Credit and Political Risk

NEWSLETTER

June 2018

Introduction

The London Market newsletter is created to inform our clients, both existing and prospective, of the capacity available in the market, short geopolitical and economic analysis of selected countries and also about the news in our company.

Total Capacity Available for Political and Credit Risk by Tenor – first half of 2018

(Total possible maximum MUSD per risk)

Max tenor (years)	Political Risk	Non-Payment risk
20	-	-
15	1 437,5	435
10	2 249,5	890
7	2 867	1 937,5
5	2 954,5	2 398,5
3	2 974,5	2 398,5

Recently, insurance periods have been prolonged: risks of commercial subjects for 5-7 years, insurance of projects with state element 10-12 years (exceptionally 15 years). Our successful projects were mainly in the countries of the former Soviet Union, Eastern Europe, Africa and Middle East (totalling about € 1.5 billion).

News in London Market

Round Table with CNB Governor Jiří Rusnok

On 11 April 2018, the British Chamber of Commerce, in cooperation with London Market, organized a roundtable with CNB Governor Jiří Rusnok.

The discussion was moderated by Petr Karel, managing partner of the London Market and attended by the new UK Ambassador Nick Archer, representatives of major Czech and British companies, banks and investors. The discussed topics included, among other things, the monetary policy of the CNB, the impact of the weakening of the exchange rate commitment on the economy and exports, the situation on the financial markets and the regulation of the banking sector.

Country analyses

Kazakhstan

The economy is expected to maintain moderate growth in 2018. Investment (25% of GDP) should continue to benefit from the development of public infrastructure, particularly road and rail and possibly as part of the Chinese “One Belt, One Road” initiative, supporting the construction sector. The site of Expo 2017 in Astana is set to be transformed into an international financial centre. The current account deficit that emerged in 2015 is expected to decline. The trade surplus would go up with increased hydrocarbon production of the Kashagan, Tengiz, and Karachaganak fields. Subsequently, the start-up of new automobile and nuclear fuel plants to reduce dependency on hydrocarbons will contribute to this. The large growing stock of foreign investment concentrated in hydrocarbons will continue to generate significant revenue outflows. Exports, consisting of 57% oil and 16% metals (steel, iron, copper, uranium), should benefit from the modernisation of three refineries, the construction of a nickel plant, and the increased production of the Kashagan oil field. The country is expected to request a revision of its quota of 1.7m barrels per day (b/d) from OPEC. The privatisation programme is unlikely to have a significant impact on productivity or competitiveness. It remains unclear how and when a presidential succession will take place. A managed process that maintains elite unity is the most likely scenario. Uncertainty about when and how a transition of power from the president, Nursultan Nazarbayev, will be enacted remains the primary risk to political stability, given the weak institutional basis of the regime. Subdued economic performance could drive further public protests. A large stock of reserves in the National Fund of the Republic of Kazakhstan (NFRK, the sovereign wealth fund) will insulate the country from external shocks. Since the abandonment of the pegging of the tenge to the dollar (August 2015) and its floating along with changes in oil prices, the central bank has focused on controlling inflation. Inflation is moderated by the lower expectations of economic agents, as well as the stabilisation of import prices related to the stabilisation of the tenge. Nevertheless, it should still exceed 6% in 2018. Tenge convertibility and exchange rate fluctuations remain an issue for export.

Uzbekistan

The president, Shavkat Mirziyoyev, who ascended to the presidency after Islam Karimov's death in September 2016, has taken steps to improve relations with Uzbekistan's neighbours and attract foreign investment. He is expected to maintain a strong state. The political risk rating remains at C, reflecting the authoritarian nature of the regime. In September 2017 the exchange rate was liberalised and allowed to float, following which the currency depreciated by 48%. Low levels of integration into the world economy limit the country's foreign liabilities. Uzbekistan is highly dependent on commodity exports, especially gas, as well as gold, cotton and copper. The contribution of exports (almost 20% of GDP) could be improved by steady increases in export prices. External demand might increase slightly (especially from China, Russia and Kazakhstan). Uzbekistan has strategic position between China and Europe (New Silk Road). The economy is uncompetitive and state intervention is high. Marked changes in democratic or civil rights are unlikely, however. In 2018-19 economic acceleration will be driven by higher global commodity prices. In 2018, the government is expected to continue its policy of stimulating activity via increased public spending. The public balance will continue to show a small surplus, and the public debt burden will remain weak thanks to withdrawals. Nevertheless, higher revenues from the export sectors should help gradually reduce these withdrawals, as will the reforms aimed at increasing the effectiveness of public spending. Uzbekistan is set to remain one of the most dynamic economies in the CIS in 2018.

