THE COFACE ECONOMIC PUBLICATION

panorama

Autumn

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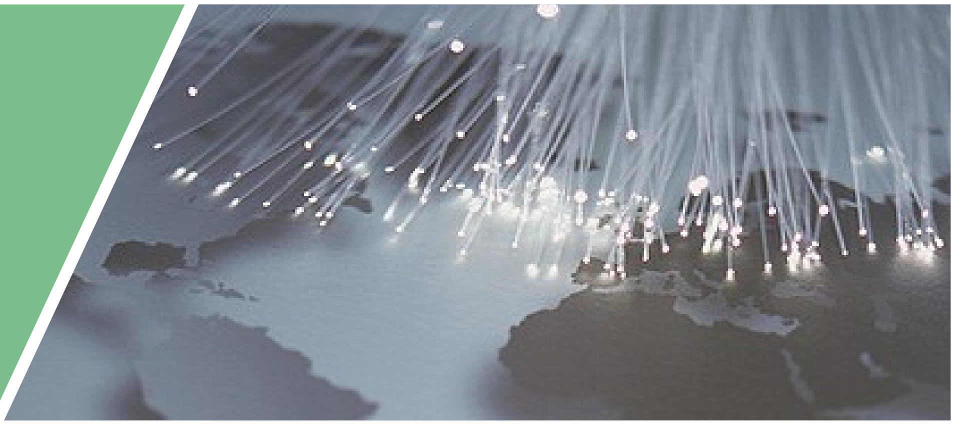
Country Risk



CONTENTS

This panorama contains a study on household consumption in Asia. In the face of the 2008-2009 global crisis, followed by the sovereign debt crisis in the eurozone in 2011, Asian household consumption has been a source of relative resilience for the region's economies. Some of their activity sectors have actually suffered very little. Many analysts place great hopes in this positive trend in Asian consumption, to the point where they can forget the unique aspects of consumer behaviour in the countries of the region, and especially the growing risks associated with household debt. In this study we pose several questions. How big is the rise in household consumption in this region? Have Asian households taken on too much debt? What are the specific consumer behaviour patterns in Asia? Which sectors are benefitting most from this expansion of consumption?

We also present, in this panorama, the latest adjustments to our country assessment (which measure the risk of company payment defaults in a given country) and an update to the country studies being currently under the spotlight, like India, Brazil, Kenya or Germany.

Should we stake everything on the Asian consumer?

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Completed on September 30, 2103

To a large extent Asian economies have been very resilient in the face of the double whammy of the 2008-2009 global crisis and that of eurozone sovereign debt since 2011. There are various rationales behind this. The significant fall in government debt has given these countries more flexibility to respond to these external shocks, as has the accumulation of foreign exchange reserves made possible by their current account surpluses. But, besides this structural improvement of their fundamentals, this resilience also comes from the growth of household consumption in the region. Since the Asian crisis of 1997-98, private consumption in Asia has been rising. While this trend is positive, it carries risks, particularly that of excessive household debt in certain of the region's countries.

Meanwhile, the rise in consumption is today reflected in the emergence of a middle class whose economic, social and political importance is increasing. It is this emergence of a middle class which was, for example, behind the protest movements in India in late 2012 after an attack on a female student, the anti-corruption demonstrations in the summer of 2013 in the Philippines, or the recurrent discontent of part of the Chinese population in the face of high property prices. Analysing the characteristics of this expansion in consumption is essential for understanding these recent events.

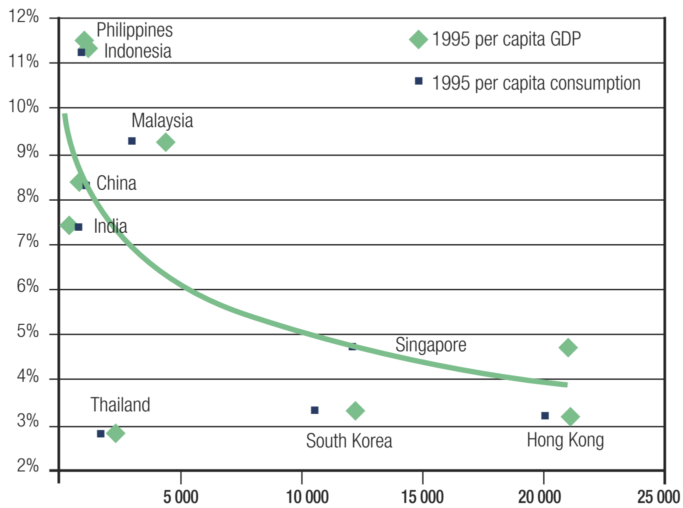
We first examine this structural expansion of household consumption in Asia over the last fifteen years, as well as the reasons for it. We then underline the risk related to the household debt burden in some countries of the region, before analysing the specific characteristics of consumer behaviour in Asia. Finally, we focus more precisely on three sectors which benefit particularly from the upsurge of Asian private consumption: tourism, the automotive industry and high-end consumer goods.

1/ ASIAN HOUSEHOLD CONSUMPTION DRIVEN BY GROWTH AND GOVERNMENT POLICY

Consumption growing strongly

Private consumption has been growing strongly in Asia since the mid 1990s. This phenomenon affects all the main countries in the region (1). Between 1995 and 2012 the average annual growth rate (AAGR) of consumption was 7.4% in India and 8.4% in China. The strength of this trend depends largely on the countries' level of development *(see chart 1)* – consumption growth is greatest in those that are less developed. Still referring to the period between 1995 and 2012, the AAGR was always in excess of 11% in the Philippines and in Indonesia *(see chart 2)*. By contrast, in Thailand, where per capita consumption levels in 1995 were about two times lower than in Indonesia and the Philippines growth was much less marked.

CHART 1
Per capita consumption and GDP growth

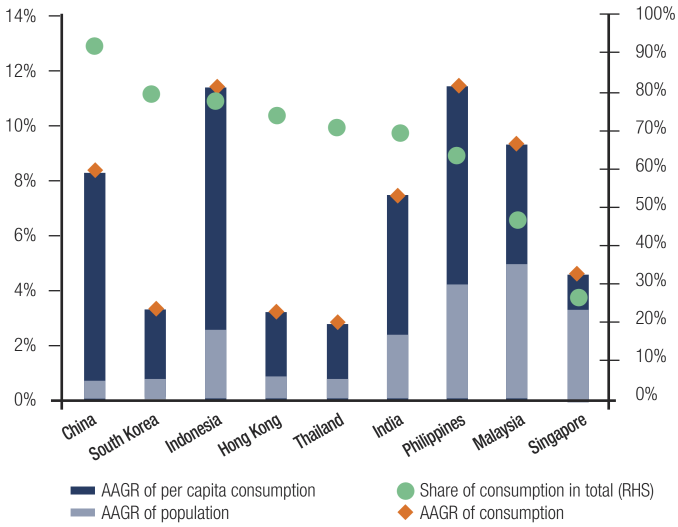


Sources: Datastream, Coface

(1) China, South Korea, Hong Kong, India, Indonesia, Malaysia, Singapore, Thailand

The scale of this expansion must, however, be adjusted for population growth. As shown in chart 2, over a third of the rise in consumption is due to population growth the Philippines or Malaysia. The proportion is lower in the other countries of the region (excluding Singapore). In other words, soaring consumption is in large measure due to an increase in per capita consumption in Asia, which contributes to at least two thirds of total consumption.

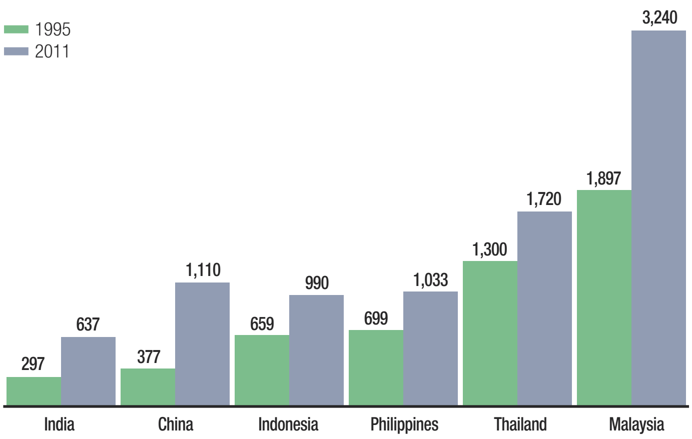
CHART 2
Average annual growth rate of household consumption (1995-2012)



Sources: Datastream, Coface

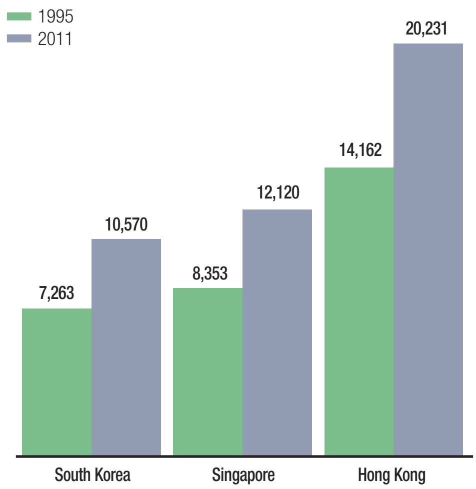
This per capita increase in consumption is particularly marked in China, where it has almost tripled (+194%) since 1995, so that it now exceeds that of the Philippines and Indonesia *(see charts 3.1 and 3.2)*. India is a case in point of how the less developed countries caught up during this period: per capita consumption more than doubled (114%). Growth in the other countries is more modest: +45% approximately in Korea, Hong Kong and Singapore. While per capita consumption in Hong Kong was 38 times that of China in 1995, it is «only» 18 times as much today.

CHART 3.1
Per capita consumption (in USD)



Source: World Bank

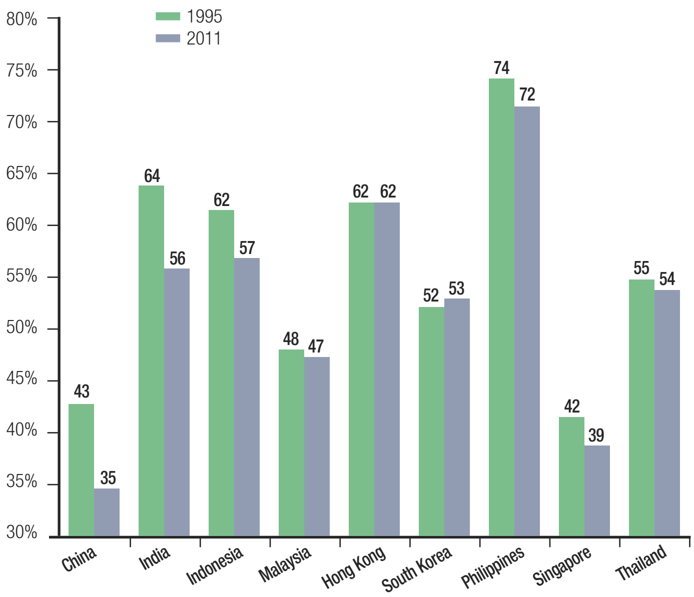
CHART 3.2
Per capita consumption (in USD)



Source: World Bank

Despite this upward trend, the share of private consumption in GDP has fallen *(see chart 6 page 6)*. The apparent paradox is explained by the level of development of the countries in question. Besides Korea, Singapore and Hong Kong, these are countries, whose economic catching up process requires high levels of investment. In other words, investment is rising more rapidly than consumption. Once this process of industrialisation and urbanisation is completed, the share of private consumption in GDP increases. In 2011 private consumption represented 62% of GDP in the eurozone and 71% in the United States. Apart from the Philippines (notably because of transfers from expatriate workers representing 9% of GDP in 2102), few emerging countries in the region are today approaching these levels.

CHART 4
Consumption as a % of GDP in Asia



Sources: Datastream, Coface

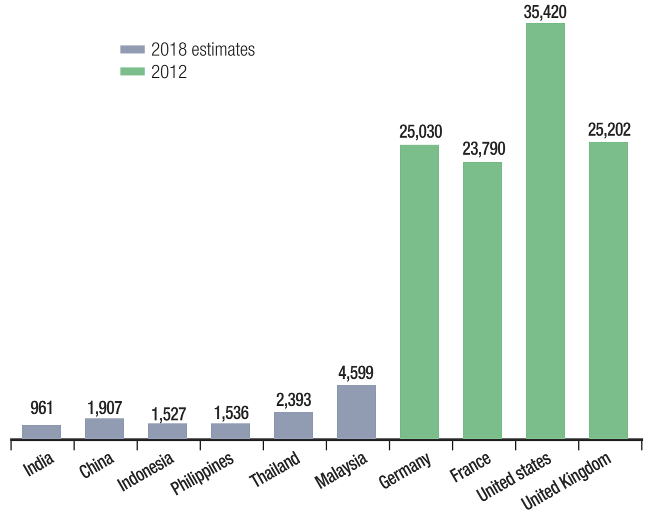
Consumption set to continue growing in the medium term...

Taking as a hypothesis Coface's GDP growth forecasts for 2013 and 2014 and those of the IMF for the following years, we anticipate that per capita consumption will increase appreciably in the countries of the region by 2018. But the levels reached will be far short of those observed in the advanced economies *(see chart 5)*. In 2018, per capita consumption in China will be 19 times below that of the United State in 2012 (37 for India, 23 for Indonesia and the Philippines, 15 for Thailand and 8 for Malaysia). This far from complete catching up therefore makes the case for a longer-term continuation of the trend and for a significant increase in the size of the middle class in these countries.

...and foster the rise of the middle classes

Soaring consumption is actually explained by the expansion of the middle class. Among the definitions of this class *(see box)* we adopt that of households having access to durable property (car, house, business), with a daily income of between 10 and 100 dollars.

CHART 5
Per capita consumption in Asia in 2018



Source: World Bank, Coface forecasts

The middle class in China [4], which today represents 150 million people, could reach 500 million by 2020 and 1 billion (or 70% of the population) in 2030 [5]. It accounts for 50 million individuals in India (5% of the total population) and doubtless will encompass 200 million in 2020 and 475 million in 2030. In Indonesia, the size of the middle class will have almost doubled by 2020, rising from 74 million to 141 million. The proportion of the middle class in the population is expected to grow from 12% to 22% in Thailand over the same period and from 9% to 22% in the Philippines. In total, the middle class in the Pacific region, which comprised 525 million persons in 2009, is expected to reach 1.7 billion in 2020 and 3.2 billion in 2030 according to the UNDP [6].

