Major Country Risk Developments July 2024

By Byron Shoulton

Overview

Voters in the United Kingdom (UK) unenthusiastically elected the Labour Party to take over the reins of governing the country. The change was needed. The outgoing Conservatives (or Tories) saw a massive shift in trust among voters who have grown disenchanted with establishment politicians. According to the latest British Social Attitudes Survey, a record 45% "almost never" trust governments to put the nation's interest first, up from 34% in 2019. The lack of faith was evident in the performance of the Reform UK, a new anti-immigration party which attracted large numbers of traditional Tory voters. It was also visible in the strong support for independent candidates. There is apparently lack of enthusiasm for Labour's incoming Prime Minister Sir Kier Starmer, who will enter office with a negative approval rating. Voters have handed an enormous win to a party about which they seem to have little excitement.

The new government is charged with solving the problem of Britain's stagnant productivity and reviving its economic growth. It will be expected to lay out a path toward structurally deeper cooperation with Britain's largest trading partner, the EU. Above all, the new Labour government will be expected to make the state machinery work to tackle complex problems like improving economic inactivity, upgrading vital infrastructure and preparing the country to adapt to next generation technology.

In France, following deadlocked snap election results,

President Macron has no replacement government ready, and is not sure how to form such a government. French political parties, unlike elsewhere in Europe, have no tradition of consensus-seeking compromise.

The logical next option would be for President Macron to ask the left-wing alliance, the New Popular Front (NFP), to try to form a government. The four-party grouping won 182 seats in the 577-seat National Assembly, more than either Mr. Macron's centrists (168 seats) or Marine Le Pen's hard-right (143). However, the constituent parties of the NFP disagree on many issues, among them who should be prime minister.

Furthermore, even if the NFP was invited to form a minority government, the thinking is that it might not last long. Many of its plans involve heavy government spending. With a budget deficit forecast to reach over 5% of GDP this year, France's public finances are already stretched. Markets would likely punish extravagant unfunded big-spending plans.

An alternative for Mr. Macron, who wants to see a stable government put in place, would be to hold out for a cross-party alliance-which might reach from the moderate left, including the Greens, to the moderate right-capable of commanding a majority.

The left, pumped-up after its unexpected first place in the elections, says it wants to govern by itself, and is in no mood to make deals with Mr. Macron and his lot.

Another option for France would be a "technical government." Run by a civil servant or technocrat, this would be designed to keep the machinery of government running rather than to enact big reforms, and to last until fresh election. Under the French constitution, fresh ele
ctions cannot occur for at least another 12 months.
In short, French voters have selected a parliament that accurately reflects the divided nature of the country, but which offers no clear or immediate path to forming a stable government.

China

The biggest glut of copper has built up in Chinese warehouses, after a price hike and tepid consumer demand prompted manufacturers to pull back on buying this most important industrial metal.

According to Bloomberg data, stocks of copper in Shanghai Futures Exchange warehouses have grown to their highest level since 2020. Analysts in China say the excess metal simply cannot be consumed as wire and cable manufacturers are currently under tremendous pressure due to the downturn in China's real estate sector.

Copper is widely used in electrical wirings, plumbing and household appliances. The build-up of copper inventories highlights the fragile state of China's industrial sector, which reined in demand when prices for the metal surged to a record high above $11,000 per ton in May. The rise in copper inventories reflects China's real estate downturn as well as sluggish manufacturing and credit activity, as Beijing shies away from directly stimulating household consumption. A month since the record high, copper prices have fallen 13% to $9,600 per ton, weighed down by weak Chinese demand. Copper inventories usually build up in the first few months of the year and start to be drawn down in the spring after the Chinese

Lunar New Year holiday as factories increase production again. However, this year the rise in inventories has gone on longer than usual.

In contrast to the situation in China, traders have warned that global copper inventories are still at dangerously low levels with only several days' worth of consumption in back up. This, the traders argue, creates a risk of volatile price surges. The weak market in China has led copper for delivery in Shanghai to trade at a discount to the global benchmark price- a rare occurrence. However, it appears that China's copper fabricators have very recently started buying the metal again, with inventories recording slight decreases in June. The build-up in copper stockpiles nevertheless points to the upheaval that the sector faces due to a global oversupply of smelters.

Indonesia, India and the Democratic Republic of Congo (DRC) are all set to follow China in adding significant smelting capacity soon. This is considered the biggest volume of new smelter capacity in a 12-to-24-month period. At the end of 2023, the closure of a giant mine in Panama and cuts to copper production guidance by the world's largest mining companies, led analysts to expect metal shortages as smelters fight for limited feedstock. Fund managers latched on to that earlier this year and placed bets on rising copper prices, but the physical shortages did not materialize. In part, that was because the DRC has managed to boost output at its mines, while China has processed more scrap, helping to alleviate the supply situation.

Meanwhile, China has sought to counter western criticism of its industrial strategy, stressing that Chinese exports of electric vehicles and solar technology are beneficial to global trade.

Coming on the heels of new U.S. and EU tariffs on Chinese EV's and solar panels as tensions with the west escalate, China's Premier Li Qiang recently boasted of "the openness of China's market." This, at a time when complaints over barriers to foreign access to China's market have intensified. Equally, the role of the Chinese government-hefty subsidies provided to industry- have come under renewed scrutiny in both Washington and Brussels. The Chinese Premier stressed the large size of the Chinese market that allows foreign and domestic companies to compete "on a level playing field." Premier Li underscored China's important role as a force promoting development and growth of emerging industries globally.

