesses the average risk of payment defaults by companies in a given country. This evaluation combines economic and political prospects of the country, Coface payment experience and business climate assessment. This evaluation has 7 grades: A1, A2, A3, A4, B, C, D and can be watch listed (positive, ascending arrows in the table; negative descending arrows).

• **Business climate assessment** assesses overall business environment and more precisely whether corporate information is available and reliable and whether the legal system provides fair and efficient creditor protection

Country risk assessments

Belgium: A2

- Return to growth confirmed (1% in 2014 and 1.3% in 2015).
- Capacity utilization rate, at close to 80%, is above the historical average of 78.8%. In addition, improved profitability will lead to higher corporate investment.
- Positive contribution from net exports, thanks to the revival of the Eurozone economy and lower energy prices.
- Rising household consumption; purchasing power increased by rising employment and lower energy prices.
- Continuous decline in insolvencies (-12% during the August 2014 – January 2015 period).
- Stable government focusing on fiscal consolidation.

Netherlands: A2

- GDP growth accelerated slightly in Q4 2014 (by +0.5% on the previous quarter, following +0.2% in Q3). Household consumption, exports and investments all contributed positively to growth.
- House prices are still slightly increasing (+3.6% in January 2015, compared to their lowest level in June 2013). As at the start of the first quarter of 2015, business confidence in the construction sector was positive for the first time since 2008.
- Bankruptcies continued to follow a downward trend in January 2015 (they decreased by 21% in 2014 from their 2013 peak).

Tunisia: B↗

Achievement of political transition

- The appointment of the new Tunisian prime minister completed the country's political transition, following the successful legislative and presidential elections.
- This relative political stability is unlikely to be threatened by the March 18 terrorist attack in Tunis and should favour an increase in household and business confidence.

Better growth outlook in 2015:

- After a period of erratic growth and instability, the country is returning to more positive economic perspectives. In fact, we expect a growth rate of around 3% in 2015, compared to 2.5% in 2014. The economy will be supported by an expansion in agricultural production and a strengthening of industrial economic activity.
- Moreover, the country will greatly benefit from the improvement in the international economic environment, with low oil prices and a recovery in Europe, Tunisia's leading export destination.

Cambodia: C

- Economic activity has been strong, with GDP growth at over 7% since 2011. The country is benefitting from robust garment exports, helped by preferential access to the European Union, the US and Canada.
- FDI continues to grow, thanks to factories relocating from China and Vietnam, as well as public-private partner- ships for energy infrastructures.
- GDP growth is also supported by the tourism sector, which shows increasing diversification in the geographical origins of travellers.
- Investments in infrastructure projects and rapid credit growth are helping to sustain the construction sector.
- The fiscal position has improved and public and external debts remain low.
- The country is receiving economic support from international donors, such as China and the EU.

Lebanon : C

- Slow economic recovery: Following 2 years of economic stagnation, Lebanon's economy appears to be beginning its recovery. Indeed, we expect a growth rate of around 2.5% in 2015, compared to 1.5% in 2014. Real estate-related activity, construction and services - traditional drivers of the country's growth - are showing sign of improvement. Business confidence has reached its highest reading in 19 months.
- Lessening of political instability: The Lebanese parliament has agreed to extend its mandate and postpone legislative elections until 2017. This motion, voted in November 2014, diminishes the political risks and excludes, for the time being, a power vacuum scenario. Moreover, the mandate extension allows the government to undertake security measures to secure the Lebanese frontier from jihadi invasion, thanks to the support of the army.

Business climate assessments

Togo : C

- Les informations financières des entreprises sont plus accessibles et les décisions de justice plus rapides
- Le pays a, par ailleurs, amélioré ses performances dans les domaines de la création d'entreprises, du transfert de propriété et de la protection des investisseurs. Il a par ailleurs réduit le taux de la taxe sur les salaires.

ASSESSMENT DOWNGRADED, REMOVED FROM POSITIVE WATCH LIST, OR PLACED UNDER NEGATIVE WATCH LIST

Country	Country risk previous	Country risk new
Brazil	A4	A4↘
Ecuador	B	B↘
Sierra Leone	C↘	D

	Business climate previous	Business climate new
Kuwait	A3	A4
Russia	B	C
Uganda	C	D

Country risk assessments

Brazil : A4↘

- Brazilian growth is expected to contract (-0.5%) in 2015 due to the decrease in investments and private consumption.
- Activity is depressing in most of sectors: car industry will be affected by Argentina's recession; construction and offshore activity should go down given the corruption scandal affecting the national giant Petrobras.
- Industrial activity could suffer further this year due to a high risk of water shortages, energy rationing and blackouts.
- The Petrobras crisis is also affecting investments flows and investor confidence.
- Household consumption (which accounts for around 60% of GDP) is decreasing due to the increase in interest rates, inflation and few employments opportunities for this year.
- Inflation is on an upward trend given notably the government decision to regulate prices of fuel taxes and public transports.
- On the political side, government is facing a strong opposition in Congress and a growing social dissatisfaction.

Ecuador: B↘

- Ecuador is the second most affected country in the region by the decrease in oil prices, after Venezuela. The economy is poorly diversified and dependent on oil income, which represents 40% of fiscal income and over 50% of exports,
- Public spending and investments, the main keys of growth, are expected to fall, given the current decrease in oil prices. The country requires oil prices of around 120 US dollar per barrel in order to maintain fiscal stability,
- Because of the dollarization of the economy, a depreciation of the local currency - that would help public accounts and make non-oil exports more competitive – is unlikely.
- The outlook for local private business appears gloomy, following disagreements over safeguards against Colombia and Peru (two of Ecuador's largest trading partners),
- High dependence on Chinese funding.

Sierra Leone : D

- The economy of Sierra Leone has been severely hit by the consequences of the Ebola virus, which has affected economic activity and many FDI operations, especially in the mining, agricultural and service sectors. Although the spread of the disease is abating, new cases are reported every day. Furthermore, the mining industry will also suffer from the sharp drop in world iron prices, which have nearly halved since the end of 2013. Iron ore accounts for over one half of total foreign-exchange earnings and about 15% of GDP. The growth forecast for 2015 is -2%.

Business climate assessments

Kuwait : A4

- Kuwait is suffering from the political instability that tends to indirectly affect its business environment. Despite some measures to attract FDI, the country has been falling steadily in international institutions' business climate rankings. In addition, there is a degradation in the business environment, mainly due to a reduction in the transparency of financial information.

Russia : C

- Performance, in terms of rules of law (property rights, transparency) and corruption, has been poor. Moreover, the situation in terms of protection of foreign assets, property rights and the effectiveness of law, are deteriorating. International sanctions are making business more difficult in some sectors.

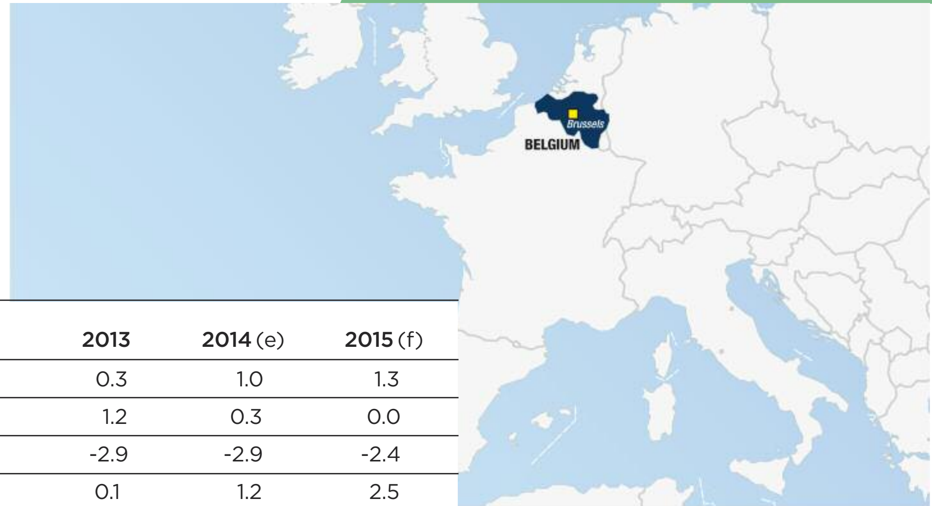
Uganda : D

- While improvements have been made in the areas of political stability, regulatory quality and reducing violence, some deterioration has been noted in terms of voice and accountability, rule of law and control of corruption. Indicators relating to the quality of infrastructure are also worsening.

BELGIUM

COFACE ASSESSMENTS

A2	Country risk
A1	Business climate



MAIN ECONOMIC INDICATORS	2012	2013	2014 (e)	2015 (f)
GDP growth (%)	0.1	0.3	1.0	1.3
Inflation (yearly average) (%)	2.6	1.2	0.3	0.0
Budget balance (% GDP)	-4.1	-2.9	-2.9	-2.4
Current account balance (% GDP)	-0.9	0.1	1.2	2.5
Public debt (% GDP)	104.0	105.0	108.0	106.0

(e): estimate (f): forecast

RISK ASSESSMENT

A moderate recovery favourable to businesses

Growth will remain moderate in 2015. All sections of the economy will contribute positively with the exception of public spending, restricted by fiscal consolidation. Households will take advantage of a relative improvement in employment and lower energy prices to increase their spending. Exports, largely comprising intermediate products, machines and transport equipment, will benefit from improvements in the Netherlands, Germany and France, while the depreciation of the euro will benefit sales outside the Eurozone, particularly on the UK market, which remains robust. Combined with the lower imported energy prices and, in general, moderate import growth, the current account surplus will increase. Thanks to continued low interest rates and the improved financial situation of households, housing construction will continue to recover. In this more favourable context, with the availability of relatively cheap credit and higher production capacity utilisation rates, businesses are expected to increase their investments. The decline in business failures, which began in 2014, will continue, helped by the slower growth in business costs (raw materials, federal measures aimed at strengthening competitiveness, freezing of wage indexation), while business productivity should gradually improve as activity increases.