HOW TO DEFINE THE MIDDLE CLASS

The middle class is a relatively vague concept, which can be summarised as «those having enough income to lead a comfortable life» [2]. To define it more precisely, objective and subjective criteria must be used.

■ **Objective criteria:** absolute terms. According to the World Bank, middle class households are those with an annual income of more than 1036 dollars. For their part, Banerjee & Duflo (2008) think that a person belongs to the middle class if daily consumption is between 5 and 10 dollars. The United Nations Development Programme (UNDP) for its part considers that it is those who have access to durable property (car, house, business); this means households with a daily income of between 10 and 100 dollars. With regard to relative terms, Easterly (2000) and Birdsall, Graham and Pettinato (2000) define the middle class as the population whose income is between 0.75 and 1.25 times the country's median income and whose consumption falls between the 20th and the 80th percentiles. Ravallion (2009) chooses a mixed approach in defining a middle class in developing countries (whose income is between the median poverty threshold of developing countries and that of the United States) and that of western countries (income above the United States poverty threshold).

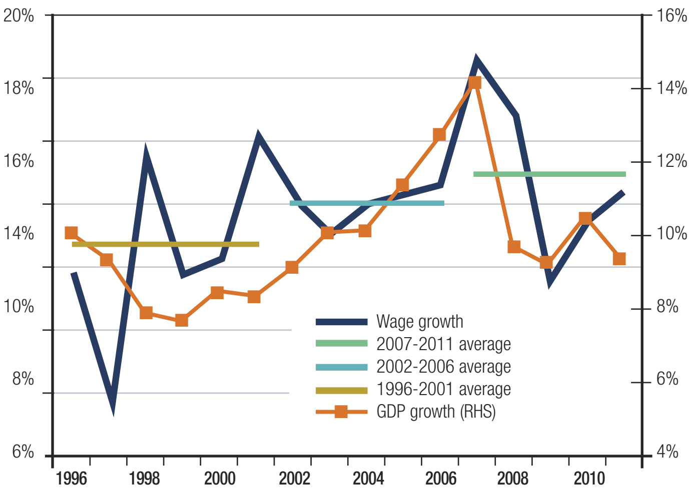
■ **Subjective criteria:** Over and above income, there are also psychological and sociological criteria for defining the middle class. While the per capita GDP of Indonesians is six times less than that of South Koreans, 81% of the Indonesian population consider themselves as belonging to the middle class, while this ratio is 74% among South Koreans. Similarly, the per capita GDP of India is close to that of Vietnam but 52% of Indians say they belong to the middle class against only 14% in Vietnam [3]. Finally, some consider membership of the middle class in terms of socio-professional and educational criteria.

(2) Homi Kharas and Geoffrey Gertz, "The New Global Middle Class: A Cross-Over from West to East," In "China's Emerging Middle Class: Beyond Economic Transformation", Chapter 2, Washington, DC: Brookings Institution Press, 2010
(3) "The rise of Asia's middle class", Silk Road Associates, May 2013.
(4) Source: Ernst &Young, which uses the UNDP's definition of the middle class.
(5) This estimate varies according to growth forecasts and will also depend on the policies adopted
(6) United Nations Development Programme

Soaring consumption explained by economic development and demographic changes

This expansion in consumption is primarily linked to rising household incomes, which result from the steady growth of GDP: businesses' sales and earnings growth has enabled them to increase wages over the last fifteen years in Asia. The chart below illustrates this rising trend in wage growth in the case of China.

CHART 6
China's wage growth (yoy in %)



Source: NBS

The underlying fall in inflation has also helped to increase household purchasing power: average annual inflation declined from 15.1% to 4.4% between 1994 and 2012 in emerging Asia [7]. This fall results chiefly from the more effective economic policies adopted since the 1997-98 crisis and more particularly from monetary policies specifically targeting inflation.

Demographic changes also help to explain the continual increase in household spending. The demographic ageing observed in the region's countries partly explains the rise in household consumption. According to the life cycle theory, the economically inactive (i.e. people under 15 and over 65) have lower saving rates than the economically active part of the population. Ageing therefore coincides with a rise in household consumption in that it results in an increase in the proportion of the inactive in the total population. Numerous studies empirically confirm this theory, among them that of the Asian Development Bank: [8] the old-age dependency ratio [9] in a country is positively correlated with the share of private consumption in GDP, even if this has less of an effect in Asian countries than in the other emerging countries. A one-point increase in this dependency ratio is thus associated with a rise of 0.2 points in the share of private consumption in GDP.

Urbanisation also has a positive effect on household consumption. For example, the proportion of the population living in an urban area has increased steadily over the last ten years in China, to reach nearly 53% in 2012. Urban households are on average richer than rural ones. According to the official data, the average income of an urban resident was 3.1 times higher than that of a rural inhabitant in 2011 [10]. Apart from this income gap, living in an urban area gives better access to consumer goods and services. Whereas 97% of Chinese urban households have a refrigerator, the ratio is only 45% in rural areas. The gap is even more marked for computers (71% of urban households but only 10% of rural ones) [11]. This urbanisation trend is confirmed in the other countries of the region: in India for example, the urbanisation rate rose from 28 to 32% between 2001 and 2011.
In this context, the Chinese authorities have announced that they want to achieve an urbanisation rate of 60% by 2020 in order to accelerate the rise in household consumption and accordingly rebalance Chinese growth. This example illustrates, moreover, the commitment of the region's governments to promoting private consumption.

Public policies to accelerate the process

Despite this endogenous process of household income growth resulting from the economic development of Asian countries, particularly since 2010, some of them have adopted policies of supporting household consumption, in order to accelerate the improvement the standard of living of their populations. Once again, China is the most significant example: in 2011 and 2012, minimum wages rose on average by over 20% a year.

Such public policies have been adopted in other countries in the region, such as Malaysia and Thailand in recent years. For example, in Thailand [12], raising the minimum wage by over 35%, after the Great Flood in late 2011, benefited about 30% of private sector wages. Together with the subsidy programme for rice producers, this policy aims to increase the population's purchasing power. In Malaysia, a minimum salary was introduced for the first time on 1st January 2013. Other measures to increase social transfers and subsidies were adopted in 2011 and 2012. In total, 20 Asian countries adopted or increased their minimum wage between early 2012 and mid 2013 [13]. These different measures have of course had a positive effect on average wages: in Thailand, the rise in the minimum wage explains the 21% leap in the average wage in 2012 (against 4.4% on average between 2007 and 2011). The effect of introducing a minimum wage in Malaysia is expected to be similar this year, in that about 30% of the workforce is expected to benefit.

These policies in support of household consumption meet two possible objectives, which it is worth distinguishing. The first is to rebalance growth in the medium term to make it less dependent on exports and business investment. The second objective is to support the economy in the short term in case of economic shocks (recession in the developed economies and floods in Thailand) or because of coming elections (as in Malaysia in 2013).

Besides these measures, the expansion of consumption has also been made possible by easier access to bank loans. Increased risk linked to excessive household debt in some of the region's countries has now emerged due to this growth in credit.

(7) Source: IMF
(8) Estrada G., Park D. and Ramayandi A. (2011) : "Population Aging and Aggregate Consumption in Developing Asia", working document 282, October.
(9) Relationship between the number of persons aged 65 or over and those aged from 20 to 64.
(10) Source: Chinese national statistics bureau
(11) Source: Chinese national statistics bureau
(12) A rise in the standard minimum wage to 300 bahts a day corresponds to an increase of 35% to 58% depending on the province. It was first applied in 7 provinces in April 2012, then in the rest of the country in January 2013.
(13) Source: United Nations.

2/ RISING HOUSEHOLD DEBT IN ASIA

Though the underlying expansion of household consumption in Asian countries primarily points to their economic development, which enables them to have higher incomes, it also results from better access to credit. In the first place, this access facilitates the purchase of durable consumer goods, thanks to finance obtained through borrowing. It also favours investment in property. Finally, the resulting rise in house prices engenders positive wealth effects on household consumption [14]. But, though this rise in bank lending to households is beneficial to growth, it can also lead to greater macroeconomic risks, particularly when accompanied by excessive household debt.

Excessive debt puts pressure on household spending

The subprime crisis in the United States and its consequences for the world economy illustrate this risk. For example, the 2009 recession in the United Kingdom and Spain is in large measure explained by high household debt levels and the associated property bubble. A too high household debt level can actually affect economic activity in various ways. Above a certain threshold, households become aware that the prolonged rise in their debt increases the cost of servicing it, which limits both their purchasing power and their ability to invest in property. This leads to a fall in consumption, as well as in property prices, which amplifies the reduction in household consumption. Households become vulnerable to a downturn in the property market: while rising property prices impact positively on household consumption, falling prices curtail it. Standard studies aimed at measuring the extent of these wealth effects have been conducted by Case and Shiller [15] and show that the 35% collapse in property prices between 2005 and 2009 in the United States is associated with a 3.5% decline in household consumption (or a carry-over effect of about 10%). The existing literature confirms the existence of such a wealth effect in the case of Asian countries. According to a study by Peltonen et al. (2009) [16] using data from 8 Asian economies from 2000 to 2008 [17], a 10% rise (or fall) in property corresponds to an average rise (or fall) of 0.4% in household consumption (or a carry-over effect of 4%, i.e. lower than in the United States).

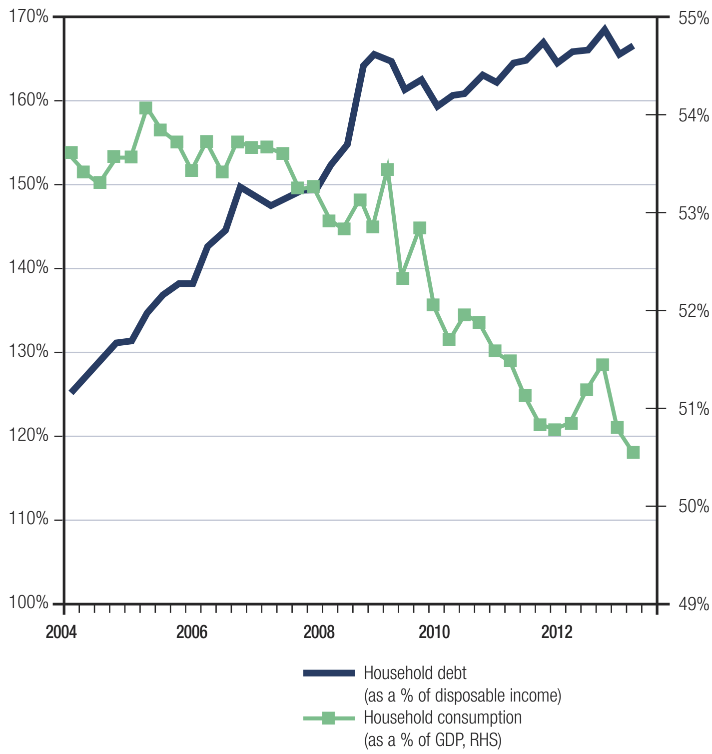
Moreover, if household debt levels are too high, the Central Bank loses its independence to make decisions on monetary policy, if tightening this could increase the household debt burden and lead to payment defaults by some households. The example of South Korea confirms this: despite the marked rise in inflation and strong growth in 2010-2011, the Bank of Korea did not raise its key rate for fear of making the most indebted households even more vulnerable (some of the debt often being at variable rates).

Korea, Malaysia, Thailand and Singapore are most at risk

Korea is a textbook case with regard to the risk linked to excessive household debt in emerging countries: the already high level of debt surged from 125% to 166% of disposable income between 2003 and 2012. It should not be forgotten that household debt in the United States was around 130% in 2008, i.e. the peak reached before American households started to clear their debts. And, as in the United States, the corollary of such high household debt is a low savings rate: 2.7% in 2011 (against about 20% on average in the mid 1990s). Besides the level of Korean household debt, its structure is also a risk factor: the proportion of variable rate mortgages reached 55% in 2012, against only 10% in the United States in 2009.

Currently, therefore, the risk of a prolonged decline in household consumption as a result of over-indebtedness seems relatively high in Korea. The following chart confirms this: the fall in household consumption relative to GDP began when the growth of household debt accelerated and exceeded 160% in 2008. Though this has not increased much since, consumption is continuing to decline, with high borrowing rates limiting consumer spending.

CHART 7
Household debt in Korea



Sources: Datastream, Coface

(14) The wealth effect measure the positive effect on household consumption resulting from renewed optimism linked to an increase in the value of their property and/or financial wealth.

(15) Case K., Quigley J. and Shiller R. (2012): "Wealth Effects Revisited 1975-2012", working document of the Cowle Foundation No 1884, December.

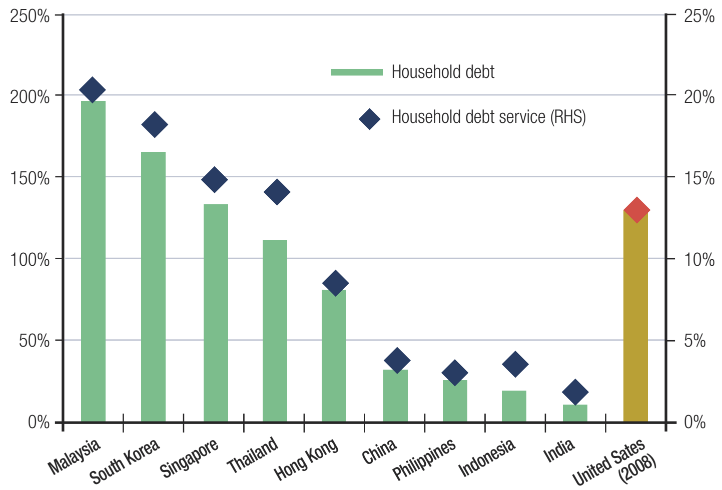
(16) Peltonen T., Sousa R. and Vansteenkiste I. (2009): "Wealth Effects in Emerging Market Economies", working document of the European Central Bank No 1000, January.

(17) China, Hong Kong, Korea, Indonesia, Malaysia, Singapore, Taiwan and Thailand.

Apart from the textbook case of Korea, other countries are exposed to the risk of an adjustment of their consumption associated with excessive consumer debt. With regard to this indicator of the ratio of household debt to disposable income, Malaysia seems particularly at risk (196% in late 2012). Next come Singapore and Thailand (respectively 134% and 112%). In Singapore, the number of people taking out at least two property loans shot up by 78% between 2008 and 2012 [18]. At the other end of the scale, Chinese, Indian, Indonesian and Philippino households have relatively little debt (under 35%).