Azerbaijan

The presidential election was held on April 11th. According to some international observers, there were irregularities in the conduct of the election. Ilham Aliyev won a fourth term with an overwhelming majority. In 2018 the economy is expected to grow by 1.6%. The government will implement limited measures to open up the economy, but a lack of competition in many sectors will hamper diversification. A return to all-out war with Armenia over Nagorny Karabakh is unlikely but cannot be excluded. Azerbaijan is heavily reliant on oil exports. The economy's adaptation to lower oil prices and the increase in gas exports to Turkey should favour a timid exit from recession in 2018. While public investment in infrastructure and public building is expected to remain sluggish due to budgetary constraints, investments related to developing the Shah Deniz gas field in the Caspian Sea and the extension of the Trans-Anatolian Natural Gas Pipeline (TANAP) to the Greek/Turkish border, with the eventual goal of carrying gas from Azerbaijan to Europe, should accelerate in partnership with foreign partners. Integration into the international financial system is relatively low, reducing the risk of external financial shocks other than through the commodity price channel. As a result of falling oil prices and the sharp depreciation of the Manat, it has had to support public enterprises, particularly the country's leading bank: the International Bank of Azerbaijan (IBA). Debt is likely to increase further, because the State wishes to develop the gas potential and the pipelines to ensure the relay of oil. Despite the deficit in services and revenues, in return for the presence of foreign companies in the hydrocarbon sector, the current account balance was traditionally positive due to the impressive trade surplus generated by hydrocarbon sales. Despite shortcomings in handling insolvency and cross-border trade, the country ranks 65th out of 190 on the ease of doing business index.

Angola

Dependent on oil activity, growth rebounded weakly in 2017 thanks to the recovery of oil prices and the dynamism of the volumes exported, particularly to China. In 2018, the rebound should continue thanks to the commissioning of the Kaombo oil field. Oil sales, which account for more than 90% of export earnings, could benefit from higher oil prices. However, the dynamics of Chinese demand, in a context of a slowing economy is a source of risk. The inflation is rising, and the fiscal and current-account balances are under pressure. In 2018, fiscal consolidation efforts are expected to be stepped up. Progress in mobilizing non-oil revenue will be a priority. In particular, the increase of several consumption taxes and a review of tax exemptions are planned. The move to a more flexible exchange-rate system in early 2018 will keep inflation elevated. The current deficit is expected to continue to decline in 2018, in line with oil prices. However, the surplus in the balance of goods will still be too small to compensate for deficits in services and income. The president, João Lourenço, will continue to take steps to reduce the influence of his long-serving predecessor, José Eduardo dos Santos. The president's focus on fighting corruption, improving governance and the business climate will need to be followed by reforms to unblock private investment.

Geopolitical outlook

Despite low approval ratings, increasingly protectionist policies and the potential of a trade war with **China**, the outlook for **United States'** economic growth is positive although we may see a decrease in international commerce.

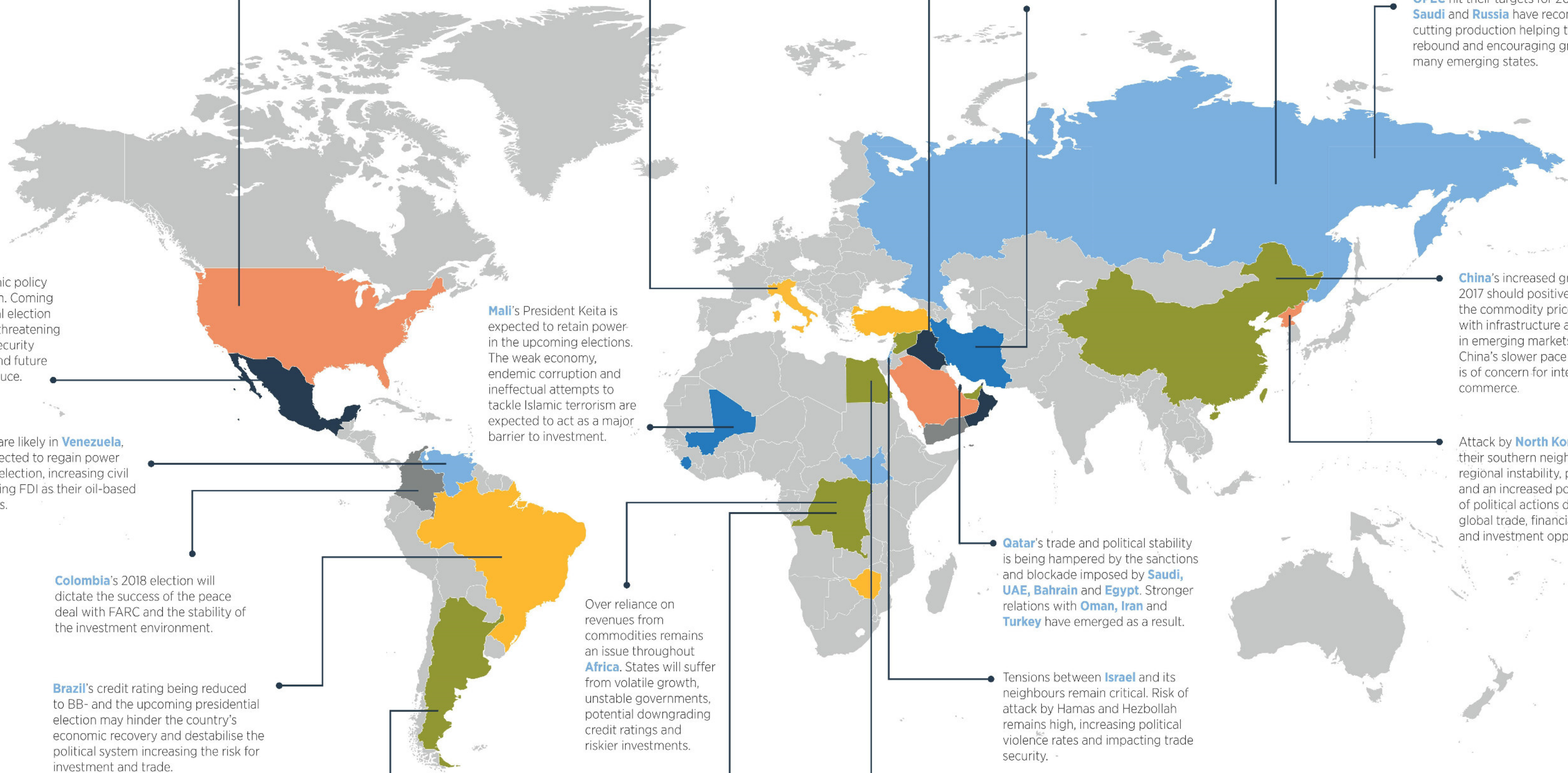
The results of the upcoming **Italian** elections could make the future and value of the euro increasingly uncertain, increasing political and credit risk for investors.