Steady progress towards a balanced budget

Progress towards a balanced budget outlined in the 2014-2017 stability programme is intended to result in structural balance in 2018, i.e. an improvement of 2.7 GDP points compared with 2013. The average annual fiscal effort between now and 2018 is expected to be equivalent to 0.5 of a GDP point. In these circumstances the budget deficit could fall significantly in 2015 and public debt, equivalent to 108% of GDP could start to come down. The new government is mainly tackling spending by replacing only one in five retiring civil servants in order to reduce the wage bill by 10% in five years, reducing investment loans by 20% and by toughening the criteria for welfare benefits. However, how the fiscal consolidation efforts are to be divided between the federation and the regions remains unclear. Meanwhile, the €43 billion guarantee given by the Belgian government in the context of the Dexia Orderly Resolution Plan, whose role is at present limited to the custody of undervalued or illiquid assets (loans to local authorities and sovereign bonds) until maturity, remains a threat.

Low current account deficit

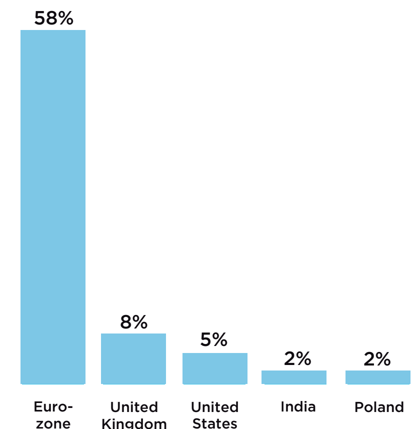
The trade deficit, which appeared in 2008, has declined greatly with the recovery of exports. However, the margin of growth is limited because the country has lost out in terms of price-competitiveness for over a decade. Wages have risen faster than productivity and are subject to high social security contributions. Market share in Europe has, accordingly, shrunk, while a surplus has arisen with the rest of the world, which currently absorbs a third of exports. Services will remain broadly in surplus thanks to revenues from transport and trade in goods. Because of its position at the heart of Europe and also as a gateway for the continent, Belgium plays a major role in the re-export of goods to or from its neighbours. Substantial investments held abroad by Belgian households and businesses generate significant financial revenues. Finally the current account balance is in surplus.

A government focused on fiscal consolidation

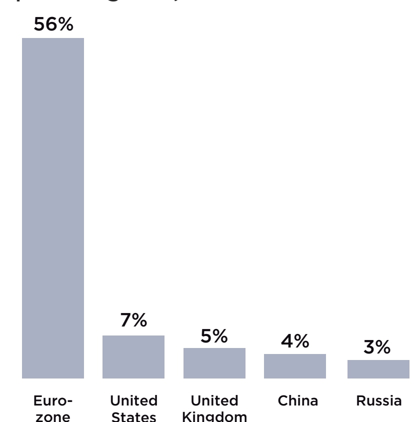
Federal and regional elections were held in May 2014. The Nieuw-Vlaamse Alliantie (N-VA), the conservative New-Flemish Alliance, became the largest party in Flanders and confirmed its lead at federal level. Its agenda includes, in particular, the abolition of the Brussels-Capital region and marginalisation of the federal state. Such radical reform seems unlikely given the reluctance of a majority of the population, even in Flanders. However, the 6th State Reform, which came into force in July 2014, transfers to the Communities and the Regions responsibility for family welfare payments, long-term care, management of the labour market, hospital infrastructure and housing benefits. This is on top of culture, education, energy and the environment. Apart from sovereign powers, the federal government retains control over most social expenditure, including pensions and health, or about half of public spending, as well as financial supervision, competition, the collection of the main taxes and income indexation. In October 2014, a centre-right coalition predominantly Dutch-speaking and composed of the N-VA, two other Dutch-speaking parties and the liberals from the French-speaking Mouvement Réformateur agreed on a programme focused on fiscal consolidation and formed a new government headed by Charles Michel, the leader of the MR reformist party. The Socialist Party, the strongest political party among French speakers, is in opposition. Conflicts have arisen in the heart of the government, with the Christian Democrats wanting to raise the very low capital gains tax rate in order to reduce the very high tax on labour. Nevertheless, the freezing of wage (both private and public) and social security payments indexation, until the cumulative increase in prices reaches 2%, with, however a negotiable wage-rise margin, possibly of up to 0.8% in 2016, is expected be approved.

TRADE EXCHANGES

Exports of goods, as a % of total



Imports of goods, as a % of total



Strengths

- Ideally located between the UK, Germany and France
- Presence of European institutions, international organisations and global groups
- The ports of Antwerp (second busiest in Europe) and Zeebrugge, canals and motorways give it good access
- Low level of household debt (56% of GDP)
- Well qualified workforce as a result of vocational training
- Positive net external asset position

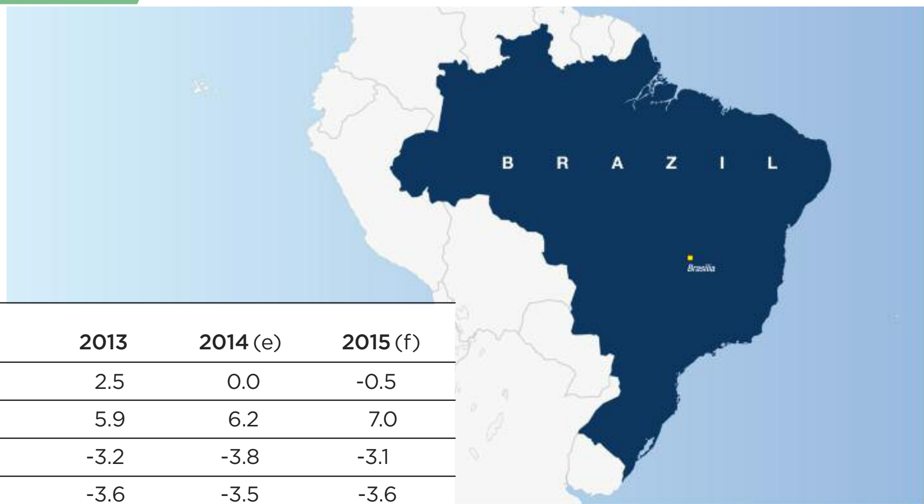
Weaknesses

- Political, social and financial tensions between Flanders and Wallonia
- Institutional uncertainty
- Exports concentrated on intermediate products and the European Union
- Loss of industrial competitiveness caused the disappearance of the current account surplus
- High prices of housing
- Weak demographics

BRAZIL

COFACE ASSESSMENTS

A4	Country risk
A4	Business climate
FAIRLY LOW RISK	Medium term



MAIN ECONOMIC INDICATORS	2012	2013	2014 (e)	2015 (f)
GDP growth (%)	1.0	2.5	0.0	-0.5
Inflation (yearly average) (%)	5.8	5.9	6.2	7.0
Budget balance (% GDP)	-2.7	-3.2	-3.8	-3.1
Current account balance (% GDP)	-2.4	-3.6	-3.5	-3.6
Public debt (% GDP)	68.1	66.2	65.8	65.6

(e): estimate (f): forecast

RISK ASSESSMENT

Recession expected in 2015

Brazil's growth was disappointing in 2014, hit by the decline in industrial activity and investment and by the slowdown in household consumption. The prospect of an upturn in activity in 2015 appears unlikely. The industrial sector is expected to continue to suffer from the lack of infrastructure and of skilled labour, resulting in a faster increase in costs to the detriment of productivity. On top of this there is a high risk of water shortage and possible electricity rationing because of the lack of rainfall, which prevents the reservoirs of the hydroelectric power stations from operating at full capacity. The economic slowdown in Argentina (this industry's main market) and the new import restrictions imposed by that country are expected to again affect the automobile industry. The construction sector and offshore oil activity also look set to suffer from the decline in domestic and foreign investment because of the corruption scandal surrounding the national giant, Petrobras. The agricultural sector, on the other hand, should benefit from an exceptional crop of oilseeds, cereals and legumes (including soya) in 2015, but production costs are expected to increase because of the severe drought affecting part of the country. Moreover, the agricultural raw materials prices are likely to remain low over the year. Although the depreciation of the real is good for exports, the parallel depreciation of several of the region's other currencies (those of Mexico, Colombia, Argentina) reduces the competitive advantage of Brazil's similar export products. Moreover, the high cost of credit, the driver of consumption, continues to affect the confidence of households, which are more reluctant to borrow. Finally, inflation is expected to increase more rapidly because of the realignment of prices and tariffs which were frozen in 2013 following country-wide demonstrations.
Administered prices, which represent 25% of the consumer price index, are expected to rise by about 10% in 2015.

A primary surplus objective more difficult to achieve

The government reshuffle in November 2014 aimed at restoring balanced public finances achieved its objective of reassuring the markets and preventing a likely downgrading of the country's sovereign rating. However, the government's aim of achieving a primary budget surplus of 1.2% of GDP in 2015 now seems more difficult to fulfil, because of a sharper than expected deterioration of the public finances in 2014, which show a primary deficit of 0.6% of GDP against an expected surplus of 0.1%. Budget cuts, such as the stopping of subsidies to the energy sector and the reform of unemployment benefits, are expected to continue. Moreover, the new Minister of Finance, Joaquim Levy, is preparing a new set of measures to enable additional savings of BRL 10bn (USD 3.6bn). These new measures are expected to include the development of corporate tax e-filing, the inclusion in the formal sector of 500,000 workers employed in the informal sector, and the reduction of spending on occupational health. Monetary policy will also be used to counter inflationary pressures. The central bank recently raised its key rate, the SELIC, from 0.5% to 12.25 %, its highest level since 2011.