As a result of these high debt levels, the cost borrowing is considerable. This is likely to affect household consumption and therefore the economy. Though no official data are available, we estimate [19] the household debt service represented on average about 20% of income in Malaysia in 2012, 18% in Korea, 15% in Singapore and 14% in Thailand. In these four countries, this ratio is higher than in the United States in 2008 (close to 14%), before household deleveraging began (about 10% in 2012) [20]. Moreover, it increased in all these countries between 2011 and 2012 (except in Korea). Conversely, the average debt interest burden on household incomes remains low in China, India, Indonesia and the Philippines (below 4% in 2012), since their debt levels are relatively low.

CHART 8
Household debt in Asia (as a % of disposable income)



Sources: central banks, World Bank, Coface

Of course these figures are national averages. The most vulnerable households have higher debt burdens, though again few data are available to confirm this. For example 5 to 10% of households devote over 60% of their monthly income to repaying their loan(s) in Singapore, according to the local central bank. If interest rates were to rise by 3 percentage points, 10% to 15% of households would then be particularly at risk. In Korea, the poorest households are also the most exposed to the risk of over-indebtedness: the household debt of the least wealthy 20% of households reached 184% of their disposable income in 2012, or 18 points above the national average [21].

These risks associated with household over- indebtedness are likely to impact negatively on growth in the medium term. This adjustment may be gradual, as illustrated in the example of Korea: above a certain level, the debt affects household spending by raising the proportion of the budget devoted to repaying it (see chart 7). But this impact can also be very sudden and result in a marked recession, as illustrated by the examples of the United States and Spain in 2009.

Apart from greater internal vulnerabilities, such excessive debt can also give rise to external imbalances. A sharp and prolonged increase in credit to the private sector actually results in a deterioration of the current account balance by stimulating domestic demand and therefore imports. In this context the marked deterioration of the current account balance in Indonesia (in deficit in 2012 for the first time since 1997), in Malaysia and Thailand (surplus down respectively by 9 and 7 percentage points relative to GDP between 2009 and 2012) is due in part to the private sector credit boom. Moreover, these worsening current account balances render these countries more vulnerable to volatile external funding and therefore to the risk of capital outflows and a sharp medium term exchange rate depreciation. The marked depreciation of a good number of emerging country currencies in summer 2013 is a case in point.

To sum up, the macroeconomic risks associated with excessive household debt can be aggravated if the country in question suffers from external imbalances (shown by a worsening current account deficit) and/or a vulnerable banking system. The table below summarises our assessment of the relevant risks. The upshot is that, countries where risk linked to household debt is high do not suffer to any great extent from external or banking vulnerabilities. Despite the appreciable fall in the current account balances of Korea and Singapore, in part linked to dynamic domestic credit, these remain well in surplus. Only the Thailand's current account balance is now nearly in equilibrium. In other words, the risk of an exchange crisis in the medium term linked to this excessive household debt remains relatively low. Conversely, in countries with the most marked external vulnerabilities (India and, to a lesser degree, Indonesia), households generally have little household debt.

TABLE 1
Risk assessments related to household debt

	Household debt	Current account	Banking sector
China	Low risk	Medium risk	Medium risk
South Korea	High risk	Low risk	Low risk
Hong Kong	Medium risk	Low risk	Low risk
India	Low risk	High risk	Medium risk
Indonesia	Low risk	High risk	Low risk
Malaysia	High risk	Low risk	Low risk
Philippines	Low risk	Medium risk	Low risk
Singapore	High risk	Low risk	Low risk
Thailand	High risk	Medium risk	Low risk

Low risk   Medium risk   High risk

Source: Coface

(18) Source: Singapore Credit Bureau
(19) Sources: World Bank, central banks and the authors' calculations. We have used the World Bank's data concerning average bank lending rates to the private sector and assumed that the average maturity of loans to households was 18 years in all the countries in the region.
(20) Source: US Federal Reserve.
(21) Source: Bank of Korea

The only remedies: Higher interest rates and stricter prudential rules

At present, this upward trend in household debt, as well as the proportion of income households devote to repaying it have not yet resulted in a significant rise in doubtful debts (at least in the countries for which such figures are available). The proportion of non-performing loans to households was less than 1% in Korea in January 2013 (0.8% a year earlier) and in the Philippines, this ratio is falling (7% at the end of 2012, against 9.3% in late 2009). Nevertheless, to deal with the risk which excessive debt places on the activity of local banks, in February 2013 the Korean government announced the creation of a rescue fund allowing the banks to sell some of these bad loans (at, however, a significant discount on their value).

But, to avoid having to set up more such rescue funds likely to weaken the banking sector, the local authorities have no other choice but to take preventive measures, i.e. more restrictive monetary policies and/or stricter prudential rules. The Malaysian central bank decided, for example, last July to limit the maximum maturities of mortgage loans to 35 years (against 45 previously) and those of consumer loans to 10 years. This measure supplements those adopted in 2010 (such as the minimum contribution required for the purchase of a 3rd residence) and 2011 (restrictions on the issue of credit cards), whose impact on the expansion of household debt has proved disappointing. Similar measures were taken in Thailand and Singapore and also in countries without excessive household debt. Thus, since January 2013, there have been restrictions on the issue of credit cards in Indonesia [22]. To a certain extent, the introduction of property taxes in China in 2011 is based on the same argument.

This growing household debt in the countries referred to above stems from the specific savings behaviour patterns in the countries of the region.

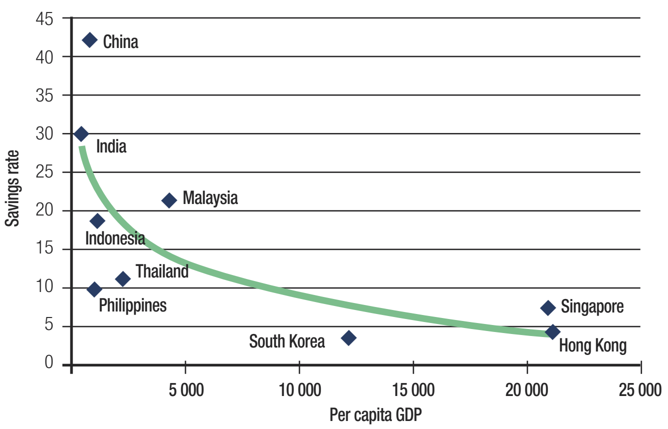
3 / MORE INDIVIDUALISTIC CONSUMPTION

Big disparities in savings behaviour in Asia

The trade-off between saving and consumption depends on economic factors and also on psychological ones. For classic authors on this topic the propensity to save would vary in line with interest rates. High interest rates would encourage a person to reduce his/her present consumption in order to increase his/her income [23], whereas Keynesians [24] consider that savings levels depend income levels. For them, savings would be what is left over, namely what is left after what has been spent by the household. According to this theory, saving increases when household income increases. The saving rate would therefore also depend on the level of development. The more advanced the country (the higher its per capita GDP) the bigger should be the saving. However, the Keynesian view of saving is not what we see in emerging Asia. The level of development is therefore not the only factor explaining the level of saving.

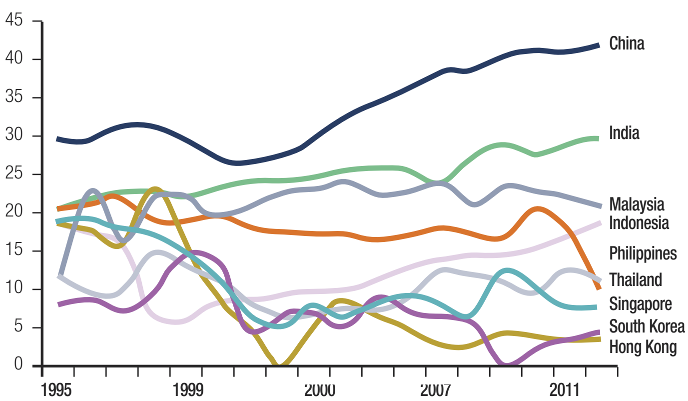
In China, India and Indonesia we observe an underlying upward trend in the savings rate. As their income increases, households tend to save a greater proportion of their income. China is the most significant example: the savings rate there climbed from 30% in 1995 to over 40% in 2013. Moreover, the savings rate rose from 20% to 30% in India, while in Indonesia it is now 19% against 6% in 1999. In Thailand and the Philippines, the savings rate is structurally lower (11% and 10% respectively). It has a tendency to fall in the so-called “advanced” Asian economies [25], declining from 8% to 4% between 1995 and 2012 in Hong Kong.

CHART 9
Savings rate and per capita GDP in Asia



Sources: World Bank, Oxford Economics

CHART 10
Savings rates in Asia (in %)



Source: Oxford Economics

(22) Maximum number of cards per person as well as a minimum age and wage.
(23) Saving reacts positively to an interest rate increase by lowering the cost of future consumption compared with present consumption: saving today to consume more tomorrow.
(24) «General theory of employment, interest and money», John Maynard Keynes, 1936.
(25) Hong Kong, Singapore, South Korea.

Meanwhile, the reasons for saving are also said to be rational. In countries with poor social welfare systems, households tend to save more in order to insure themselves against risks related to health, unemployment and retirement. Hence the measures taken in China to improve the level of social welfare and thus reduce precautionary saving. For example, a social security law for private businesses came into force in 2011.

But besides these theories explaining the consumption/saving trade-off, cultural and psychological factors explain decisions on consumption. While the Korean social security system was very under-developed until the mid 1990s, household consumption increased by 7.1% per annum on average between 1970 and 1996. And South Korean households are today highly indebted despite a still relatively poor social security system.

Similarly, in Thailand consumers are very attentive to the quality of products bought. They tend to buy, even if the products cost more than they can afford. This partly explains why Thai households do not mind borrowing to buy the goods of their choice *(see part 2)*.

Consumption: Becoming more of an individual act

Once they have decided to spend, individuals consume differently. The consumer's attitude is strongly influenced by his/her culture. For example, the proportion of households possessing a radio, a television and a refrigerator is distinctly higher in the Philippines than in India, for the same income class (26). Numerous analyses have been made of these differences in Asia. Several of them point particularly to the possible importance of the relationship to the group to explain consumer spending which is relatively less individualist (27) in Asia.

But beyond these debatable theories, recent developments tend, on the contrary, to highlight the similarities of consumer behaviour with that observed in the United States and Europe. The success of luxury brands in Asia partly explains, as elsewhere, the desire of individuals to assert their success and their purchasing power in relation to their group. The Veblen (28) effect, according to which the more the price of a product increases, the more its consumption increases, seems, therefore, to be confirmed in this region. The purchase of a product at a high price actually symbolises power, wealth and social status. This observation of course also applies in other regions.

Moreover, the generation born after 1980 (particularly in china) tends to behave in a relatively more individualistic way. The behavioural change in China comes in part from the one child policy and also from the rising standard of living. China is currently undergoing the same change as Japan, Taiwan and South Korea. Rapid industrialisation, declining birth rates (29), changing household structures (30) and rapidly improving living standards are changing Chinese society: households now aspire to a more westernised life style. They consume and will consume more for themselves than for the group.

This change results in the first instance in higher household spending. A study carried out in 2007 on 6000 people reveals that the Chinese devote 9.8 hours a week to shopping against 3.6 for Americans (31). Moreover, the consumption boom in China and the development of the middle class is linked to access to property. With housing reforms allowing for privatisation, households have sought to acquire their own home. This has become a priority, a symbol of wealth and of membership of the middle class. Access to property has also enabled Chinese households to become richer. This tendency was also to a certain extent previously observed in Korea. Korean households tended to buy big cars as a sign of success and wealth. Now they prefer more comfortable cars, those more pleasant to drive, because buying these cars now meets more individualistic criteria. These two examples thus illustrate the tendency to the individualisation of consumer behaviour in certain countries in the region.

(26) «Key indicators for Asia and the Pacific», Asian Development Bank, 2010.
(27) «Consumer behaviour in Asia», Euro-Asia Research Series, INSEAD EURO-ASIA CENTER, February 1995.
(28) «Theory of the leisure class», Thorstein Veblen, 1899.
(29) The age at which a woman has her first child has gone from 24 to 27 in 10 years in China. «Meet the 2020 Chinese Consumer» Mac Kinsey Consumer & Shopper Insight", March 2012.
(30) The number of persons per household went from 2.8 in 2000 to 2.5 in 2010. Today 50% of households are composed of a single generation, 40% of two generations and only 10% house 3 generations – «Meet the 2020 Chinese Consumer», Mac Kinsey Consumer & Shopper Insight », mars 2012.
(31) «The characteristics and challenges of the emergence of the Chinese middle class: towards the construction of a new Chinese profile», Lisa Chassin, 2011.

4/ THE RISING MIDDLE CLASS IS BOOSTING TOURISM, HIGH END CONSUMER PRODUCTS AND THE AUTO SECTOR

Although the coverage of countries and industries is by no means exhaustive, we have identified three key industries in certain Asian economies that would see dramatic changes on the back of the economic shifts described in the precedent parts of the study. In particular, their respective dynamics and risks have been highlighted.

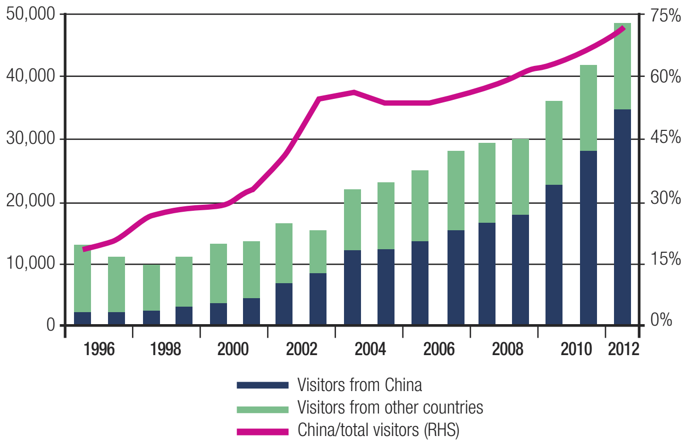
Chinese travelers to flood Asia

According to ITB World Travel Trends Report, Asia was a key growth engine of traveling in the last two years, registering 6% and 7% growth in international travel for 2011 and 2012, respectively [32]. Outlook of tourism-related businesses will continue to improve on the back of strong growth of China and other economies. In this section, we examine how the growth in these Asian countries is affecting the tourism industry in various Asian economies.