Iraq, **Syria** and **Turkey** are being impacted by the Kurdish push for independence, disrupting trade and increasing the risk of political violence.

Iran's tussle with **Saudi Arabia** for regional dominance may impact global oil prices and proxy wars in countries like **Yemen** and **Syria** may hinder growth and trade.

Current and future investments in **Russia** may be impacted by the Western sanctions and rising political tensions which may well result in military or cyber retaliation. Putin is expected to comfortably win Russia's 2018 Presidential election but the economic outlook is poor with weak growth projected despite more favourable borrowing conditions and an uptick in oil prices.

OPEC hit their targets for 2017 while **Saudi** and **Russia** have recommitted to cutting production helping the oil price rebound and encouraging growth for many emerging states.



Mexico's economic policy remains uncertain. Coming into a Presidential election year and the US threatening to quit NAFTA, security of investments and future appetite may reduce.

Mali's President Keita is expected to retain power in the upcoming elections. The weak economy, endemic corruption and ineffectual attempts to tackle Islamic terrorism are expected to act as a major barrier to investment.

China's increased growth in 2017 should positively impact the commodity prices along with infrastructure and trade in emerging markets, though China's slower pace of growth is of concern for international commerce.

Further defaults are likely in **Venezuela**, with Maduro expected to regain power in the upcoming election, increasing civil unrest and reducing FDI as their oil-based economy declines.

Attack by **North Korea** on their southern neighbour risks regional instability, proxy wars and an increased possibility of political actions disrupting global trade, financial markets and investment opportunities.

Qatar's trade and political stability is being hampered by the sanctions and blockade imposed by **Saudi**, **UAE**, **Bahrain** and **Egypt**. Stronger relations with **Oman**, **Iran** and **Turkey** have emerged as a result.

Colombia's 2018 election will dictate the success of the peace deal with FARC and the stability of the investment environment.

Over reliance on revenues from commodities remains an issue throughout **Africa**. States will suffer from volatile growth, unstable governments, potential downgrading credit ratings and riskier investments.

Brazil's credit rating being reduced to BB- and the upcoming presidential election may hinder the country's economic recovery and destabilise the political system increasing the risk for investment and trade.

Tensions between **Israel** and its neighbours remain critical. Risk of attack by Hamas and Hezbollah remains high, increasing political violence rates and impacting trade security.

Argentina's relative political stability in Latin America should encourage prospective investors, especially in emerging metals markets.

DRC's President Kabila refuses to relinquish power. The lack of infrastructural investment, widespread violence and displacement of people is threatening investment, particularly in the commodities sector, disrupting trade and regional growth and stability.

Egypt, Sierra Leone, Zimbabwe, South Sudan and **Mali** are all planning to hold Presidential elections in the first half of 2018. Critics suggest that elections could result in political violence, jeopardise foreign investment and slow economic growth.

The probable re-election and continued reform policies of **Egypt**'s incumbent President El-Sisi makes Egypt a more attractive investment prospect, despite the poorly performing economy, political violence and civil unrest.