Foreign trade losing momentum

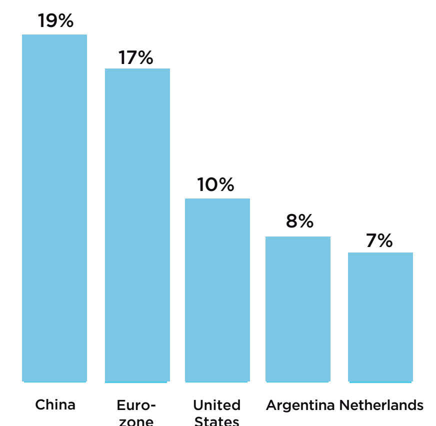
The current account deficit should remain fairly stable relative to the previous year. Despite renewed export competitiveness due to the exchange rate adjustment, import growth is still outstripping that of exports. The trade surplus, which has been falling since 2008, is expected to benefit from the drop in oil prices (the country imports more hydrocarbons than it exports) and from the rise in agricultural output, which should partly offset the fall in current prices. However, automobile shipments to Argentina fell 16% in 2014, a trend which is expected to continue. The Central Bank of Argentina has been further restricting imports since the beginning of the year and is expected to tighten its import policy still further because of the real's depreciation. Trade in services and revenues (tourism, dividends, interest) will remain in deficit. The current account deficit will be covered by foreign direct investment (about 2.6% of GDP, excluding re-investment) and by public debt.

Loss of confidence in Mrs Roussef's new administration

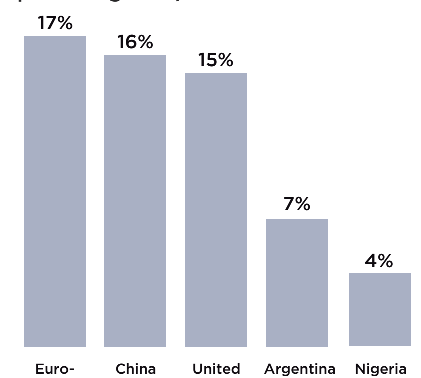
The aim of President Dilma Roussef (narrowly re-elected in October 2014) to put an end to four years of weak growth by attracting more investment seems unattainable in the short term. The handling of the corruption scandal at Petrobras and its subcontractors, particularly in construction, which involved funnelling funds to the main political parties and rewarding elected representatives, is contributing to investor mistrust. Despite the resignation of the entire Petrobras management team, the company's image and that of the government now seems in tatters. Moreover, the government is up against strong opposition in Congress and within its own coalition, whose members are dissatisfied with the fiscal adjustment measures adopted. Finally Dilma Rousseff's administration has lost popularity and credibility among the people.

TRADE EXCHANGES

Exports of goods, as a % of total



Imports of goods, as a % of total



Strengths

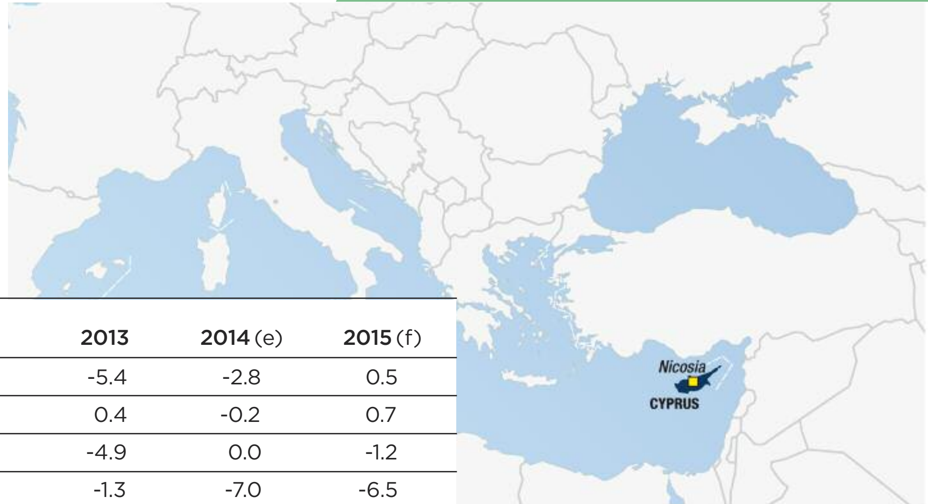
- 6th-largest economy worldwide
- Growing active population
- Varied and abundant mineral and agricultural resources
- Advanced manufacturing industry: aerospace, chemicals, pharmaceuticals and oil engineering
- Resistance to external shocks: creditor external position, considerable reserves
- Major macroeconomic balances maintained

Weaknesses

- Lack of qualified labour/incomplete educational system
- Shortcomings in infrastructure (transport, energy)
- Insufficient investment
- High production costs (wages, energy, logistics and credit)
- Public expenditure high and inefficient
- Corruption flourishing due to inequalities

COFACE ASSESSMENTS

C	Country risk
A3	Business climate



MAIN ECONOMIC INDICATORS	2012	2013	2014 (e)	2015 (f)
GDP growth (%)	-2.4	-5.4	-2.8	0.5
Inflation (yearly average) (%)	3.1	0.4	-0.2	0.7
Budget balance (% GDP)	-5.8	-4.9	0.0	-1.2
Current account balance (% GDP)	-5.5	-1.3	-7.0	-6.5
Public debt (% GDP)	80.0	102.0	105.0	113.0

(e): estimate (f): forecast

RISK ASSESSMENT

Economic contraction at an end

After shrinking for three years, the economy is expected to pick up in 2015. Economic confidence is rebuilding gradually. However the process of debt reduction (still 160% of GDP for households and 200% for companies) will continue. Households have been hit by falling property prices, with house prices down by 30% since the 2008 peak, a trend which could continue. Public sector wages, which, like those of the private sector, have already been cut, will remain frozen until 2016. Unemployment is affecting 16% of the economically active population (40% among the young). Public investment is constrained by fiscal consolidation. Construction of tourist facilities and offices has barely resumed. The decisive contribution to growth will once again come from foreign trade through tourism and non-financial services to businesses, whose competitiveness has increased thanks to the fall of the euro and lower wages. But this assumes that relations between the European Union and Russia will not get worse. Another depreciation of the rouble and a strong recession in Russia could further deter Russian tourists and businesses, which are major clients.

A huge and weak banking sector

After the country's accession to the EU (2004) and adoption of the euro (2008), the Cypriot banking sector expanded to seven times the size of its GDP. The downturn in the local property market at the end of 2008 and the collapse of the Greek economy at the beginning of 2010, in which it had made substantial investments, were fatal for the sector, triggering insolvency of its main players. The authorities, unable to rescue the sector on their own, given the sharp deterioration of the public and external accounts, under pressure from the European Commission, the ECB and the IMF (the Troika), which made this a condition of their €10 billion bailout package (60% of GDP), restructured the sector largely at the expense of creditors and depositors. Despite the liquidation of one of the leading banks, the sector still accounts for 315% of GDP, excluding foreign banks (160%). Non-performing loans account for 50% of the portfolio. Dealing with these is deemed a priority by the Troika, which is making continued aid conditional on the application of modernised legislation on foreclosures and bankruptcies. Dependence on non-resident deposits (40% of the total) and on liquidity from the central bank remains high. The last restrictions on movements of capital abroad can be lifted only when confidence returns.

Fiscal consolidation underway

Even though the deficit seems to have disappeared thanks to spending cuts representing 7.5% of GDP over 2013 and 2014, an additional squeeze amounting to 4% of GDP need to be made in order to reduce public debt. This continues to rise, is not sustainable in the medium term and does not include the State guarantees for bank loans (20% of GDP). For this purpose, the primary surplus, i.e. excluding interest on the debt, is expected to reach 4% of GDP in 2018, whereas it amounted to 2.8% in 2014.

The services surplus partially offsets the trade deficit

Even though it has fallen since 2008, when it stood at 32% of GDP, the trade deficit is nearly 20%. It is linked to the poor diversification of local manufacturing production and is 80% offset by the surplus from tourism and business services. While withdrawals of foreign deposits fell sharply with the adoption of exchange controls in 2013, they still represented 27% of GDP in 2014. They are compensated for by funds raised on the markets by the banks and the state, by international financial aid and the return of foreign investment in tourist and office property. The external debt is massive (440% of GDP), but a substantial portion relates to private sector commitments, notably non-resident bank deposits and loans taken out by foreign companies based on the island.

A minority government which is struggling to bring about the island's reunification

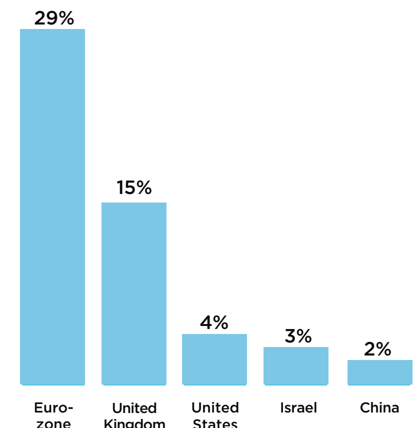
Nicos Anastasiades, elected President for 5 years in 2013, leads a minority government as his party, the Conservative Democratic Rally (Disy), no longer has a majority in parliament since the defection of the centralist Democratic Party (Diko). Diko defection was a way of demonstrating its disagreement with the Joint Declaration by Nicos Anastasiades and Derviş Eroğlu, the leaders respectively of the Greek Cypriot and Turkish communities, aimed at relaunching negotiations for the island's reunification, stalled since 2012. In opposition, the communist-leaning Progressive Party of Working People (Akel) has almost as many MPs as Disy. Reaching an agreement between the two communities would enable, in particular, the profitable exploitation of offshore gas and its export through a pipeline to Turkey. Moreover, the lack of a majority has forced the government to delay the entry into force of legislation on foreclosures, a condition imposed on the payment of the balance (a third) of the international aid.