Dynamics:

With the proximity and the closer ties to China after the handover in 1997, Hong Kong's tourism enjoys the much benefit from the economic growth of China. Between 1997 and 2012, annual inbound visitors from mainland China increased from less 2.4 million to 35 million, with a compound annual growth rate (CAGR) of 19.7%. Not only does the flow increases, Chinese visitors are spending more money in Hong Kong during their visits as well. Spending of Chinese visitors who stayed in Hong Kong overnight also grew at CAGR 17.4% between 2002 and 2012. Moreover, mainland Chinese is the biggest spender on a per capita basis, too.

Chart 11
Number of foreign visitors in Hong Kong (in thousands)

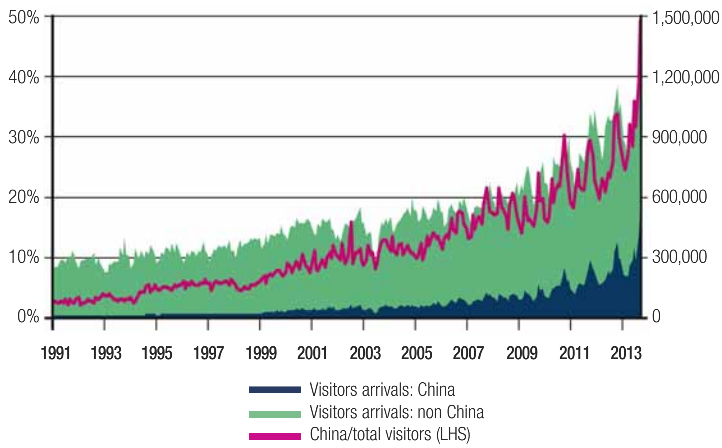


Sources: CEIC, Hong Kong Tourism Board, Coface

Similarly, Macau's proximity to China is a key advantage for the city to benefit most from the economic growth of China. On top of that, with its legalized gaming industry, Macau's tourism sector also profits from the Chinese's love of gambling. Hotel occupancy rate has been staying at around 80% level since its recovery from the post-crisis period in 2008/09, despite the growing number of hotels in the city. The city first took over Las Vegas' top spot in gaming revenues in 2007 and gaming revenue has seen CAGR of 27.1% in the last 12 years, albeit the fluctuation in growth trends over the years. Such trends would not be made possible without the Chinese economic boom.

Total visitors to Korea more than doubled from 2002 to 2012, while tourism revenue has increased from US$5.9b to US$14.2b during the same period. The growth of Chinese visitors to Korea was 5 folded during the period, increased from less than 540,000 to more than 2.8 million during the period. As we can observe from the following chart, in 2013, Chinese visitors to the country has been growing even faster, making up some 47% of the total visitors to the country.

Chart 12
Number of foreign visitors in South Korea



Sources: CEIC, Korea National Tourism Organization, Coface

Key risks to be monitored:

External economic environment remains a key variable – which could be both positive and negative – for tourism-related industries in general. Moreover, strength of the renminbi (RMB) will be supportive of tourism-related businesses. Since China's currency reform began in 2005, USD has depreciated 30% against RMB and we expect the trend to continue. On the contrary, China's policy toward overseas traveling is a disruptor to Asia's tourism industries – particularly in the case of Macau – although we do not see the government launching any restrictive policies on traveling in the near-term.

Chinese preference on foreign high-end brands and India's crave of gold

The high-end consumers sector should be positively impacted by the rise of Asia's middle-class – who presumably do not encounter problem of meeting basic needs. Such trend should have a positive impact on China's domestic market and the gold market in India.

(32) ITB World Travel Trends Report 2012/2013.

Dynamics:

According to Mckinsey, share of Chinese spending around the world on "high-end bags, shoes, watches, jewelry, and ready-to-wear clothing" will be higher than 1/3 of the world's total spending on such items by 2015 [(33)]. Indeed, the upper-middle class (i.e. with US$16000-34000 annual income) will grow 22.4% p.a. between 2012 and 2022, and they will be the stimulants of demand for high-end items. Such messages are in-line with the findings from our on-the-ground conversations with some 30 China-based professionals located in Shanghai in Beijing. These professionals tend to show the following characteristics:

- Given constraints, they are more willing to spend on fewer but more expensive items (see Part 3);
- given the similar products, they are willing to pay more money for foreign branded products.

Key risks to be monitored:

However, the demand growth of high-end products would not jump dramatically from a year to another. Not all policies in China are supportive of the high-end consumers market. Since the Xi-Li administration began its tenure in March, the government is determined to clamp down on corruption, and such scheme in China is having negative effect on the high-end consumers sector as the scheme has made officials and top executives in state-owned enterprises being more cautious on purchasing or receiving expensive gifts. For instance, with the Chinese central discipline committee issuing notice of banning the use of public funds to purchase moon-cakes, various local media have reported that the sales of high-end moon-cakes have been adversely impacted severely [(34)].

While India's consumption on high-end products is not as strong as that in China, Indians' love of gold is well-documented. In fact, India is the largest consumer of gold, both in terms of jewelry and total demand. According to statistics compiled by the World Gold Council, for the year ended in June 2013, India was the biggest consumer of gold jewelry, representing 30% of world's demand.

TABLE 2
World gold demand by country (% of total)

	Jewelry	Total bar and coin invest	Total
India	30.0%	27.0%	28.8%
China	28.5%	22.3%	25.9%
World total	100.0%	100.0%	100.0%

Source: World Gold Council

Due to the high inflation in the country, demand for gold and gold jewelries will continue to be strong in the near-term, all the more since the rupee has depreciated by 16% from May to September 20. There is medium-term downside risk coming from negative wealth effect led by rupee depreciation. Moreover, the India government lifted the import duty on gold from 8% to 10% in August. Such policy, if it continues to stay in force, will curb the gold demand.

Automakers on China's highway

Dynamics:

The rising middle-class is also having a positive impact on the auto sector, especially in China. According to a study done by the Economist Intelligence Unit, purchasing a car and running it for 3 years in Shanghai is roughly 3 times as expensive as a similar purchase and usage in New York [(35)]. Yet, auto sales growth was at CAGR 19.5% per annum between 2002 and 2012. The resilient demand growth was a result of the positive income and wealth effects, driven by the growth in income and property prices in the last ten years (see Part 1). Chinese automakers have benefited significantly from such development. According to Katsuhiro Sasuga (2011), Chinese automakers depend on capability transfers by foreign companies [(36)]. With more local-foreign joint-ventures and partnerships set up in the 2000s, technology was brought into China via the establishments of these companies.

Some may worry that the Japanese automakers could be hurt by the rise of Chinese automakers. Yet, as product segmentation and differentiation in the region remains strong, automobiles made by leading Japanese brands are significantly different from their Chinese competitors. In order to facilitate easier understanding of the sector, the average selling price (ASP) can be used as a differentiator of products [(37)].

Using the company data, for the year ended in March 2013, the average ASPs of Toyota and Honda were RMB165,372 and RMB163,614, respectively. For 2012, ASPs for China's Dongfeng Motor was RMB126,675 and BYD was RMB111,557. While we understand that the product-mix would lead to differences in ASP, such price differentials imply that Japanese and Chinese automakers are not directly competing with each other. Historically speaking, exchange rate fluctuation is a key factor that determines Japanese automakers' performances, and the strength of RMB is a tailwind for Japanese automakers. One of the three-arrows introduced by Japan Prime Minister Shinzo Abe in 2013 was a weak-Yen strategy; As of September 11, Japanese yen has depreciated by more than 24% against the Chinese yuan since Abe won the LDP presidential election on September 26, 2012. If the weak-yen strategy prevails, ceteris paribus, it will provide strong advantage to the Japanese automobile industry.

(33) Dominic Barton, Yougang Chen, and Amy Jin, "Mapping China's Middle Class," McKinsey Quarterly, June 2013.
(34) http://english.cntv.cn/program/china24/20130918/101477.shtml
(35) http://www.economist.com/blogs/graphicdetail/2013/04/daily-chart-2
(36) Katsuhiro Sasuga, « The Impact of the Rise of Chinese and Indian Automobile Industries » in The Scale of Globalization. Think Globally, Act Locally, Change Individually in the 21st Century, p. 286-291. Ostrava, University of Ostrava, 2011.
(37) ASP, in our context, is calculated using: ASP = Revenue/no. of vehicles sold.

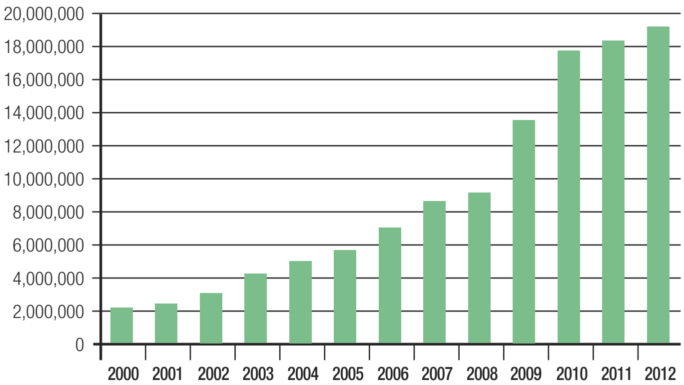
Key risks to be monitored:

Nevertheless, there are also risks associated with the Japanese and other foreign automobile makers in relation to its exposure to the Chinese market. For instance, on August 23, according to the state-run Xin Hua News, China's Ministry of Commerce (MOC) announced that the Ministry is working on improving regulations on auto-sales as a result of the rising number of complaints over «price fixing that has led to exorbitant prices of foreign cars» [38]. Similar regulation changes would undoubtedly cast uncertainties over the automobile players that have presence in China.

Another important element that could potentially be detrimental to the industry is Chinese government's determination to cut down on pollution. China is the biggest producer of carbon dioxide in 2009, responsible for 25.4% of the world's total output [39]. Together with the heavy traffics in key cities, this development could be a drag to the economy. Against this backdrop, Chinese officials have expressed potential measures to limit pollution. One of those directly related to the automotive industries is to launch vehicle purchase limits in first-tier cities like Beijing and Shanghai. Officials are considering implementation of similar auto purchase limits in eight cities, including Tianjin, Shenzhen, Hangzhou, Chengdu, Shijiazhuang, Chongqing, Qingdao and Wuhan [40].

On the other hand, an easier access to credit for consumers could impact positively the car sector in China. As described in Part 2, China's household debt is comparatively low by regional standards. Auto-financing is only a very tiny fragment of the loan portfolio, taking up RMB261.5b, or 2.5%, of the total consumer loans. Such finding suggests that auto-financing in China is regarded to be at a very beginning stage, which is in-line with view of a report prepared by Deloitte and Minsheng Bank in 2012 [41]. However, banks could slow down the approval process of auto loans, which would essential reducing the auto purchases for those who need financing, as the total credit outstanding to the private sector is seen as being too high by the authorities. Such policy disruption is a key risk to the sector – including both foreign and local automakers.

Chart 13
Automotive sales in China



Sources: CEIC, China Association of Automobile Manufacturers, Coface

(38) http://news.xinhuanet.com/english/china/2013-08/23/c_132657611.htm
(39) http://image.guardian.co.uk/sysfiles/Guardian/documents/2011/02/10/CarbonWeb.pdf?guni=Graphic:in%20body%20link
(40) http://www.bloomberg.com/news/2013-07-10/china-passenger-vehicle-deliveries-rise-9-3-amid-cash-crunch.html
(41) Deloitte Automotive Practice et Min Sheng Bank, 2012 China Auto Finance Report.

Conclusion

The dynamic growth in Asia, excluding Japan, since the 1997-98 crisis, has been accompanied by a marked expansion of household consumption. This tendency, which affects all the major countries in the region (but not uniformly), has important economic and social consequences, since it has resulted particularly in the rise of the middle classes.

Despite big rise living standards in the past, this trend is set to continue over the coming years with economic prospects in Asian countries remaining favourable and with the majority of them still being well behind the advanced economies in terms of per capita consumption. Sectors such as cars, luxury consumer goods and tourism will continue to benefit from the continuation of this process in the years to come.

But beware of being too optimistic: these favourable prospects must not be allowed to obscure the growing risks related to excessive household debt. We think these risks are particularly high in Korea, Malaysia, Singapore and Thailand. The debt repayment burden is actually bigger today than it was in the United States in 2008, i.e. at the beginning of the subprime crisis. It is also above that observed in Spanish households in 2012, where it is largely responsible for the country's deep recession. Though these comparisons do not necessarily mean that a crisis of a similar magnitude is imminent in these countries, it at least argues for a moderation of household consumption in future years.

COUNTRY RISK ASSESSMENTS CHANGES

Assessment either upgraded, or removed from negative watch list or placed under positive watch list

Country	Previous CRA	New CRA
United States	A2	A2↗

United States : A2↗

- GDP growth is strong and should accelerate in 2014. (1.5% in 2013 and 2.2% in 2014). Leading indicators are well positioned.
- Companies' margins and profitability are growing with a low level of indebtedness (55% of GDP) even if growth in some sectors (e.g. steel, building materials, paper and packaging) is somewhat anemic.
- Private consumption is the main driver of the GDP growth, with a safer growth (2%, YoY) than pre-crisis (3.8%). The reduced saving rate (4.4% only in July, i.e. a 2 point decrease in the last 2 years) point to the end of the household deleveraging process. The lower unemployment rate (7.3%) and the steady income growth (+2.2% yoy in July) have boosted household spending
- The government shutdown has surprised but it should not have any significant impact on activity providing that it does not last in the long term. However, uncertainties related to the US public debt ceiling remain high and the risk it can't be increased can't be ruled out. Within this risk scenario, private domestic demand could be significantly affected. Nevertheless, this deadlock should be avoided at the end according to our baseline scenario. Therefore, private consumption and investment would remain robust despite some new possible budget cuts.