Strengths

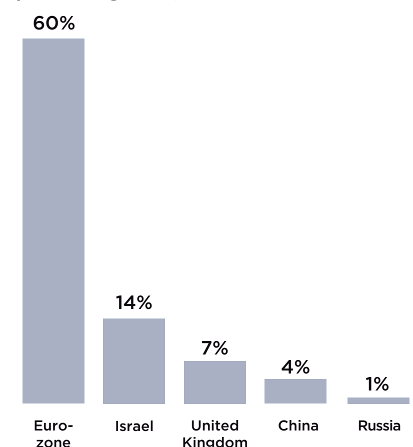
- At the cross roads of Europe, Africa and Asia: trade
- Tertiary sector: tourism, business services, marine shipping
- Skilled Anglophone labour force
- Good quality transport and telecommunications infrastructures

TRADE EXCHANGES

Exports of goods, as a % of total



Imports of goods, as a % of total



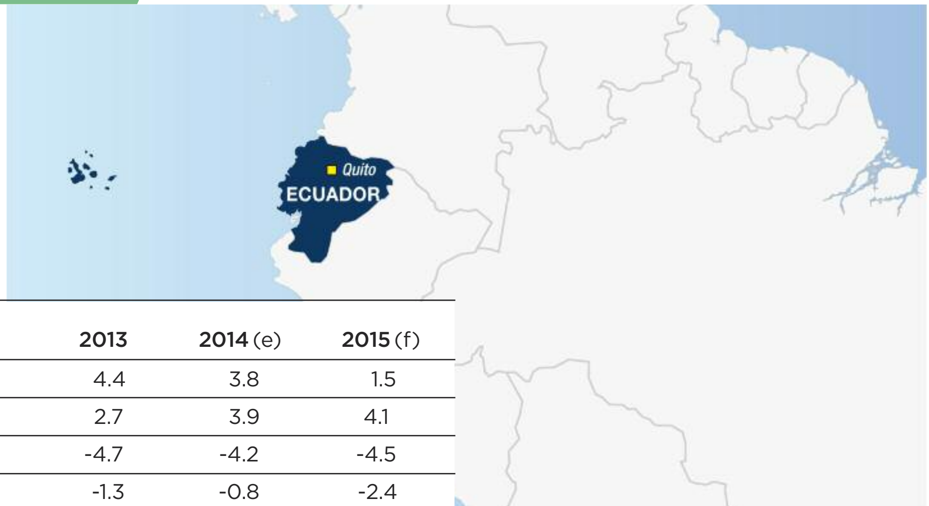
Weaknesses

- Division of the island (since 1974) and tense relations with Turkey
- Small domestic market, remote from the heart of Europe
- Poor economic diversification (tourism, construction, financial, accounting and legal services) and of the foreign clientele (British and Russian)
- Geopolitical instability in the region
- High public and external debts
- Huge banking sector, over-concentrated and burdened with non-performing loans

ECUADOR

COFACE ASSESSMENTS

B	Country risk
B	Business climate
HIGH RISK	Medium term



MAIN ECONOMIC INDICATORS	2012	2013	2014 (e)	2015 (f)
GDP growth (%)	5.1	4.4	3.8	1.5
Inflation (yearly average) (%)	4.1	2.7	3.9	4.1
Budget balance (% GDP)	-1.1	-4.7	-4.2	-4.5
Current account balance (% GDP)	-0.3	-1.3	-0.8	-2.4
Public debt (% GDP)	21.3	24.3	27.0	34.0

(e): estimate (f): forecast

RISK ASSESSMENT

Growth set to slow in 2015

The country's growth, mainly sustained by public spending, is expected to suffer from the fall in the oil price. Oil accounts for nearly 40% of public revenues and provides a good part of foreign exchange earnings. The government has already announced a 4% reduction in the state budget initially planned for 2015. The allocation of USD 330 million to the construction of the 4G network should go some way to reducing pressure on the state budget over the year. Domestic demand is expected to remain moderate because of budgetary stimulus, but Ecuadorians' external purchasing power will be greater because of the appreciation of the US dollar. Private investment will still be hit by the slowdown in credit supply, with the banks under numerous regulatory restrictions and prioritising the financing of the public sector. Chinese investment in the mining sector and renewable energy (hydroelectric power stations) made in partnership with the State is expected to slow a little because of budget cuts. The contribution of foreign trade will remain moderate. Although the recovery of the US economy is a positive sign for the country's exports (45% of exports are to the USA), the appreciation of the US dollar weakens the competitiveness of non-oil exports (bananas, prawns, cocoa, flowers) mainly to Europe.

Deteriorating public accounts because of the fall in oil revenues

The public deficit is expected to grow because of the fall in the price of oil, which represents 40% of public revenues. The country's 2015 budget, which was approved on the basis of the oil price at USD 79.7 a barrel, has been revised downwards (-4% in January 2015) because of the recent drop in prices. The government has, moreover, imposed new taxes and customs duties on imports since January with the aim of maintaining the country's liquidity in dollars (dollarised economy). The country expects it will need additional financing of about USD 7.2 billion over the year, of which USD 5.3 billion (at 2% over 30 years) has already been agreed by China. The country can also resort to the international markets as it did in 2014 (bond issue of USD 2 billion over ten years at 7.95%, its first since a selective default in December 2008), but at higher cost, given a possible increase in US interest rates. This is pushing up external public debt which is expected to exceed 34% of GDP in 2015, but will remain at a relatively low level. The debt is mainly held by China, whose loans are secured on the grant of mining concessions, oil revenues and future electricity production.

Increased current account deficit affected by the fall in the oil price and the appreciation of the dollar

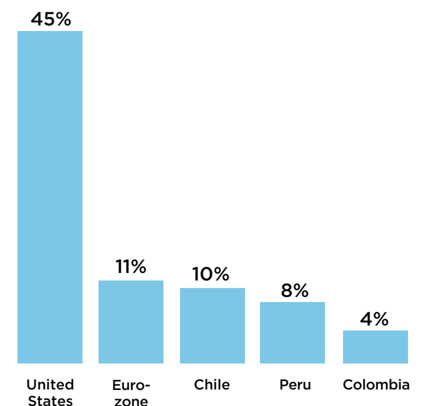
The current account deficit is expected to widen due to the deteriorating trade balance, affected by the fall in the price of oil products and the appreciation of the dollar. Exports of oil and its derivatives represent over half of the country's exports and 20% of its imports. Although increased oil production expected for 2016 is favourable to the balance of trade, the lasting drop in prices could limit earnings in the future. Non-oil exports, mainly to Europe, are expected to slow because of the appreciation of the dollar, which weakens the competitiveness of local products. Despite the rise in taxes and customs duties on imports, put in place at the beginning of this year, imports are growing faster than exports because of the weakness of the local manufacturing industry and the rise in household purchasing power resulting from the dollar's appreciation. The balance of services remains in deficit, with freight costs and oil services paid to foreign countries exceeding tourism income. The revenue balance is affected by significant capital outflows and falling FDIs are not enough to fund the current account deficit. The country thus has to borrow from multilateral organisations and China, which has now become the country's biggest lender.

Diplomatic frictions with neighbouring countries on concerning protectionism

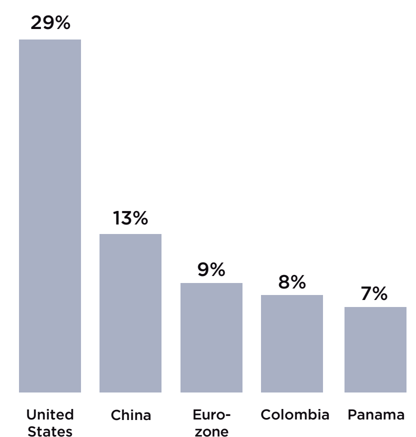
The over 50% drop in the price per barrel of oil together with the weakening of the Colombian peso and the Peruvian nuevo sol against the US dollar (Ecuador's currency) have led the government to impose new tariff protection measures against these countries. This decision has provoked a diplomatic row with Colombia and Peru, both of them members of the Andean Community of Nations (ACN), a free-trade association of which Ecuador is a member. This disagreement is expected to hit Ecuadorian value-added exports mainly intended for the ACN market. Moreover, the sudden departure of the Minister of Foreign Affairs, Rivadeneira, an advocate of trade deregulation, worries private sector businesses, concerned about the future return of a protectionist commercial policy. Finally, the government will continue to favour Sino-Ecuadorian relations, China having become the country's main investor and creditor.

TRADE EXCHANGES

Exports of goods, as a % of total



Imports of goods, as a % of total



Strengths

- Significant mining, oil and gas potential
- Imminent energy self-sufficiency thanks to hydro-electricity
- Tourism potential (flora, fauna, cultural heritage)
- Climatic diversity making various forms of agriculture possible
- Marine wealth: world's biggest exporter of shrimps
- Low public and external debt

Weaknesses

- Poorly diversified economy, dependent on oil
- Inadequate infrastructures (roads, dams) and lack of skilled labour
- Oil production stagnating
- History of sovereign default
- Weak domestic and foreign investment
- State interventionism
- Expensive and still poorly developed credit supply
- Opposition of indigenous populations and ecologists to the development of primary resources

GREECE

COFACE ASSESSMENTS

C	Country risk
A3	Business climate

MAIN ECONOMIC INDICATORS	2012	2013	2014 (e)	2015 (f)
GDP growth (%)	-6.6	-3.9	0.8	0.6
Inflation (yearly average) (%)	1.0	-0.9	-1.4	-1.0
Budget balance (% GDP)	-8.6	-12.2	-2.7	-1.0
Current account balance (% GDP)	-2.4	0.6	1.3	3.0
Public debt (% GDP)	156.9	174.9	174.0	170.0

(e): estimate (f): forecast
* incl. recapitalisation of the banking sector

RISK ASSESSMENT

A recovery held back by political instability

After shrinking by nearly 30% over the period 2008-2013, GDP began to recover slightly in 2014. The recovery recorded over the first nine months of the year was driven mainly by private consumption and exports, especially of services (tourism and shipping). However, growth stalled in the last quarter because of the political uncertainty. Syriza's coming to power in January 2015 and the new government's showdown with its international creditors could mean that the performance in the first half of this year could prove equally disappointing. The loss of consumer and business confidence is likely to lead to a drop in production and investment. Unemployment began to decrease at the end of 2013 but remains massive. Inflation remains negative, reflecting low capacity utilisation, falling unit labour costs, lower oil prices and increased competition in the retail, health and energy sectors. Nonetheless, activity should strengthen noticeably in the second half of 2015. The definitive normalisation of relations with international creditors and the resumption of lending should encourage more investment. Consumption is likely to benefit from low energy prices and higher household disposable income. The depreciation of the euro and gains in competitiveness should sustain exports.

The quality of banks' portfolios remains greatly impaired and political uncertainty has triggered capital flight

The banking sector emerged less weakened than expected from the ECB's October 2014 stress tests, the four systemic banks under review having largely repaired their capital shortfall during 2014. Interest income has increased and the cost-cutting measures are bearing fruit. This positive result is however overshadowed by the burden of non-performing loans, which represent on average more than 30% of their loan portfolio. This soaks up liquidity and capital, which cannot then contribute to financing the real economy. Credit to businesses and households remains at a low level (still negative year on year). Moreover, political uncertainty triggered substantial withdrawals from deposits between December 2014 and February 2015, the banks again being at risk at any time of finding themselves short of liquidity.

Progress made at fiscal level but hardly sustainable public debt

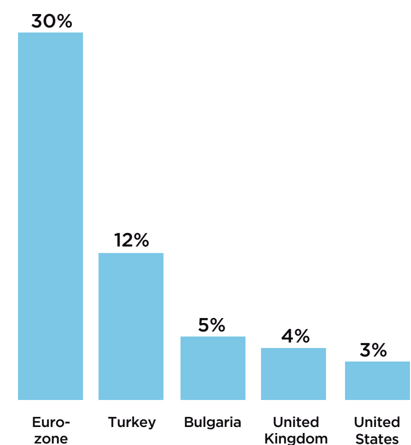
Greece benefited from two bailouts in 2010 and 2012 for a total of €240bn, the second including a haircut on Greek sovereign debt held by the private sector. The country made a return to the bond markets in April 2014. The political context and the concerns surrounding the exit from the European bailout plan, due to expire at the end of December 2014, drove up Greek interest rates from the end of September 2014. Initially, Brussels decided to extend Greece's rescue programme until the end of February 2015. Then, ten-year rates peaked, at the end of January 2015, on the day following the victory of the radical left whose programme envisioned going back on the current agreements and quickly renegotiating the public debt. After a laborious negotiation process the new government nevertheless decided to bow to the demands of Brussels (agreement of 20 February). It obtained an extension of the bailout until the end of June 2015 in exchange for a list of reforms (combatting tax fraud and corruption, implementing social measures the cost of which must, however, be neutral for the budget). It now remains for the international institutions to examine the government's proposals in detail. Once the reforms are on track, the country will be able to receive the last bailout tranche. Praiseworthy efforts have been made at the fiscal level up to now with Greece managing to achieve primary budget surpluses in 2013 and 2014. Public debt, however, is still too high, which could, someday, necessitate relief to be negotiated with the country's public creditors.

A precarious political situation

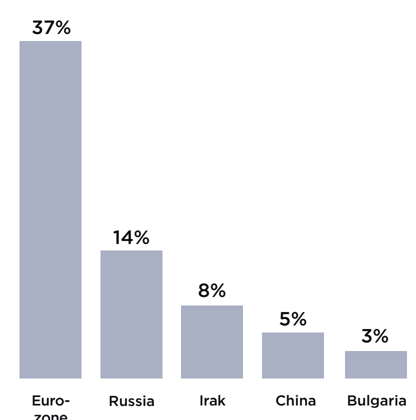
The authorities had promised to free themselves from international tutelage at the end of 2014. Weakened by the deadlocked negotiations with the Troika and the initial extension of the rescue plan, the authorities decided to bring forward the presidential elections to December 2014. The government coalition (conservative right and socialists) nevertheless took excessive risks. Its candidate failed to win the required majority in the parliament, which led to its dissolution and the organisation of early legislative elections (25 January 2015). The Greeks gave the victory to Syriza, the party of the radical left. It failed, however, to obtain an outright majority and chose to ally itself with the sovereignist right in order to govern. The political situation remains fragile. The coalition parties have little in common, apart from their rejection of Europe's austerity policy, and Syriza's left wing is unhappy about the agreement concluded with the Eurogroup.

TRADE EXCHANGES

Exports of goods, as a % of total



Imports of goods, as a % of total



Strengths

- Financial support from the international financial community
- World's leading shipowner
- Adjustment of public and external accounts
- Tourist attractiveness

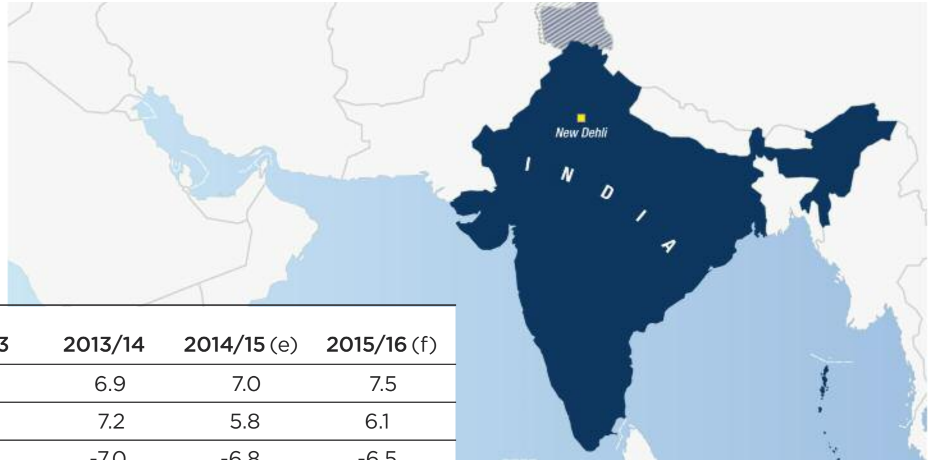
Weaknesses

- Public debt still very high
- Deteriorating quality of the banks' portfolios
- Weak public institutions, widespread tax evasion
- Limited industrial base, low technological content of exports (foodstuffs, chemical products, metals, refined oil)
- Social tensions fostered by fiscal austerity and massive unemployment

INDIA

COFACE ASSESSMENTS

A4	Country risk
B	Business climate
FAIRLY LOW RISK	Medium term



MAIN ECONOMIC INDICATORS	2012/13	2013/14	2014/15 (e)	2015/16 (f)
GDP growth (%)*	5.1	6.9	7.0	7.5
Inflation (yearly average) (%)	10.0	7.2	5.8	6.1
Budget balance (% GDP)**	-7.1	-7.0	-6.8	-6.5
Current account balance (% GDP)	-4.7	-1.7	-1.2	-0.3
Public debt (% GDP)**	66.2	65.3	64.9	63.1

(e): estimate (f): forecast
* Take into consideration changes in GDP calculation method introduced in February 2015
** Includes federal public debt and debt for local authorities. Fiscal year: April – March

RISK ASSESSMENT

The fall in the oil price is benefitting growth

The economic recovery should continue during the 2015/2016 financial year. The Indian economy will benefit from the fall in the oil price and from the first effects of the structural reforms undertaken by Narendra Modi. Since he came to power in May 2014, the Indian prime minister has initiated numerous measures aimed at promoting the Indian manufacturing sector, attracting foreign direct investment and easing the structural constraints affecting the Indian economy, such as the land acquisition law and the rigid labour laws. Meanwhile the budget for the 2015/2016 financial year includes the creation of a sovereign fund for financing important road, rail and electricity infrastructure projects. Nevertheless, the implementation of these projects remains dependent on the progress of land reform.
Moreover, the government has also announced the introduction of universal social security which will make it possible to sustain private consumption, the main growth driver.
The services sector will also continue to support activity, particularly the high tech branch. Meanwhile, inflation is now under control thanks, especially, to the fall in commodities prices, primarily oil and gold prices. Nevertheless, inflation will remain volatile, since this is correlated with the monsoon which directly affects the quality of the harvests. Inflation control allowed the central bank to lower its key rate in January and March 2015 and new rate cuts are expected in the course of the year. Monetary policy easing is likely to support both private consumption and investment, which also benefits from the fall in the oil price.

External accounts under control but public finances remain weak

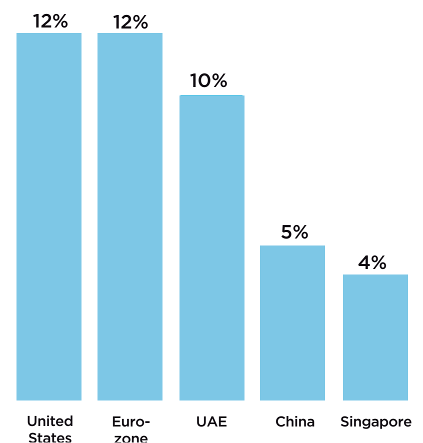
Despite the intention to balance the public accounts, the fiscal deficit and the public debt remain substantial. Nevertheless, the infrastructure spending planned by the Modi government is not expected to be funded by debt but by the sale of licences and the privatisation of state-owned enterprises. Moreover, the reform of subsidies, particularly those on oil, will make it possible to reduce spending, and the adoption of VAT at the federal level is due in 2015 for implementation in 2016.
As for the external accounts, the current account deficit is expected to remain under control despite the lifting of restrictions on gold imports because the fall in gold and oil prices will enable the value of imports to be controlled, while exports will benefit from the recovery of the advanced economies.
Despite expectations of a tighter US Federal Reserve monetary policy, the rupee should remain stable in 2015, the current account deficit being limited and the foreign exchange reserves at comfortable levels (nearly 6 months of imports in 2015). Moreover, direct FDIs and portfolio investments are on a rising trend.
Finally, the public banks, which account for three quarters of bank assets and are burdened with the funding of the non-profitable sectors, are showing a deterioration in the quality of their assets.