Assessment either downgraded, or removed from positive watch list or placed under negative watch list

Country	Previous CRA	New CRA
Brazil	A3	A3↘
Thailand	A3	A3↘

Brazil : A3↘

- Growth is and will remain slow, with 2,3% expected for this year and 2,9% for the next. The probability that we will have to revise down the latter number is high.
- Rising interest rates with the Selic likely to reach nearly 10% at the end of the year will impede any significant revival.
- Household consumption, mainly based on credit, is no longer supportive. Debt service reaches 21% of their income (16% in 2005), while in the US it is only 10%. Rising interest rates are going to add to the load. Households as well as banks are getting more cautious. Industries and commerce that use to rely on it, like automotive, appliances, leisure electronics could (if not already) suffer.
- Corporate investment won't make up for consumption. Rising interest rates and inflated prices for imported components and machines, due to the real depreciation, added to the still high taxation and production costs (energy and labour) are not going to induce firms to accelerate their investment.
- Investment in infrastructures, though badly needed, could be slow to take off. Public resources are centred on current expenses. Private investors are concerned by state interventionism, bureaucracy and high costs.
- Real depreciation (15% since May 2013 and 30% since the last peak of June 2011) is weighing on firms that got indebted in foreign currencies to finance their development in the «good» years, not mentioning the buyers of imported goods billed in foreign currencies.
- And, not least but the last, overdues have risen significantly in the last months.

Thailand : A3↘

- Economy has moved into recession: qoq basis GDP shrank by 0.3% in Q22013 and by 1.7% in Q12013.
- Exportations remain weak affected by the Chinese slowdown (China is the first client of Thailand).
- Moreover private consumption (largest component of GDP) still slows but the Central Bank of Thailand, concerned by household level of debt (80% of GDP), has decided to hold its main policy rate. -Besides some infrastructure projects are delayed and effects of government's stimulus policies are weakening.
- On political side, the reconciliation process is struggling despite initiatives from Yingluck Shinawatra (prime minister).

Australia

Coface Assessments

Country risk	A2
Business climate	A1

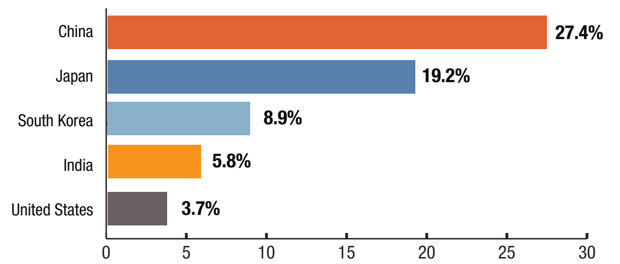
Main economic indicators

	2011	2012	2013 (e)	2014 (f)
GDP growth (%)	2.4	3.7	2.5	2.8
Inflation (yearly average) (%)	3.4	1.7	2.2	2.9
Budget balance (% GDP)	-4.2	-2.9	-1.1	-1.3
Current account balance (% GDP)	-2.3	-3.9	-2.4	-3.1
Public debt (% GDP)	24.1	27.2	27.6	26.7

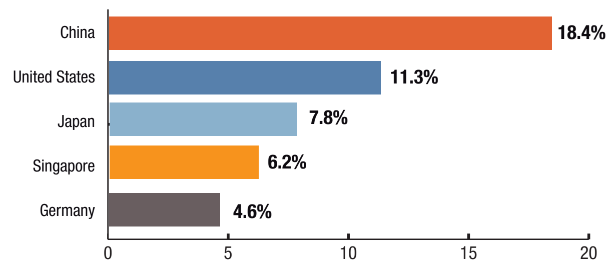
(e): Estimate (f): Forecast

Trade exchanges

Exports of goods, as a % of total



Imports of goods, as a % of total



Risk assessment

Investment and consumption drivers of growth in 2014

Growth slowed in 2013, in line with the downturn in commodity prices, correlated with the sluggishness of the international economy and the decline of activity in China. Domestically, household consumption also slowed against a background of a weaker international environment.

The change of majority, a consequence of the September 2013 general elections, brought the Liberals to power. The new Prime Minister, Tony Abbott has promised to liberalise the country and promote investment. The first measures taken will therefore be directed to businesses. Abbott has pledged to abolish the carbon tax and the tax on mining companies' profits. In early 2013, the Bureau for Resources and Energy Economics confirmed that 18 major mining and energy investment projects worth a total of AUD149bn (9%of GDP) had been deferred or cancelled in the previous 12 months (expansion of the Olympic Dam copper-uranium mine, construction of an export terminal at Port Hedland...). Investment will therefore contribute positively to growth in 2014. Household consumption will continue to drive growth in 2014. The 2.5% cut in the Reserve Bank of Australia's (RBA) key rate in August 2013 will impact positively on household finances, especially by bringing down interest payments on mortgages, most of it taken out at variable rates. As a result, disposable income will rise slightly, helped also by better real wages. However, the noticeable rise in unemployment in 2013 (5.8% in August 2013, +0.7% per year) is affecting household confidence – savings levels are much higher than pre-crisis levels (10.5% of household income against 3.5% previously) and households are choosing to pay off debt (more than 150% of disposable income). Manufacturing sector activity has fallen. Ford announced the closure of two factories blaming its decision on production costs that are double those in Europe. The services sector (tourism, education) continues to suffer from a competitive price disadvantage due to the strength of the Australian currency.

Exports hampered by the strength of the dollar

The Australian current account deficit is expected to increase in 2014. On the import side, recent government measures will boost demand for machinery and capital goods. On the export side, the mining (coal and iron ore) and energy (coal gas and natural gas) activity is largely dependent on demand from China (21% for goods and services, 60% for iron). Chinese demand for Australian products will again slow, as the high exchange rate of the Australian dollar against the American dollar, despite an expansionary monetary policy, is affecting price competitiveness. Moreover, China is keen to diversify its suppliers in order to maintain clout in negotiating prices. To boost its competitiveness and attractiveness, Australia is seeking to sign free trade agreements with its main trading partners (China (No 1), Japan (No 2, 12% of trade), South Korea (No 4, 5.5%)).

Public debt (27%) is low compared with that of other developed countries (75%). The new government therefore has room to manoeuvre in order to sustain domestic demand. In this context, fiscal revenues could decline in 2014.

A change of majority

Elected in September 2013, Tony Abbott is the 28th Australian prime minister. With 88 seats out of 150 in the House of Representatives, the liberal coalition has a large majority. It replaces the Labour Party, which became very divided only a few months before the elections. Julia Gillard, Prime Minister until July 2103, was hurt by the fall-out from the carbon tax, which, together with a sharp fall in commodity prices, weakened the economy. Less than three months before the elections, the Prime Minister was ousted by her party in favour of the former Prime Minister, Kevin Rudd. Tony Abbott made combatting illegal immigration (essentially from the Islamic Republic of Iran) one of his campaign's priorities.

Internationally, Australia has two main concerns. On the economic front, it is seeking closer relations with the ASEAN member states, while on the diplomatic front, it will remain close to the United States in view Chin's rising power in the Asia Pacific region.

Strengths

- Geographic proximity to emerging Asia
- Mineral resources
- Moderate public debt
- Solid banking system
- Dynamic demographics
- Geographic features which favour tourism

Weaknesses

- Vulnerable to commodities cycles and Chinese demand
- Substantial household debt (over 150% of disposable income)
- Shortage of skilled labour
- Highly exposed to natural hazards
- Wide disparities between the federal states

Brazil

Coface Assessments

Country risk	A3
Business climate	A4
Medium term	FAIRLY LOW RISK

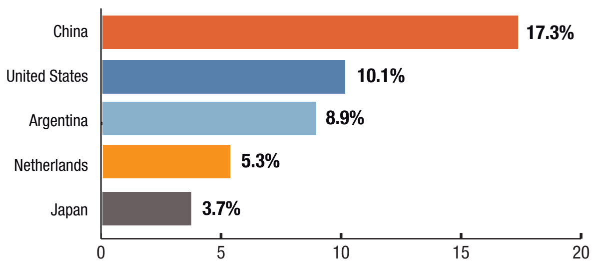
Main economic indicators

	2011	2012	2013 (e)	2014 (f)
GDP growth (%)	2.7	0.9	2.3	2.9
Inflation (yearly average) (%)	6.5	5.8	6.1	5.8
Budget balance (% GDP)	-2.6	-2.5	-3.2	-3.8
Current account balance (% GDP)	- 2.1	-2.4	-3.5	-2.9
Public debt (% GDP)	68.0	68.0	67.0	66.0

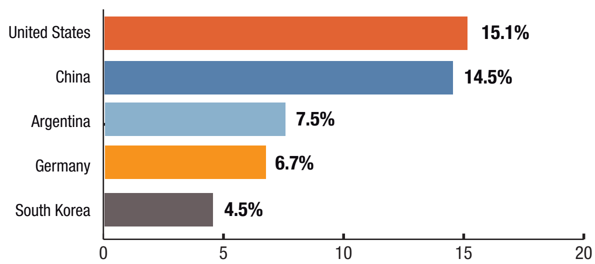
(e): Estimate (f): Forecast

Trade exchanges

Exports of goods, as a % of total



Imports of goods, as a % of total



Risk assessment

Still moderate growth

Growth will remain moderate in 2014. Consumption, long the main source of growth, will increase modestly, with fewer jobs created. Credit, the essential fuel driving consumption, will slow because of the caution of banks and households, whose debt servicing costs (already 21% of their income) will rise due to higher interest rates. Investment is likely to accelerate, if the concessions for the construction and operation of transport infrastructures find takers among foreign investors. Construction is expected to benefit again from public funding of social housing and the completion of facilities for the Football World Cup and the Olympic Games. Exports could benefit from the recovery in the United States (11% of sales), the revival of the European economy (16%) and Chinese resilience (17%). Oil exports will increase with the start of operations in the new oil fields and firm prices. However, with commodity prices stabilising (49% of sales - iron ore, soya, cereals, coffee and sugar) there is little hope of a clear recovery. The real's sharp depreciation, begun in May 2013, will restore competitiveness only to manufactured goods such as automobiles, avionics, steel, paper pulp, orange juice and meat.

Public accounts continue to deteriorate but remain under control

With fiscal policy remaining accommodative in view of the October 2014 elections, the public deficit is set to widen further, while the primary surplus (i.e. not including debt servicing) narrows. Tax reductions granted to households and businesses have been increasing since 2012. Current spending, the bulk of the budget, with wages and social benefits indexed to inflation, is rising rapidly. Despite some adjustment, fuel price subsidies will increase, as the gap between domestic and international prices (30% in August 2013) is likely to grow. With this deterioration, there will be no reduction in public debt (67%, but 34% net of claims). However, the small foreign proportion reduces the risk of its getting out of control.

Continued monetary policy tightening

Unlike fiscal policy, monetary policy could be further tightened (key rate above 10% in 2014?) to combat strong inflationary pressures. The Central Bank is also likely to prolong its interventions on the foreign exchange market to mitigate a further depreciation of the real, which could intensify these pressures. The policy's effectiveness will be limited by the significant structural causes of inflation. Meanwhile, the currency needs to retain foreign investor confidence because businesses have to attract foreign capital to make up for insufficient domestic savings monopolised by the public sector. So, although the real floats freely, the Central Bank intervenes when it fluctuates (up or down) too strongly.

Depreciation of the real will impact positively on solid external accounts

The depreciation of the real will stem the increase in the current account deficit. The trade surplus, shrinking since 2008 to the point of almost disappearing in 2013, will return to a healthier level as exports of manufactured goods receive a boost and imports are discouraged. There will still be a large deficit in the trade in services and related revenues (tourism, dividends, interest). However, the depreciation will lessen the foreign currency equivalent of the dividends repatriated by foreign companies and encourage Brazilians to cut back on foreign travel. The current account deficit will be three quarters funded by foreign direct investments, the rest by foreign investments in Brazilian debt. The burden of foreign debt is modest (15% of GDP) but growing. The proportion of public debtors has fallen distinctly in favour of the private sector. It is largely covered by the foreign exchange reserves, which represent a year and a half of imports. Moreover, in view of the foreign debt obligations to Brazil, the country is a net creditor.

Growth potential hampered by structural shortcomings

Brazil benefits from abundant resources and diversified industry, the operation of which is hampered by the lack of infrastructures and skilled labour, state interventionism and red tape. Costs to businesses are rising more quickly than their productivity, forcing them to increase prices to maintain profitability but to the detriment of their competitiveness. Protectionist and fiscal measures have been adopted to alleviate these pressures. The tax burden, however, remains heavy. Slower consumption is weakening the industries and trade that depend on it: household appliances, cars, electronics ... The real's depreciation also adversely affects businesses, whose foreign currency debt has grown.

Strengths

- World's 6th largest economy
- Growing workforce
- Varied mineral and agricultural resources
- Cutting edge manufacturing industry: aeronautics. chemicals, pharmaceuticals, oil engineering
- Resistance to external shocks: primary budget surplus, net external creditor position, considerable reserves
- Maintenance of key macroeconomic balances

Weaknesses

- Lack of skilled labour / deficient educational
- Infrastructure shortcomings (transport, energy)
- Inadequate investment (18% of GDP)
- High production costs (wages, energy, logistics, credit)
- High and inefficient public spending
- High public debt and debt servicing costs
- Corruption thriving on inequalities

Germany

Coface Assessments

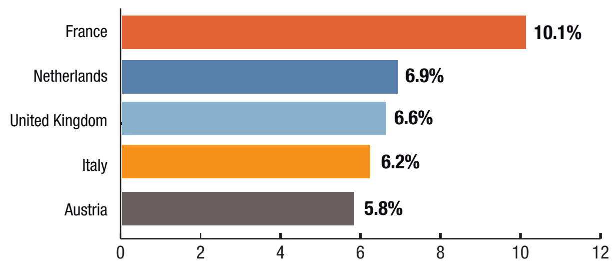
Country risk	A2
Business climate	A1

Main economic indicators	2011	2012	2013 (e)	2014 (f)
GDP growth (%)	3.3	0.7	0.6	1.8
Inflation (yearly average) (%)	2.1	2.0	1.6	1.9
Budget balance (% GDP)	-0.8	0.1	0.1	0.3
Current account balance (% GDP)	6.2	7.0	7.0	7.0
Public debt (% GDP)	80.0	81.2	78.5	75.7

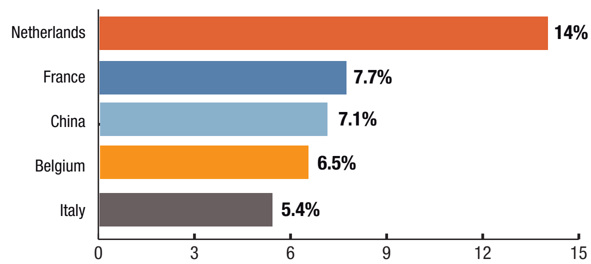
(e): Estimate (f): Forecast

Trade exchanges

Exports of goods, as a % of total



Imports of goods, as a % of total



Risk assessment

Recovery continuing

The economic recovery begun in 2103 will continue in 2014. It will be based, in equal parts, on household consumption as before and, a new element, on an upturn in business investment. The contribution of foreign trade to growth will again be nil, with imports and exports increasing in equal proportions. Further employment gains will boost household consumption, while immigration and increased female employment will increase the number of people in work. Disposable income will rise by over 3% (allowing for inflation of over 1%) due to wage increases negotiated with the main industries and also due to lower pension contributions, the raising of the threshold for income tax liability and of allowances for dependent children obtained in 2013. Financial revenue is expected to rise on the back of higher interest rates. Business investment in equipment is expected to increase steadily after three years of stagnation. Decision makers are drawing comfort from the overall improvement in the economy and are set to benefit from still favourable credit conditions. Construction of commercial and public buildings is expected to pick up strongly, while housing construction is expected to remain buoyant, particularly in the big cities and in regions attracting the most immigrants like Bavaria, Baden-Württemberg, Hessen and Berlin. Exports, which represent over 50% of GDP, are expected to benefit from stronger economic recovery in America (7% of sales) in the non-eurozone European countries (20%), as well as from the resilience of Chinese growth (6%). Capital goods and intermediate products make up respectively 45% and 30% of exports, with China absorbing 20% of the former and 5% of the latter. Much will therefore depend on the investment component of world growth. It would, though, be futile to expect strong growth without better growth in the eurozone, which still absorbs 37%.