Despite his popularity, Prime Minister Modi's reforms will be difficult to implement

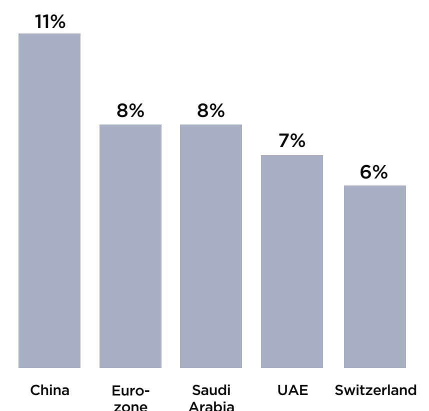
Following the May 2014 elections which resulted in a big victory for the BJP (Bharatiya Janata Party), Narendra Modi was named prime minister and his party holds an absolute majority in the Lok Sabha (lower house of Parliament). The holding of elections in several big states confirmed the BJP's popularity. However, the BJP experienced its first electoral reverse in a regional poll in Delhi in February 2015 and the Congress Party will continue to dominate the upper house at least until the end of 2015, which could delay the structural reforms promised during the campaign and awaited by the business community, which reacted very positively to Mr Modi's election.
Even though Mr Modi's record while he was Chief Minister is blemished by the violence of 2002, in which thousands of Muslims died, India's partners, notably the United States, greeted his election favourably. After receiving Mr Modi in September 2014, Barack Obama visited India in January 2015. However, relations with Pakistan remain tense. Despite the Pakistani Prime Minister's presence at Mr Modi's investiture, India suspended its talks with Pakistan after the meeting between the Pakistani High Commissioner in New Delhi and the Kashmiri separatist leaders. However, a resumption of dialogue was initiated in March 2015 thanks to the meeting in Islamabad of the senior foreign affairs representatives.
Finally, despite the expected reforms, the business climate will continue to suffer from persistent shortcomings.

TRADE EXCHANGES

Exports of goods, as a % of total



Imports of goods, as a % of total



Strengths

- Diversified growth drivers
- Sound fundamentals: high level of savings and investments
- Effective private sector in services
- Moderate external debt and satisfactory foreign exchange reserves

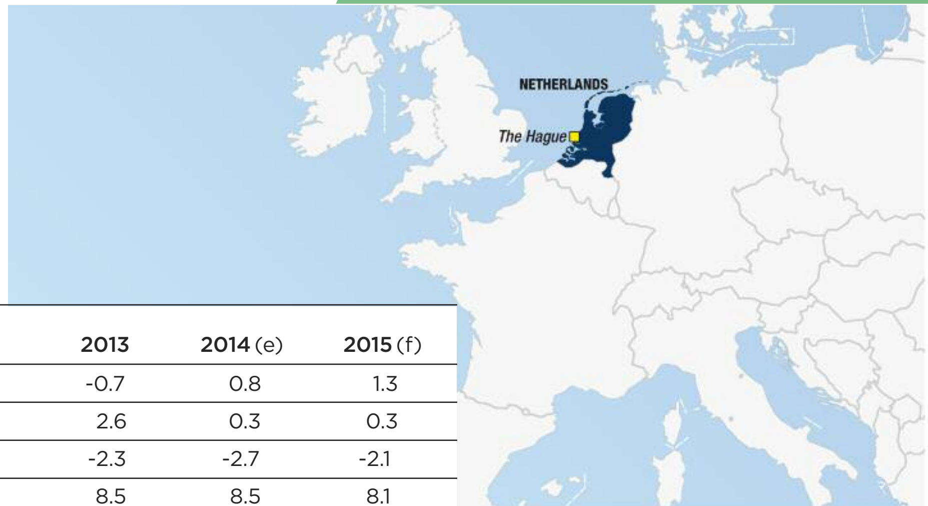
Weaknesses

- Lack of infrastructure and shortcomings in the education system
- Cumbersome bureaucracy and persistent political deadlocks
- Net importer of energy resources
- Rising debt of private companies
- Weak public finances
- Persistent uncertainties over the Kashmir issue

NETHERLANDS

COFACE ASSESSMENTS

A2	Country risk
A1	Business climate



MAIN ECONOMIC INDICATORS	2012	2013	2014 (e)	2015 (f)
GDP growth (%)	-1.6	-0.7	0.8	1.3
Inflation (yearly average) (%)	2.8	2.6	0.3	0.3
Budget balance (% GDP)	-4.0	-2.3	-2.7	-2.1
Current account balance (% GDP)	8.8	8.5	8.5	8.1
Public debt (% GDP)	66.5	68.6	69.3	70.3

(e): estimate (f): forecast

RISK ASSESSMENT

Domestic demand is expected to drive growth more strongly in 2015

After a slight drop associated with weather conditions at the start of 2014, growth subsequently took off again. All the components of growth, excluding public consumption, have developed positively by the end of the year. Overall, activity was chiefly driven last year by exports and investment. Given the economy's high degree of openness, growth will continue to be guided, in 2015, in part by the development of external demand, in particular that from the Eurozone. But domestic drivers of growth are likely to significantly increase their contribution this year, even though the rise in consumption could be dampened by household deleveraging. Consumption is, nonetheless, expected to benefit from the improved labour market, the recovery of the property market, rising wages and continued low inflation. At the start of 2015, consumer and industrial confidence was stabilising but became positive in the construction sector for the first time since 2008.

Public deficits remain contained and inflationary pressures are weak

After dipping below the 3% threshold in 2013, then climbing slightly in 2014, due, in particular, to a one-off increase in the contribution to the Community budget, the fiscal deficit looks set to shrink from this year thanks to better control of pension and health spending. New reforms in this area could, however, be more difficult politically to implement in future. The public debt ratio is expected to remain virtually stable, at around 70% of GDP, and below the Eurozone average. Meanwhile, inflation is set to remain weak thanks to the recent drop in the prices of energy and imported goods, even though the impact of this drop will dissipate over the course of the year.

Exports are expected to continue benefiting from the moderate recovery in advanced economies

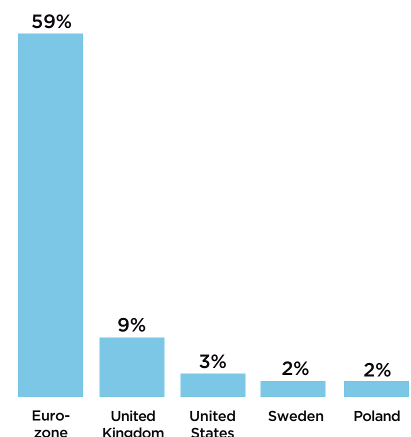
The Dutch economy is commercially very open and the country is among the world's top ten exporters, mainly supplying refined oil, natural gas, automobiles, electrical equipment and IT equipment. Half of these sales are re-exports, with the country acting as a hub for European trade. It is expected to benefit from renewed growth in the advanced economies, even if the pace of the recovery will remain moderate in the Eurozone, which absorbs almost 60% of goods exports (of which 25% for Germany alone), and even if the Russian-imposed embargo on foodstuffs continues to hit sales to Russia.

Improving situation for banks and businesses

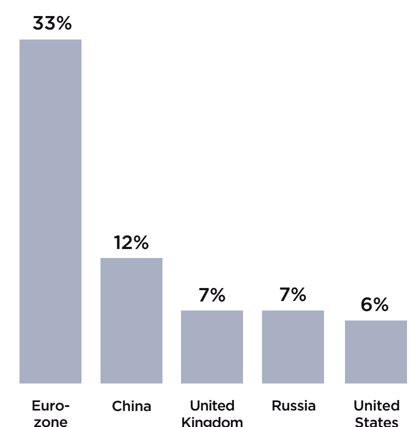
Hit by the 2007-08 financial crisis, the deterioration of the local property market and the decline in activity, the banks had to cut back on lending and resort to State aid in the form of capital injections, nationalisations and the granting of guarantees. The concentration of the banking market has increased and banks have refocused on the domestic market. The conditions for accessing liquidity have returned to normal and the sector's solvency has improved. However, the quality of banking portfolios has worsened slightly. The default rate of households, whose debt levels - mainly resulting from mortgage loans - are very high (245% of their gross disposable income at the end of 2013), is nonetheless still contained, due in particular to significant financial savings. Meanwhile, after falling 20% from their August 2008 record levels, property prices have been edging upwards since April 2014. The financial situation of businesses is improving gradually after a difficult period. Accordingly, bankruptcies, which peaked in 2013, significantly affecting the construction and retail sectors, started to decline from the third quarter of 2013. They were down 21% in 2014 year on year and continued on a downward trend as we went into 2015.

TRADE EXCHANGES

Exports of goods, as a % of total



Imports of goods, as a % of total



Strengths

- Port activity (Rotterdam, leading European port)
- Good competitiveness indicators
- Diversified exports and external accounts in surplus
- High quality infrastructures

Weaknesses

- Economy dependent on European economic cycle
- Convalescent banking sector
- Substantial household mortgage debt
- Ageing population, high cost of healthcare

NIGERIA

COFACE ASSESSMENTS

Rating	Assessment
C	Country risk
D	Business climate
FAIRLY HIGH RISK	Medium term

MAIN ECONOMIC INDICATORS	2012	2013	2014 (e)	2015 (f)
GDP growth (%)	4.3	5.4	6.5	5.0
Inflation (yearly average) (%)	12.2	8.5	8.3	8.8
Budget balance (% GDP)	0.4	-2.3	-2.5	-2.8
Current account balance (% GDP)	4.4	3.9	2.0	1.2
Public debt (% GDP)	10.4	10.4	10.6	11.1

(e): estimate (f): forecast

RISK ASSESSMENT

Non-oil sector not dynamic enough to avoid a slowdown in growth

The economy of Nigeria, Africa's leading country in GDP terms, ahead of South Africa, is dominated by services (more than 50% of GDP). The non-oil sectors (construction, telecoms) will continue to drive Nigerian growth in 2015. Manufacturing industry (cement) will benefit from the realisation of infrastructure projects, but hydrocarbon production is still affected by thefts and sabotage of the installations. The continued relatively low price per barrel will limit the contribution of net exports to growth.
Private consumption, the driver of growth, will be less dynamic than expected because of lower public spending. Moreover, inflationary tensions will be sustained by the higher import costs resulting from the naira's depreciation. Furthermore, the high level of interest rates will restrict credit and therefore domestic demand.
Because of its strong exposure to the oil sector (about a quarter of all loans), the banking sector could be affected by a deterioration in the quality of its portfolio, resulting from the fall in crude oil prices. Its already weak profitability could worsen further.

A widening fiscal deficit and a dwindling current account surplus

The public finances are expected to deteriorate in 2015. Spending cuts announced in February 2015, following the budget revision based on an oil price of $65/bl (previously $78/bl), are not expected to prevent a rise (though modest) in welfare spending and wages, in the context of the presidential elections. Oil sector income (70% of the total) will be constrained by weak price and output growth.
The measures to broaden the tax base and improve tax collection, the increase of certain taxes and the reduction of fuel subsidies should help mitigate the worsening of the deficit. But the government's room for manoeuvre is much reduced, with reserve funds now representing only 1% of GDP (against 5% in 2011). Public debt, nevertheless, remains low.
The current account surplus is expected to decline in 2015. Oil exports (90% of the total) will be hampered by structural problems (theft, lack of investment) and on-going weak world demand. The fall in price will reduce export revenues but will also lower the energy bill, imports of oil products accounting for nearly a third of Nigeria's imports due to the lack of refining capacity. Dividend repatriation by international companies also impacts on the current account balance while net foreign direct investment inflows are slowing: some oil companies are selling their assets and the successive delays in the adoption of the Petroleum Bill, as well as political uncertainties, are not conducive to foreign investment.

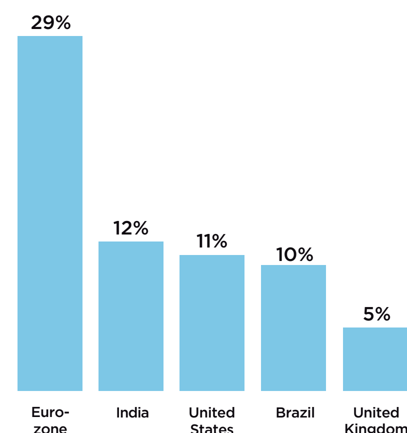
After the devaluation of the naira, decided at the end of November 2014, pressures on the Nigerian currency are expected to persist in 2015 or even increase, especially if the security and political situation deteriorates.

Worsening security situation and risk of heightened tensions in the run up to the elections

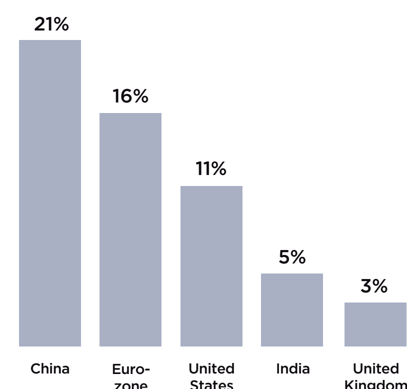
The still tense political situation in the Niger Delta oil-producing region has significantly deteriorated, especially in the north with the intensification of attacks by the radical Islamist movement, Boko Haram. The presidential elections, initially planned for February 2015, have been postponed to 28 March in view, officially, of the persistent instability in this part of the country. President Goodluck Jonathan, nominated, after intense negotiations, as his party's candidate (People's Democratic Party) is seeking a second term. But the main opposition party (APC) has become considerably stronger thanks to mounting popular discontent with the current government's difficulties in dealing with the country's security and economic problems. The victory of the PDP candidate, who has won every election since 1999, is considerably less certain this time. The risk of tensions fuelled by massive unemployment, poverty and regional inequalities is increasing, leading to fears of social instability as the elections approach. The country suffers from ineffective administration and increasing corruption, as shown by Nigeria's fall on the World Bank's Governance Indicator rankings regarding the Control of Corruption (191st in 2013 against 179th in 2010).

TRADE EXCHANGES

Exports of goods, as a % of total



Imports of goods, as a % of total



Strengths

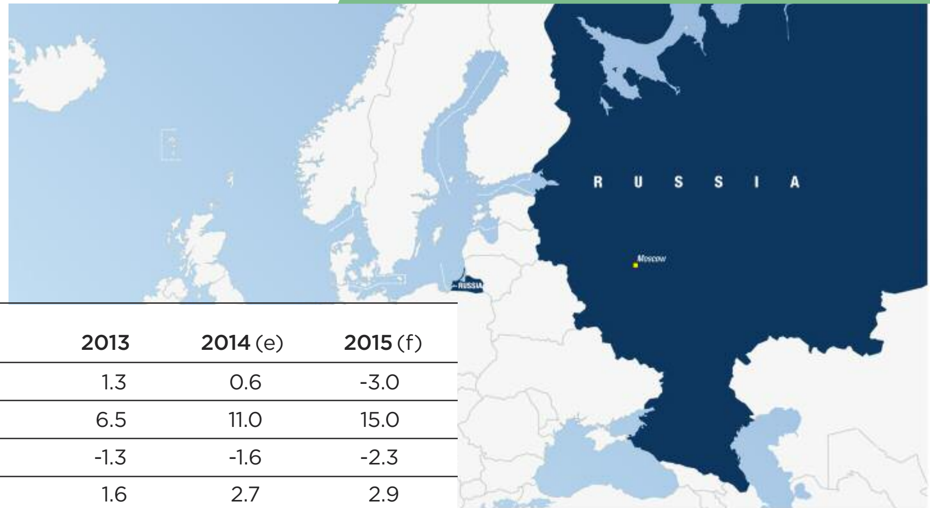
- The leading African power in terms of GDP and the country with the largest population in Africa (162 million)
- Significant hydrocarbon resources and large agricultural potential
- Low level of foreign debt

Weaknesses

- Highly dependent on oil revenues (90% of exports and 80% of tax revenue)
- Very reduced refining capacity, requiring costly imports
- Ethnic and religious tensions
- A negative impact on the business climate from insecurity and corruption

COFACE ASSESSMENTS

C	Country risk
C	Business climate
FAIRLY LOW RISK	Medium term



MAIN ECONOMIC INDICATORS	2012	2013	2014 (e)	2015 (f)
GDP growth (%)	3.4	1.3	0.6	-3.0
Inflation (yearly average) (%)	5.1	6.5	11.0	15.0
Budget balance (% GDP)	0.4	-1.3	-1.6	-2.3
Current account balance (% GDP)	3.3	1.6	2.7	2.9
Public debt (% GDP)	11.8	10.8	11.6	12.7

(e): estimate (f): forecast

RISK ASSESSMENT

Economy to shrink in 2015

The slowdown in growth observed since 2013 will sharpen in 2015. Private consumption, the main driver of activity, will be hit by faster inflation and growing household debt. Investment will be hampered by the lack of business confidence, but also by restrictions on foreign currency financing imposed under western sanctions. Meanwhile, the high level of interest rates, despite a cut by the central bank (CBR) from 17% to 15% in January and to 14% in March 2015, will squeeze the availability of credit.

Inflation is expected to accelerate sharply in 2015. Price increases for imported goods triggered by the depreciation of the rouble as well as the consequences of the embargo on certain agrifood products thus pushed prices up by 15% in January 2015.

The banking sector's solvency and liquidity risk has increased significantly as a result of the worsening quality of the portfolio in a context not only of an economic crisis, but also the high cost of financing associated with the international sanctions which stop the major banks from accessing the financial markets. The rouble's depreciation is, moreover, increasing the value of their dollar-denominated debt.

Worsening fiscal balance but improved current account balance

The budget deficit will widen in 2015, while remaining moderate. The weakening oil price will reduce income from the hydrocarbons sector (50% of the total) and the downturn in activity will limit non-oil income. Controls on spending to limit the deterioration of the public finances and government debt are likely to make themselves felt in the form of slower increases in wages and pensions. However, the defence budget is expected to rise. Meanwhile, an aid programme for certain sectors has been announced aimed at supporting import substitution production. Russia's public finances are, however, still sound. The State has reserves, which, though falling remain comfortable (6 months of imports) and, notably, a reserve fund and a sovereign fund totalling $165 billion (more than 10% of GDP).

The current account surplus is expected to increase in 2015. Exports, largely dominated by oil and gas (2/3 of income) will be constrained by unfavourable price movements. A moderate recovery in external demand and weak competitiveness of Russian products which the rouble's depreciation is not enough to boost, will limit non-oil exports. But the decline in imports will be more marked than that of exports, considering the sharp slowdown in domestic demand as well as the impact of the sanctions and the embargo (food products represent 13 to 14% of the total).

The ruble's exchange rate fell by almost 45% in 2014, chiefly because of the sanctions and the falling oil price. The introduction of a free float ruble policy in late 2014 will sharpen exchange rate volatility in 2015. The defiance shown towards the country's economic and political developments is encouraging capital flight (more than $150 billion in 2014). High levels of capital flight and downward pressure on the ruble exchange rate will continue in the context of ongoing low oil prices and uncertainties over the situation in Ukraine. Given the impact of the depreciation on inflation and the maturity profile of the external debt of banks and businesses (more than $100 billion due in 2015), the authorities may have to introduce foreign exchange controls. Company and/or bank default risk cannot, moreover, be ruled out.