Sound public and external accounts

Despite lower statutory charges and higher social transfers, revenues will grow faster than spending. Faster growth means revenues will increase mechanically while reducing the benefits paid to the unemployed. Moreover, the low rates charged on German debt are also containing expenditure. A slight surplus is expected on the public accounts and public debt will decline as a share of GDP. However, Greek debt relief and/or additional help for banks in difficulty would undermine this prognosis. But, as always, the objective of consolidating the federal public accounts (maximum structural deficit of 0.35%) contained in the "Schuldenbremse" (debt brake), incorporated in the Constitution in 2009, has already been achieved.
There will be an ample current account surplus thanks to the massive trade surplus (5% to 6% of GDP). The services balance is in equilibrium, with the tourism deficit offset by the surplus on services to business. The income balance is slightly in surplus, as income from investments abroad exceeds transfers by immigrants and foreign investors to their country of origin. This sizeable current account surplus is used to acquire significant assets abroad (direct investments, shares, bonds). It is also used by the Bundesbank, though as confidence grows increasingly less so since 2013, to accumulate claims on fellow banks in difficulty in the eurozone. Nine consecutive years of current account surplus close to or above 6% have enabled the country to accumulate foreign assets well in excess of its foreign liabilities.

Brighter economic and political picture

After being hit by the sluggish economic climate from the spring of 2012 to the winter of 2013, both with regard to exports and the domestic market, businesses have benefitted since spring 2013 from an improving domestic and external economic situation. Non-payments are expected therefore to decline in 2014. Moreover, now that the September 2013 elections have been held, the new coalition led by Angela Merkel will be able to tackle a range of problems. In addition to European issues, one can cite financial solidarity between the Länder, the decreasing population, inadequate structures for young children, worsening infrastructures and educational opportunities to the detriment of productivity, the introduction of a minimum wage at a time when a quarter of jobs are poorly paid and temporary, and funding the increase in renewable energy from 25% to 80% by 2050.

Strengths

- Solid industrial base (1/4 of GDP)
- High quality contributing to competitiveness and profitability
- Strong foothold in emerging markets (1/3 of exports)
- Export-oriented SMEs (Mittelstand) are family-minded and have strong regional base
- Central and Eastern Europe integrated in the production process
- Importance of the ports of Hamburg, Bremerhaven and Kiel
- Institutional system fosters representativeness and consensus

Weaknesses

- Aging infrastructures
- Demographic decline partially offset by immigration
- Lack of engineers and risk capital
- Low female employment rate
- Highly dependent on world markets, particularly European ones
- Predominance of the automobile industry
- Persistent backwardness of the eastern Länder, though gap is narrowing
- High energy costs

Greece

Coface Assessments

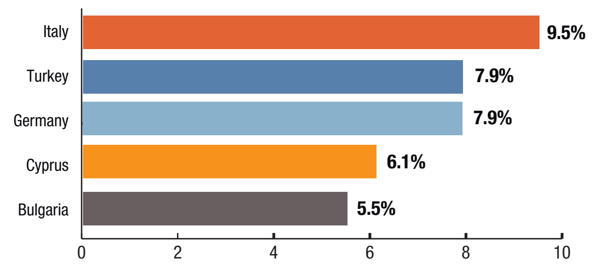
Country risk	C
Business climate	A3

Main economic indicators	2011	2012	2013 (e)	2014 (f)
GDP growth (%)	-7.1	-6.4	-4.0	-0.6
Inflation (yearly average) (%)	3.1	1.0	-0.8	-0.4
Budget balance (% GDP)	-9.6	-6.3	-4.4	-3.5
Current account balance (% GDP)	-9.9	-3.4	-0.8	0.8
Public debt (% GDP)	170.3	156.9	175.8	177.2

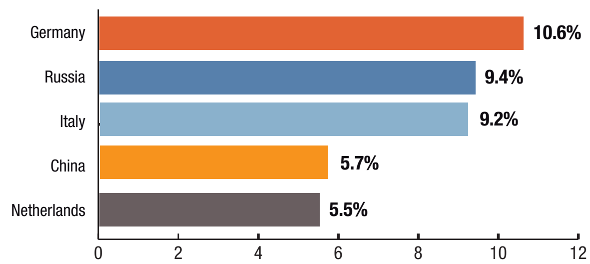
(e): Estimate (f): Forecast

Trade exchanges

Exports of goods, as a % of total



Imports of goods, as a % of total



Risk assessment

The country could suffer a seventh year of recession in 2014

The pace of economic contraction slowed in 2013 due to improving European demand and better export performances. Domestic demand has remained weak, with private consumption still constrained by massive unemployment (although it has begun to slow slightly) and by falling wages (cumulative decline set to reach 20% by the end of 2014). The same applies to public consumption, due to the planned spending cuts under the agreement concluded with the IMF and the EU, and to investment, suffering from low business confidence, weak capacity utilisation and the lack of liquidity. The recession is expected to continue over the first part of 2014, with recovery possibly starting towards the end of the year, with exports continuing to accelerate and investments benefiting from greater private sector confidence. Exports could start to take advantage of competitiveness gains resulting from lower wage costs, if foreign demand holds up and trade finance resumes. The external accounts could even be in surplus in 2014, as imports continue to shrink.

Businesses hard hit by the crisis; banking sector in convalescence

The economic fabric remains weak. Businesses are still confronted by falling order books, increased tax pressures, a drying up of credit and lengthening customer payment terms. Many companies have had to close their doors and lay off workers. Bank credit, on which SMEs, especially, depend, continues to contract, though it remains positive in the services sector and is stabilising in the construction sector. The banking sector is only beginning to recover. Deposits have picked up since mid-2012 but remain well below pre-crisis levels. The sector is, however, making less use of the ECB's liquidity. Greek sovereign debt restructuring has resulted in heavy losses and the recession has led to a marked deterioration in the quality of bank portfolios. Bank sector restructuring is, however, nearing completion: The Hellenic Financial Stability Fund has recapitalised the four main credit institutions, which now hold 96% of total deposits, and most of the other banks have been the subject of resolution plans.

Towards a third bailout?

After the first international rescue plan of €110 billion in May 2010, the country had to be bailed out again in March 2012, involving additional funding of €130 billion and haircuts on privately-held Greek sovereign debt. In November 2012, the eurozone and the IMF granted Greece further debt relief of about €40 billion through a combination of measures (new repayment deadlines and lower interest rates on certain loans already granted, repurchase by the Greek government of the debt still held by private creditors). The public debt/GDP ratio, however, fell only slightly and began growing again in 2013. Uncertainties remain over the future rollout of the programme agreed with the Troika: sources of friction remain numerous (in particular civil service reform, privatisation, overhaul of the tax system). A third bailout is, however, looking necessary. With the German elections now over, a new agreement will probably be negotiated, once the current reforms have been audited. It remains to be seen whether this extension will be accompanied by a haircut on the Greek debt held by official creditors.

A difficult political and social climate

The centre-right victory in the June 2012 legislative elections with backing from the Socialists and a moderate left-wing party has reassured investors and considerably allayed fears of Greece leaving the eurozone. The coalition was reduced to the two main parties following the departure of the small Democratic Left party in response to the closing of the public broadcasting service. The coalition government has a parliamentary majority but remains weak, caught between the requirements of international lenders (particularly regarding the implementation of civil service reforms) and the necessity of preventing a social explosion. As the economic situation worsens, support for populist and nationalist groupings grows stronger.

Strengths

- Supported by the international financial community
- World's leading ship owner
- Tourist attractiveness

Weaknesses

- In crisis because of swollen public and private debt, with fiscal and external imbalances among the largest in the eurozone
- Weak public institutions, resulting especially in widespread tax evasion
- Small size of industry, low technological content of exports (food and chemical products)
- Business environment handicapped by red tape
- Social tensions fostered by fiscal austerity and massive unemployment

India

Coface Assessments

Country risk	A4
Business climate	B
Medium term	FAIRLY LOW RISK

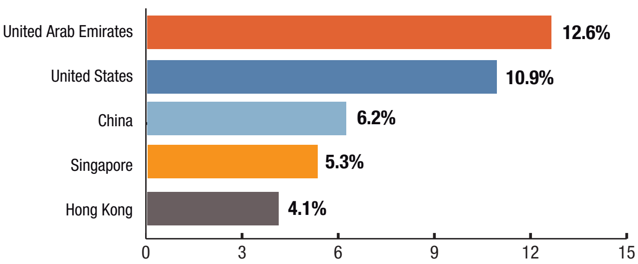
Main economic indicators

	2011	2012	2013 (e)	2014 (f)
GDP growth (%)	6.2	5.0	5.0	5.5
Inflation (yearly average) (%)	8.9	7.8	7.2	7.0
Budget balance (% GDP)	-8.1	-7.1	-7.4	-7.3
Current account balance (% GDP)	-4.2	-3.9	-3.6	-2.7
Public debt (% GDP)	65.0	65.6	64.6	64.6

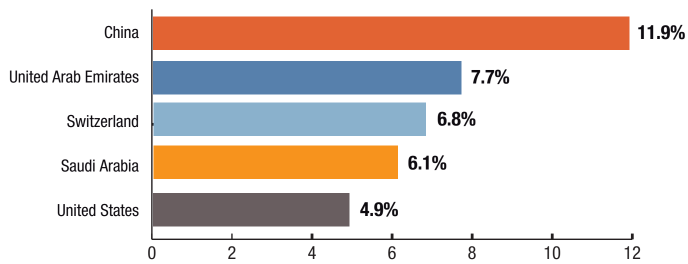
(e): Estimate (f): Forecast

Trade exchanges

Exports of goods, as a % of total



Imports of goods, as a % of total



Risk assessment

Moderate recovery of growth and opening of the capital market

Growth slowed in 2012/2013 due to weakening domestic demand. A slight recovery is expected in 2013/2014. The possible introduction of structural reforms related to the energy market, the facilitation of procedures for infrastructure projects, as well as to the capital market suggests better prospects lie ahead. Moreover, the dynamism of the services sector is still contributing to growth, particularly in the high tech segment. Exports will also benefit from the fall in the value of the rupee and a slight global recovery. Finally, consumption, the main growth driver, is expected to continue growing at a moderate pace thanks to households' higher disposable income linked to fiscal support. Inflation has slowed in 2013 due to lower prices for manufactured products and oil but is still high (inflation stood at 5.8% in August 2103). There will be a significant risk of imported inflation in 2014, as the country's already big energy bill will be hit by the rupee's weakness.

Persistence of the twin deficits and depreciation of the rupee

The fiscal deficit at local and federal level was cut in 2012/2103. It is expected to stabilise but will remain substantial in 2013/2014, despite intended consolidation of the accounts characterised by an overhaul of the system of subsidies, tax rises and the redirection of spending towards investment. Nevertheless, the amount of the subsidies is expected to remain high despite the reform. Moreover, the political agenda (legislative elections in May 2014) partially explains the noticeable increase in social spending. The Congress Party succeeded in getting its food security bill adopted (1.5% of GDP), under which the purchase of rice and cereals will be subsidised. Recapitalisation of the banks and support for Discom, the public electricity operator, will also fuel public debt.

The current account deficit is expected to continue improving in 2013/2014 due to rising exports, although the scale of oil, gold and coal imports will prevent any significant reduction. Meanwhile, the balance of services and transfers explains the current account improvement. The expected increase in foreign direct investments, linked to the reforms aimed at liberalising the retail market, is expected to result in improved coverage of the deficit by long-term capital. In addition, the cut in the tax on corporate bond holdings denominated in rupees could help to ease the pressures on the currency. The Indian rupee plunged 26% between May and early September 2013, attributable to the American Federal Reserve's announcements of a change in monetary policy and also to India's internal weaknesses. The authorities therefore introduced numerous measures to halt this fall (raising key rates, taxes on metal imports...). The public banks, which account for three quarters of bank assets and fund the non-profitable sectors, are seeing a deterioration in the quality of their asset portfolios. Finally, the rupee's devaluation is putting pressure on businesses with foreign currency loans and could also put pressure on asset quality. However, the entry into force of Basel III regulations in April 2013 should shore up the financial system.

Very difficult business environment

In 2012/13, the Trianamool Congress left the UPA (United Progressive Alliance), a coalition led by the National Indian Congress, in disagreement over the reforms aimed at opening the retail sector to foreign investment. The passing of the bill, despite the hostility of local retailers, meets the objective of attracting investment to sustain growth and halt the depreciation of the rupee. But foreign multilaterals can penetrate the market only by concluding franchise agreements: they cannot own more than 49% of their Indian subsidiaries. The disagreements, defeat in the regional elections and the weakening of the UPA in parliament have led to speculations over early elections before the end of the current legislature in May 2014. The beginning of 2013 was marked by border tensions with Pakistan. The business environment suffers from persistent deficiencies: high levels of corruption and inadequate energy supply. Medium-sized businesses are under structural and regulatory constraints.

Strengths

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

Weaknesses

- Lack of infrastructures and shortcomings in the educational system
- Wage rises for skilled labour could erode comparative advantage
- Net importer of energy resources
- Rising debt of private businesses
- Weak public finances
- Persistent uncertainties over the Kashmir issue

Kenya

Coface Assessments

Country risk	C
Business climate	C
Medium term	HIGH RISK

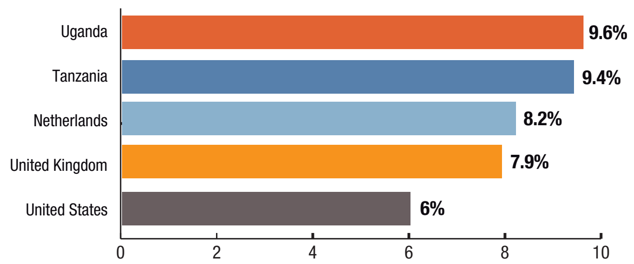
Main economic indicators

	2011	2012	2013 (e)	2014 (f)
GDP growth (%)	4.4	4.7	5.8	6.0
Inflation (yearly average) (%)	14.0	9.4	5.0	5.3
Budget balance (% GDP)	-5.1	-5.3	-4.6	-4.0
Current account balance (% GDP)	-9.8	-11.0	-8.7	-6.9
Public debt (% GDP)	48.5	48.2	47.9	47.3

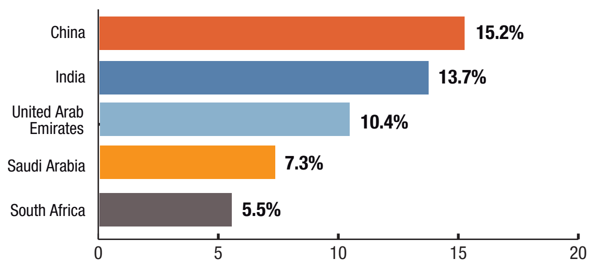
(e): Estimate (f): Forecast

Trade exchanges

Exports of goods, as a % of total



Imports of goods, as a % of total



Risk assessment

Growth stimulated by private consumption

Kenya's economy is the largest in East Africa. In 2013, activity picked up with an easing of monetary policy. Growth will be steady in 2014, due especially to investment related to the discovery of oil and gas in 2012. Investors will, moreover, be reassured by the successful holding of the March 2013 general elections. Private consumption (79% of GDP) will still be the main driver of growth, provided inflation remains moderate. This is, however, very dependent on food prices and therefore on the weather. The Central Bank's key rate cut will boost consumption, so household and business credit is set to continue to climb in 2014. Moreover, the growing size of the middle class fosters private spending.

The primary sector will remain robust and the opening of a large titanium mine in late 2013 has strengthened activity in the sector. The services sector, one of the continent's most attractive, is sustained by telecommunications and financial services. In July 2013, the Kenyan Equity Bank and Airtel Kenya, a subsidiary of the Indian telecommunications group, Bharti Airtel, teamed up to provide mobile commerce solutions. Meanwhile, in tourism 2014 is expected to be slowdown year linked to the risk of terrorist attacks after the assault against a shopping centre in the downtown of Nairobi.

Slight fall in the fiscal deficit

The Kenyan fiscal deficit is expected to fall slightly in 2014. VAT harmonisation has led to increased revenue in 2013. Moreover, the country is expected to introduce tax reforms in 2014 (higher taxes on unearned income). Spending will be mainly focused on infrastructure construction such as the Lamu deep-water port ($3.5nn, 8.5% of GDP) as well as education and health. The level of debt remains sustainable in view of increased support from international partners.

The expansion of regional trade contributes to adjustments in the current account balance

Kenya's trade deficit (20% of GDP) will remain large but stable until the country begins the exploitation of its titanium, oil and gas deposits (2018-2020). The energy bill, representing about 10% of GDP, has a considerable impact. Exports are, however, dynamic, driven by the tea and horticulture sectors, which are benefitting from growing Asian demand, as well as greater regional integration in the East African Community. Nonetheless, the country's greater regional integration will bring in higher revenues linked to transport services and an increase in transfers from cross-border workers. In 2014, the Kenyan current account deficit will drop slightly. Moreover, the many opportunities offered by Kenya are attracting a growing number of foreign investors (FDI) (telecoms, factories, land use), which make for more stable funding of the current deficit. Kenya is second largest recipient of FDIs in sub-Saharan Africa, after South Africa and ahead of Nigeria.

The March 2013 elections were peaceful

In December 2007, the presidential elections brought the country to the brink of civil war, claiming 1300 deaths and displacing 600,000 people. In August 2010 a new constitution was established to ensure a clearer separation of powers, to increase the power of local counties and to guarantee the transparency of future elections. In March 2013, 6 elections were held simultaneously, including the presidential elections. Closely watched by the international community, they passed off peacefully. Uhuru Kenyatta (The National Alliance) was elected President of the Republic after the first round with 50.07% of the votes. The election result was briefly contested by the outgoing president and candidate, Mr Odinga. Odinga subsequently accepted the decision of the Supreme Court, whose six judges unanimously endorsed the election result. The president set himself the targets of protecting civil rights, improving governance, fighting corruption and ensuring widespread access to water and electricity.

The risk of terrorist attack is significant

Externally, the maintenance of Kenyan troops in the southern Somalia since 2011 increases the risk of terrorist attacks on Kenyan territory. The 21st of September 2013, Al-Shabaab, a Somalia-based extremist group, led an attack against a shopping centre in the downtown of Nairobi. More than 72 people died.

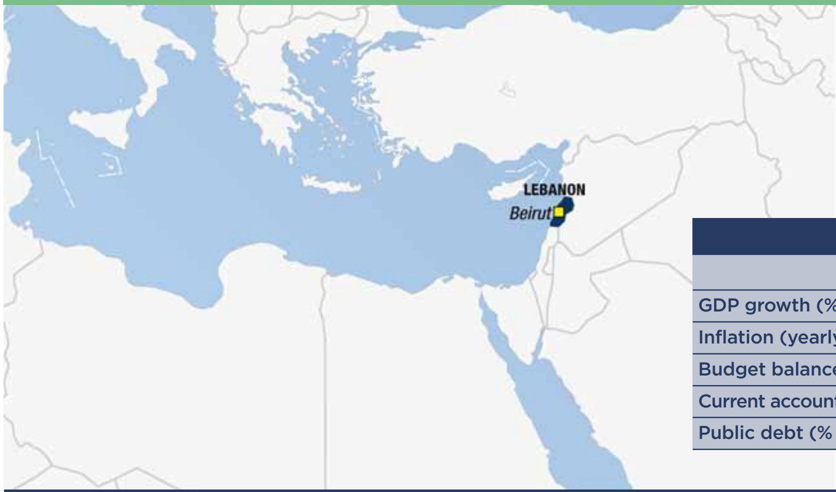
Strengths

- Strategic position between West Africa and East Africa
- Pivotal role in East African Community, leading African common market
- Diversified agriculture (maize, tea, coffee, horticulture)
- Good telecommunications and financial services
- Lively demographics and emergence of a middle class
- Adoption of a new constitution

Weaknesses

- Agricultural production highly dependent weather conditions
- Inadequate infrastructure hinders economic development
- Widespread poverty
- Governance improving but persistent corruption

Lebanon



Coface Assessments

Country risk	C
Business climate	B
Medium term	HIGH RISK

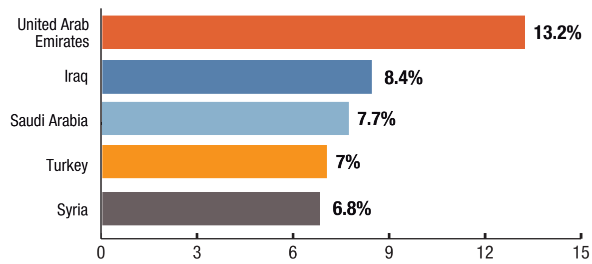
Main economic indicators

	2011	2012	2013 (e)	2014 (f)
GDP growth (%)	1.8	0.9	0.5	2.0
Inflation (yearly average) (%)	6.7	4.6	6.5	7.0
Budget balance (% GDP)	-8.5	-9.7	-8.5	-8.0
Current account balance (% GDP)	-13.1	-12.8	-13.2	-10.0
Public debt (% GDP)	136.5	140.5	140.0	135.0

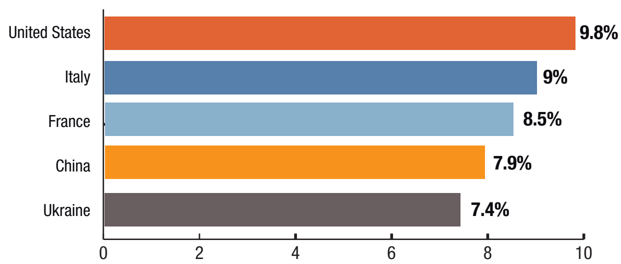
(e): Estimate (f): Forecast

Trade exchanges

Exports of goods, as a % of total



Imports of goods, as a % of total



Risk assessment

Economic situation still dependent on a critical local and regional political environment

Domestic political tensions are running very high, aggravated by the protracted civil war in neighbouring Syria, which has resulted in a large influx of Syrian refugees. In this context, the government coalition formed in mid-2011 fell apart in late March 2013, at the instigation of Hezbollah, a powerful, armed pro-Syrian Shiite group. An interim government has been formed – led by the moderate Sunni Tammam Salam – although no agreement has yet been made between the two main Lebanese political blocks, the March 14 Alliance (purportedly pro-western, led by the former prime minister, Saad Hariri) and the March 8 Movement dominated by Hezbollah. In view of this, the Lebanese Parliament agreed to postpone the legislative elections planned for June 2013 and extended its mandate until 2014.

Growth is expected to remain very weak in 2013, because of the negative impact of internal political instability on private consumption and investment and also because of growing troubles in Syria. The economy could recover slightly in 2014, provided that the region's geopolitical tensions are eased, as the Lebanese economy – in which services play a prominent role – is very sensitive to such tensions. Traditionally, nationals of the region's Arab States and, more particularly of the Gulf, are the main users of the country's services, particularly through tourism, and the main investors in real estate.

Continuing slippage in twin deficits, excessive public debt and huge external debt

The scale and persistence of the fiscal deficits – in particular due to interest payments equalling about 50% tax revenues – would require implementation of the planned reforms aimed at consolidating the public finances, in particular, raising VAT, widening the tax base, modernising the administration and restructuring the state-owned energy company, Electricité du Liban. However, conflicting interests within weak governmental authorities are inhibiting economic policy formulation. Moreover, the postponement of the legislative elections means that no progress will be made in the near future. Meanwhile, the structural public accounts deficits and the chronic problems of a bloated and heavily subsidised public sector, compounded by the cost of post-civil war reconstruction, explain the very high level of public debt, which although hardly sustainable is mitigated by the preponderance of the domestic portion in local currency.

Externally, the economy suffers from a narrow export base, as evidenced by a structural trade deficit, attributable to imports of oil, raw materials and agricultural products. However, the services and transfers surplus is expected again to help partially contain the huge current account deficit, while capital flows from the diaspora and the Gulf countries should enable it to be funded. Nevertheless, the burden of foreign debt will still be very heavy (about 85% of GDP), especially since it is mainly short term (about 83% of total debt). Furthermore, because of serious political unrest, capital flight cannot be ruled out, but in such a situation Lebanon could draw on its substantial foreign exchange reserves – representing more than a year and a half of imports – and would probably benefit from the financial support of "friendly" countries.

Sound banking system but overexposed to sovereign risk

Lebanon's banks remain well capitalised, liquid and profitable, with non-performing loans under control. Deposits are expected to continue growing modestly, given the attractive rates of return and the confidence that the banking system and the pegging of the Lebanese pound to the dollar inspire in depositors (local, diaspora, Gulf residents). However, the banks still prefer to finance a significant portion of the needs of the State rather than lend to the private sector. They thus remain overexposed to sovereign risk and are also vulnerable due to high deposit dollarization, exposure to the property market and regional instability.

Meanwhile, Lebanese companies are traditionally very resilient to major political shocks and have hitherto endeavoured to pay, even in critical situations, given, moreover, that the business environment is relatively favourable compared with that of most other countries in the region.

Strengths

- Financial support from the diaspora and the international community, and high capacity for recovery
- Robust banking system
- Discovery of offshore natural gas deposits

Weaknesses

- Political divisions along faith lines fostering a latent risk of civil war
- High exposure to regional geopolitical tensions
- Political differences hindering the reforms needed to consolidate the public accounts
- Very high public debt

Portugal

Coface Assessments

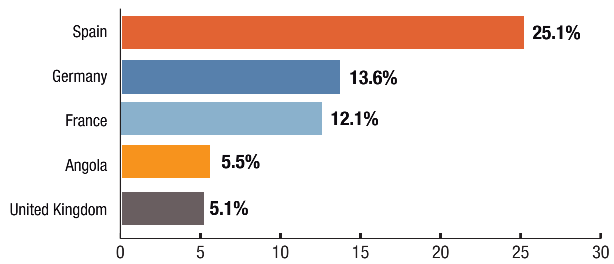
Country risk	B
Business climate	A2

Main economic indicators	2011	2012	2013 (e)	2014 (f)
GDP growth (%)	-1.3	-3.2	-2.1	0.1
Inflation (yearly average) (%)	3.6	2.8	0.6	1.0
Budget balance (% GDP)	-4.4	-6.4	-5.6	-4.4
Current account balance (% GDP)	-7.0	-1.6	0.5	1.3
Public debt (% GDP)	108,3	123.6	132.6	134.3

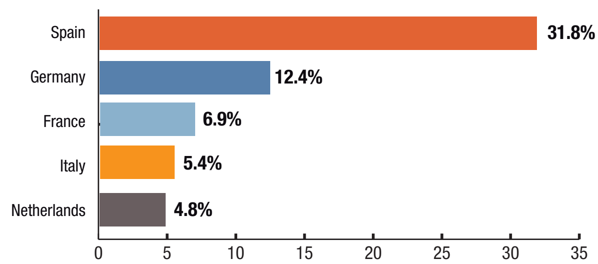
(e): Estimate (f): Forecast

Trade exchanges

Exports of goods, as a % of total



Imports of goods, as a % of total



Risk assessment

A timid return to growth in 2014?