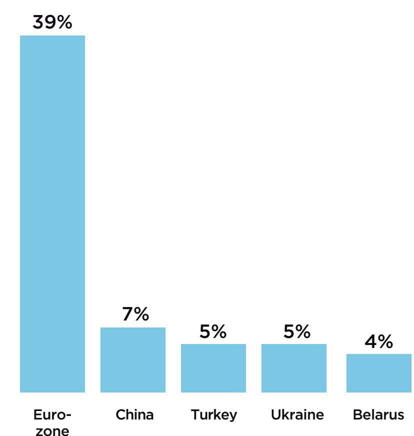
A fragile political and social situation and shortcomings in the business environment

Vladimir Putin's popularity nationally increased with the Russian intervention in Crimea in March 2014. There is however, discontent within the population, as shown by the demonstrations in September 2014 demanding a halt to the military operations in Ukraine, or in December opposing the health sector reforms. The social situation could get even worse in a context of a slowing economy, rising inflation and also a hardening of the regime as reflected in tighter state control of the media and the internet which considerably limits the ability of opposition movements to organise and express themselves.

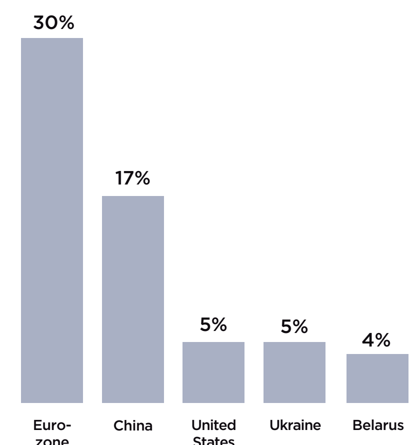
Shortcomings relating to the protection of property rights, weak governance and lack of corporate transparency significantly weaken the business environment. Russia is therefore ranked 176th according to the World Bank governance indicators on the control of corruption, which is still a recurring weakness.

TRADE EXCHANGES

Exports of goods, as a % of total



Imports of goods, as a % of total



Strengths

- Abundant natural resources (oil, gas and metals)
- Skilled labour force
- Low public debt and comfortable foreign exchange reserves
- Assertion of regional and energy power

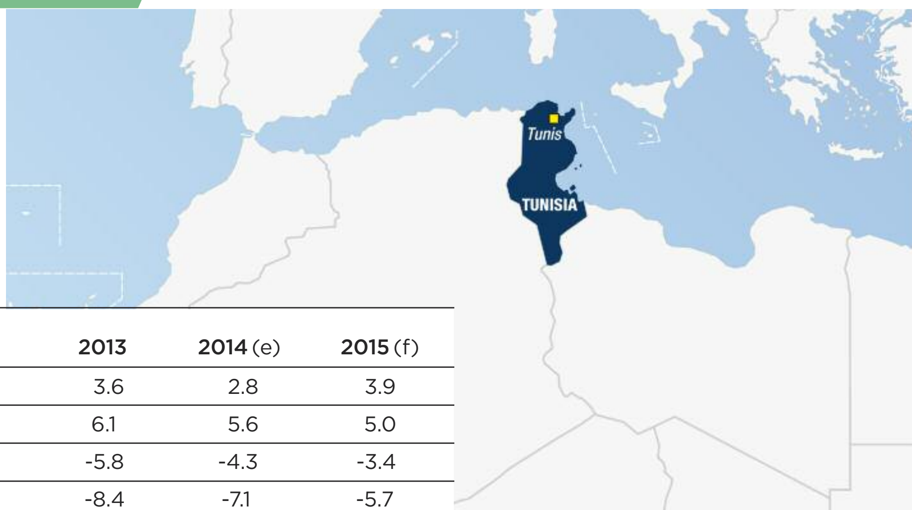
Weaknesses

- Increased rentier nature of the economy
- Lack of competitiveness of the industrial sector
- Weak private banking sector
- Weak infrastructures
- Declining demography
- Persistent deficiencies in the business climate

TUNISIA

COFACE ASSESSMENTS

B	Country risk
B	Business climate
MODERATE RISK	Medium term



MAIN ECONOMIC INDICATORS	2012	2013	2014 (e)	2015 (f)
GDP growth (%)	3.7	3.6	2.8	3.9
Inflation (yearly average) (%)	5.5	6.1	5.6	5.0
Budget balance (% GDP)	-5.1	-5.8	-4.3	-3.4
Current account balance (% GDP)	-8.2	-8.4	-7.1	-5.7
Public debt (% GDP)	44.5	44.8	50.4	54.0

(e): estimate (f): forecast

RISK ASSESSMENT

Pursuing the political transition

At the end of 2014, the Nida Tounis coalition led by a former Bourguiba minister, Béji Caïd Essebsi won the parliamentary and presidential elections ahead of the Islamic party, Ennahda. These elections held a year after the vote on the new Tunisian Constitution resulted in the establishment of the new Tunisian semi-parliamentary system. The country would now seem to have entered a phase of increased political stability that will make it possible to revitalise the economy in the longer term.

The new government will however have to deal with a considerable number of social and economic challenges, as well as the expectations of its people. The key issues remain job creation and a fairer social and geographic distribution of growth given that the interior of the country continues to be disadvantaged relative to the coastal regions.

Tunisia also remains exposed to terrorist threat inside its borders. The presence of jihadist movements in isolated areas and over-representation of the Tunisian community in Libya's jihadi groups remain a risk for internal security as showed by the attack of March 18, 2015 in a Tunis museum. Moreover, porosity of the Libyan frontier reinforces the threat of an overspill of the Libyan conflict in Tunisia. This and the large-scale influx of Libyan refugees across the border could have an impact on economic activity.

Weak economic expansion expected for 2015

Growth in the Tunisian economy should increase slightly in 2015. The activity will continue to be supported by market sales sector and telecommunication, but also by a more dynamic expansion of agricultural and olive oil production. However, the slowdown noted in the extractive sectors as a result of social tensions could continue into 2015 and limit any economic recovery. Consumption and investment are expected to increase by 5%. The expansion should also be sustained by a small rise in exports, but this will clearly depend on the scale of the weak recovery within the Eurozone, which is the leading export destination.

Small decrease in large twin deficits, financed by international financial aid

With the cuts in current expenditure and subsidies, the budget deficit could shrink slightly in 2015. Public debt is gradually rising, but it remains partly domestic with the rest granted subject to concessionary conditions.

Its external accounts are going to remain under pressure but the current account deficit should contract somewhat in 2015. The fall in oil prices combined with the start of production at a number of oilfields discovered in 2013 should help reduce the energy deficit.

The slight increase in exports should also help to offset the expected acceleration in imports resulting from the high level of internal demand.

Its external debt ratios are going to improve somewhat in 2015. Tunisia has had a stand-by arrangement with the international Monetary Fund since 2013. This two-year SBA worth $1.75 bn has helped to prevent the worsening of the sovereign debt risk for the country with a program for reforms to the public finances. The budget deficit has as a result been gradually reduced.

Concerns for banking sector and the business climate

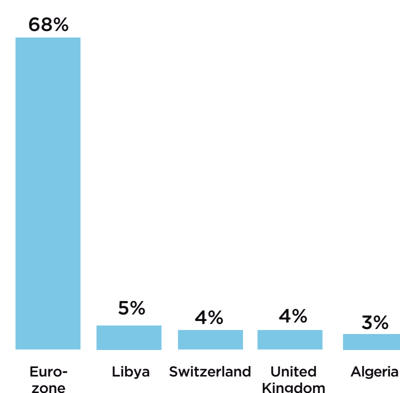
Solvency, the quality of assets and profitability in the banking sector, has worsened. With the support of the IMF, the country has implemented a series of actions aimed at dealing with the vulnerabilities of its banking sector. These have included, among others, a restructuring of the system with a recapitalisation of certain State-owned banks.

As a result of the collapse of the old regime and the ensuing political and economic instability, the business climate remains problematic. The law on insolvency and a revision of the code covering investments in 2014 should help improve this. However, the business climate remains marked by a lack of competitiveness, bureaucracy and enduring corruption and insecurity.

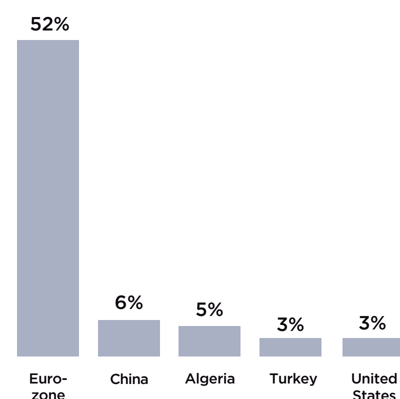
Coface has also noted an increase in payment incidents and a lengthening in the debt collection process.

TRADE EXCHANGES

Exports of goods, as a % of total



Imports of goods, as a % of total



Strengths

- Natural resources (gas, phosphates), agricultural, tourism
- Diversification of the economy underway and reasonably skilled labour
- Proximity to the European market and Association Agreement with the EU

Weaknesses

- Social and geographic inequalities
- High youth, unemployment
- Economic importance of agriculture
- Tourist sector facing political-security issues and increasing competition

RESERVATION

This document is a summary reflecting the opinions and views of participants as interpreted and noted by Coface on the date it was written and based on available information. It may be modified at any time. The information, analyses and opinions contained in the document have been compiled on the basis of our understanding and interpretation of the discussions. However Coface does not, under any circumstances, guarantee the accuracy, completeness or reality of the data contained in it. The information, analyses and opinions are provided for information purposes and are only a supplement to information the reader may find elsewhere. Coface has no results-based obligation, but an obligation of means and assumes no responsibility for any losses incurred by the reader arising from use of the information, analyses and opinions contained in the document. This document and the analyses and opinions expressed in it are the sole property of Coface. The reader is permitted to view or reproduce them for internal use only, subject to clearly stating Coface's name and not altering or modifying the data. Any use, extraction, reproduction for public or commercial use is prohibited without Coface's prior agreement.Please refer to the legal notice on Coface's site.

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