Portugal looks set to emerge from recession in 2014 after three consecutive years of GDP decline. Exports, which are benefitting from gains in competitiveness linked to falling labour costs and more robust European demand, are expected to remain the most dynamic component of GDP in 2014. Domestic demand, which, like exports, rebounded in the second quarter of 2013 but is still negative year on year, is likely to remain constrained by the ongoing adjustment programme conducted under the aegis of the EU and the IMF. The strength of the recovery will greatly depend on the behaviour of consumption (66% of GDP), which is still hampered by higher taxes, lower household incomes and unemployment of around 17%. It will also depend on the health of the EU economy, which absorbs 70% of Portuguese exports. Investment, for its part, is benefitting from tax incentives. It could however continue to suffer from a prolonged credit crunch and excess production capacity. Finally, inflation is expected to remain relatively low because of weak domestic demand and the moderation of raw materials prices, despite a probable further hike in indirect taxation.

Businesses still in difficulty

Businesses, already weakened by poor profitability, low self-financing capacity and sizeable debt, have been hardly hit by the recession. Their margins are, however, improving due to lower wages and higher unemployment but insolvencies are continuing to rise dangerously, chiefly affecting domestic market-oriented SMEs (trade and craft industry, construction). Payment incidents recorded by Coface, for their part, reached a peak in 2012. The banking sector has withstood the crisis relatively well and has strengthened its solvency position in recent years, although bank profitability has been affected by the worsening economic situation and the need to deleverage.

Internal and external imbalances being reduced

Excessive wages and consumption increases and poor productivity gains have led to a significant loss of competitiveness, higher deficits and a marked increase in debt. Government debt is close to 130% of GDP. Those of households and businesses are reaching respectively 91% and 166% of GDP, among the highest rates in the eurozone. The deleveraging process will therefore take a long time. However, the reduction in the unit labour cost has reversed the trend towards loss of competitiveness and the increase in exports, in a context of lower imports, has resulted in the emergence of a current account surplus. Moreover, along with fiscal consolidation (targets have been reset twice but the primary deficit has been largely cleared), numerous structural reforms have been implemented: greater labour market flexibility, opening up of product markets and protected professions, privatisation, control of health sector costs and improvement of the judicial system.

Exit from the crisis, nevertheless, more difficult than expected

Portugal had to resort to a €78 billion EU/IMF bailout package in April 2011. This assistance and the injections of liquidity from the ECB into the banking sector cover the country's external financing needs. Moreover, improved financing conditions enabled the Treasury to re-enter the bond market in 2013, removing the threat of public debt restructuring. The government's weakness, however, contributed to renewed yield spikes on Portuguese debt issues in July 2013. Although these have since stabilised, this could compromise the country's emergence from the crisis, though it was supposed to be entirely free of supervision by the Troika by mid-2014. Austerity is finding less and less popular acceptance and the ruling centre-right coalition, which nearly came apart last July, after the resignation of two government heavyweights, remains weak. It still has a majority but growing internal tensions could eventually lead to early elections (the next legislative elections are normally scheduled for October 2015).

Strengths

- Good quality logistic and communication infrastructures
- Tourist attractiveness
- Beginning of sector and geographic diversification, rapid development of food processing industry
- Absence of a property bubble and banking sector holding up relatively well
- Fall in unit labour costs and reform effort

Weaknesses

- Limited size of manufacturing industry, specialisation in low value-added sectors exposed to strong international competition
- Inadequate innovation effort and lack of skilled labour
- Highly dependent on Europe's economic situation
- High levels of private and public debt
- Banks strongly exposed to sovereign risk

Thailand

Coface Assessments

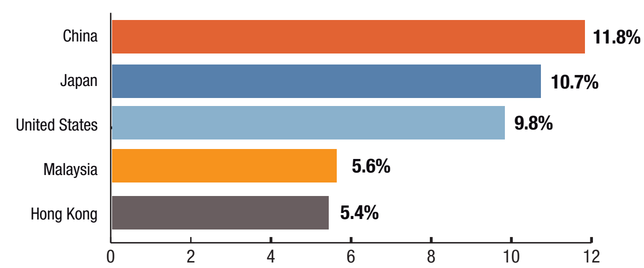
Country risk	A3
Business climate	A3
Medium term	FAIRLY LOW RISK

Main economic indicators	2011	2012	2013 (e)	2014 (f)
GDP growth (%)	0.1	6.4	2.5	3.0
Inflation (yearly average) (%)	3.8	3.0	3.0	3.4
Budget balance (% GDP)	-1.8	-4.5	-4.3	-4.2
Current account balance (% GDP)	1.7	0.7	0.4	0.2
Public debt (% GDP)	41.7	44.3	45.9	48.2

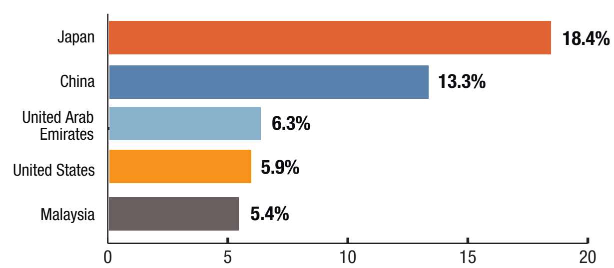
(e): Estimate (f): Forecast

Trade exchanges

Exports of goods, as a % of total



Imports of goods, as a % of total



Risk assessment

Growth expected to stabilise in 2014

After a marked rebound in 2012, Thailand's growth slowed noticeably in 2013. Since being elected in 2011 and the floods in the same year, the government had introduced a number of measures – notably a 35% rise in the minimum wage and tax cuts for first-time car and home buyers – aimed at stimulating household consumption to reduce the country's dependence on external demand. These measures led to big increase in household debt (80% of GDP) and their impact is fading, while the country has been hit by weak growth in the advanced countries. The rise in household consumption has slowed, as have exports.

Growth is expected to stabilise in 2014. It will still be constrained in particular by household debt. There are, moreover, growing tensions between the government, which wants to stimulate growth and the Central Bank, which favours a less accommodating monetary policy. Besides, the country will continue to suffer from sluggish external demand and particularly from the Chinese slowdown. In addition, the country is facing a labour shortage, which could lead businesses to move their activities elsewhere in Asia, particularly to Myanmar. Although the government's spending policy is falling behind, ($11.3bn plan), the iron and steel sectors are expected to continue benefitting from infrastructure spending. Tourism from Asia will remain dynamic. However, the raw materials sector (palm oil, rice, rubber and cane sugar) will continue to suffer from falling prices.

Satisfactory financial situation

After deepening in 2012, the fiscal deficit has improved slightly in 2013 and is expected to remain stable in 2014. Although some of the stimulus measures are coming to an end, public spending will continue to support activity: infrastructure investment, wage rises, rice subsidy scheme, etc. Despite these measures, public debt is expected to remain sustainable. Thailand's sovereign default risk should still be contained.

Externally, the current account balance will worsen in 2013 and 2104, due to sluggish exports. However, foreign direct investments are expected to grow strongly, as Thailand is still a favoured manufacturing base for the automobile and electronics industries. These steady capital flows should cover most of its financing needs. Nevertheless, the country, like other emerging countries, is suffering from the effects of the US Federal Reserve's announcement of an exit strategy for Quantitative Easing III. As a result, the Baht fell against the dollar by 11% between the end of April and the beginning of September 2013. A depreciation of this scale raises the cost of servicing debt denominated in foreign currency (36.6% of GDP) but equally makes exports more competitive.

Finally the comfortable level of foreign exchange reserves (6.8 months of imports in 2013) provides the country with a satisfactory ability to resist sudden capital flight. Meanwhile, despite persistent shortcomings in terms of supervision, the Thai banking sector has become stronger in recent years: fewer non-performing loans, improved solvency and profitability ratios. In addition, despite high household debt levels, the volume of non-performing loans remains unchanged.

Persistent internal divisions

Yingluck Shinawatra, prime minister since the victory of the Pheu Thai party in the early elections of July 2011, is still confronted by a deeply divided society and her populist measures are sharply criticised by the Democratic Party. Deep internal political divisions between Thaksin supporters and those of Democratic Party are expected to remain and the rift could intensify as the succession of King Rama XI approaches. Finally, the Pheu Thai party's attempts to change the constitution to allow the return of Thaksin (brother of the current Prime Minister) could reignite the tensions. A reconciliation process is under way, involving, particularly, Tony Blair, but the opposition has boycotted the process saying it will not participate in the discussions if an amnesty for Thaksin is discussed.

Strengths

- Diversified and high performance in agriculture and industry
- Moving upmarket in manufactured products
- Regional hub open to its dynamic neighbours
- Strengthened banking system

Weaknesses

- Thai foreign trade depends on Chinese economy
- Inadequate structural reforms
- Business climate marked by enduring links between the private sector and political circles
- Recurrent political instability since 2006

Turkey

Coface Assessments

Country risk	A4
Business climate	A4
Medium term	MODERATE RISK

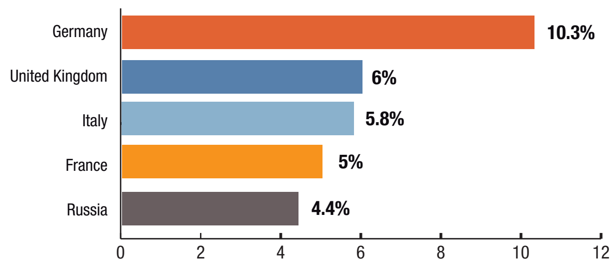
Main economic indicators

	2011	2012	2013 (e)	2014 (f)
GDP growth (%)	8.5	2.2	3.5	3.9
Inflation (yearly average) (%)	6.5	8.9	7.5	6.0
Budget balance (% GDP)	-0.4	-1.5	-2.2	-2.5
Current account balance (% GDP)	-10.0	-6.1	-6.7	-6.2
Public debt (% GDP)	39.2	36.8	35.0	33.0

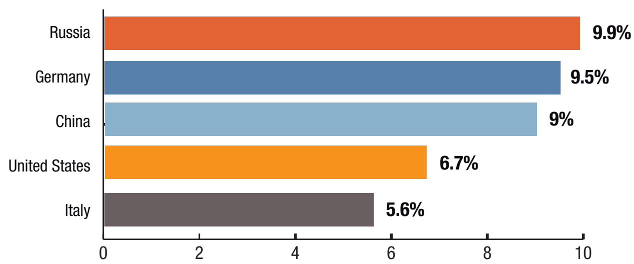
(e): Estimate (f): Forecast

Trade exchanges

Exports of goods, as a % of total



Imports of goods, as a % of total



Risk assessment

Growth sustained by domestic demand

In 2013, Turkish growth has benefitted from higher public spending as well as from the recovery of household consumption. Begun in 2012, the Central Bank's expansionary monetary policy provides support for credit growth (+24% in July 2013) and hence for private sector consumption. Household consumption benefits from the country's demographic vitality. This has significantly increased the labour force (+13% since 2010) while unemployment rate has stabilised at about 10%. On the other hand, public investment will remain strong with the approach of the August 2014 presidential elections. However, the structural weakness of private investment since 2012 limits the potential for long-term growth. In the short term investment will also benefit from the strong credit growth. As for industry, high value-added products (cars, durable consumer goods) and services related to tourism are expected to benefit from the recovery of European demand (60% of tourists). Finally, inflation will rise in the short term on the back of increasing prices for imported goods linked to the depreciation of the Turkish lira.

Public finances under control but external financing becomes scarce

The government's three-year medium term programme has noticeably improved the public finances mainly driven by new levies. This programme foresees a public deficit of 2.3% of GDP in 2013, with the objective of reaching 1.8% in 2015. Except in 2009, the primary balance (excluding interest payments) has been historically in surplus. As a result, the current public deficit does not undermine the viability of the public debt: the level of which is moderate while maturity and proportion of local currency increasing.
The size of the current account deficit, the second highest in the world after the United States, remains the main source of vulnerability for the Turkish economy. In the short term, exports will benefit from the Eurozone recovery (30% of exports), but their growth will be limited by the negative effects of imported inflation on the competitiveness of prices linked to the depreciation of the Turkish lira. External funding depends on volatile foreign capital. But the growing likelihood of tighter monetary conditions in the US led to a withdrawal of capital during the summer of 2013 in the major emerging countries. Therefore, the Turkish lira depreciated by 15% between May and September 2013. But this depreciation is severely testing Turkish companies largely indebted in foreign currencies. In response, the Central Bank intervened by selling foreign currencies thanks to its satisfactory foreign exchange reserves (representing 5 months of imports) although the impact will be modest. The challenge is to restore confidence in the institution's ability to contain inflation which stands above the upper limit of 7% (5% target with a fluctuation band of 2%). Therefore, interest rate hikes seem inevitable in order to restore investor confidence.

A decisive electoral year in a tense geopolitical context

In May 2013, Prime Minister Erdogan's government endured three weeks of demonstrations. Harshly repressed by the police, the demonstrations broke up despite the heterogeneity of the demonstrators (extreme left, Kemalists, Alevis) protesting against the radicalisation of the AKP's pronouncements (pressure on the media, justice, individual freedoms). The social climate remains tense in the run-up to the August 2014 presidential elections. The fragmented opposition leaves the field free for the conservative AKP party. At the same time, Mr Erdogan coveting the presidency unable to seek a fourth term as prime minister. Before the elections, a referendum on the ratification of a new constitution seems possible. Among other things, this would make it possible to grant more executive powers to the president, a position that is currently honorary. Moreover, the peace process begun in May 2013 with the Kurdistan Workers' Party (PKK) remains precarious. In September 2013 the rebels announced that they were stopping their withdrawal from the territory complaining of the government inaction to enhance the rights of Turkey's Kurdish community (right to education in the Kurdish language, regional autonomy). The prime minister's firmness is likely to weaken the peace process. Finally geopolitical tensions have been intensified by the Syrian conflict. The presence of 500,000 refugees and the Syrian military attacks on Turkish territory (Bomb attack in a frontier village causing 54 deaths in May 2013, attack by Turkish army to a Syrian military helicopter into Turkish airspace in September 2013) remain major destabilising factors.

Strengths

- Dynamic private sector
- Positioned as a regional hub, which reinforces attractiveness of the Turkish market
- Demographic vitality and highly skilled workforce
- Public finances under control
- Resilient banking sector

Weaknesses

- Insufficient domestic savings, substantial current account deficit and heavy dependence on foreign capital
- Increased external indebtedness of companies raises their exposure to currency risk
- The Kurdish issue remains a source of social and political instability
- Geopolitical stability tested by the Syrian conflict
- Little likelihood of progress in negotiations with the EU notably because of the Cyprus issue