China has heavily touted its industrial strategy this year, with official backing of everything from artificial intelligence to renewables, against an economic backdrop of a prolonged slowdown in the important real estate sector which has weighed on growth. However, Chinese officials project that the economy is on course to meet a growth target of 5% this year. Trade tensions with China have intensified after a period of worsening geopolitical relations with the west, including a focus on reducing supply-chain dependency on Chinese made goods.

The EU has imposed tariffs of up to 48% on imported Chinese EV's, while the U.S. imposed levies of 100% on Chinese EV's. China has labeled recent western measures as "regressive actions of decoupling" which they predict would drag the world into a destructive spiral where fierce competition for a larger slice result in a smaller pie. The Chinese premier also emphasized that the rise of Chinese industry was part of a global tech revolution, and that its products were helping to address climate change. He stressed that there is a need for a fairer, non-discriminatory business environment for China's

technology advancement. China has entered talks with the EU over the new tariffs, which follows an investigation into state subsidies.

Meanwhile, the imposition of tariffs usually means a slump in the targeted company's shares. Not so for Chinese electric automaker BYD. The imposition of steep European tariffs on electric car imports from China has had the opposite effect on BYD, the country's largest EV manufacturer. The EU's additional tariffs on EVs shipped from China became effective on July 1, 2024. For BYD the new EU tariff will be 27.4%-compared with 10% previously. For local rival Geely, it will be 30%. Nonetheless, shares in these companies rose.

The positive market reaction was partly because BYD, the biggest threat to the European auto market, was hit with the lowest additional tariff among companies named. The extra levy came in at half of what analysts had estimated. Even if most of those tariffs are passed on to buyers, the price point for BYD cars would still be lower than the competing models made by European counterparts. Furthermore, even at lower prices, BYD's car designs, safety and battery technologies have continued to improve rapidly.

In addition, BYD gross margins exceed 20%-making it a rare example globally of a profitable EV automaker and giving it more leeway amid price wars and tariff rises.

For Europe, the extra tariffs came with costs. Tariffs will add to EV sticker prices for European customers. It now makes sense for Chinese EV makers to speed up plans to place production in the EU, cutting long-term production costs and making them more competitive. This exercise in protectionism has simply emphasized that stopping BYD's march into Europe's car market will not be easy. To complicate matters further, BYD recently signed a $1 billion agreement to build an EV plant in Turkey, as it looks to increase its European production and continue its expansion overseas. The Turkish plant will be capable of producing 150,000 vehicles each year. Production will begin in 2026 and is projected to create 5,000 jobs.

Meanwhile, the risk of retaliation from Chinese to the new tariffs cannot be ruled out.

USA

The Federal Reserve (the Fed) insists that it has made 'considerable progress' in its mission to beat back inflation, but it seeks 'more good data' before cutting interest rates from their 23-year high. Recent inflation reports were encouraging and showed modest progress in inflation moving towards the 2% target, says the Fed. Lowering rates too early could foil plans to tame inflation. Keeping them too high for too long could push more Americans into unemployment than is necessary. Officials remain on edge after inflation flared up earlier this year, upsetting expectations that the Fed would begin slashing rates before the summer. It has left policymakers eager for more proof of disinflation before they cut borrowing costs.

Recent signs of a cooling in the labor market have, however, bolstered expectations for a fall in borrowing costs after the summer. The unemployment rate now sits at 4.1%, a level last registered in November 2021.

Meanwhile, the power to raise prices is slipping from some of the biggest U.S. food and packaged goods

groups, threatening their sales growth even as it spells relief for inflation-bruised consumers.

According to recent research and analysis, U.S. consumers are adjusting to higher prices at the cash register by buying less food. Shoppers have put billions fewer items in their grocery carts over the past two years compared with pre-pandemic levels. Instead, consumers have resorted to a combination of online purchases, bulk buying-and by simply consuming less, especially in lower-income households.

This is in response to higher prices for food, but also for other essentials such as housing and insurance that have taken a bite out of the average consumers' pocketbook. Producers of consumer-packaged goods were able to boost revenue by raising prices during the run of high inflation 2021-23. But now, even as price increases have moderated, retailers and producers are rushing to reinvigorate sales volumes via markdowns and promotions. Increased prices have meant smaller basket sizes, and more consumers seeking to eliminate products deemed non-essential, was the conclusion reached by research firm NielsenIQ, in a recent analysis of sales of perishable goods.

Adjusted for inflation, Americans on average spent 3.1% less on food at home in 2023 than in 2022 according to the U.S. Department of Agriculture. Checkout terminals at U.S. stores scanned 248 billion items over the past twelve months, down 3 billion from the previous year and 20 billion fewer than the year leading up to June 2020. The declines have put pressure on retailers and their vendors to offer more discounts.

While consumers are visiting stores more often, they are purchasing fewer items per trip. Target, with nearly 2,000 U.S. stores, announced price cuts on 5,000 items in June, including groceries such as milk, meat, bread, coffee, vegetables and fruits. Target's chief growth officer told analysts in June that the company was cutting prices to get shoppers back in stores and drive sales volumes back up. Kroger, the largest U.S. supermarkets operator by revenue, reported that its staff aimed to return to unit volume sales growth. Suppliers are reportedly offering more money for in-store promotions and discounts than in the past. Meanwhile, Walmart has said it is offering so-called rollbacks on prices for approximately 7,000 products, 50% more than a year ago in the grocery category.

Though some food purchases have shifted to other venues, they do not fully account for the decline in food sales at stores. Spending at restaurants is at the lowest level in seven months, and customer visits have been declining for 13 consecutive months, according to the National Restaurant Association. Though online grocers and discount stores have made gains, they were outweighed by the volume declines at traditional food stores, according to McKinsey. The consultancy also concluded the boom in weight-loss pharmaceuticals has had limited impact on food retailers. More than three-quarters of consumers cited prices as the top reason they are purchasing fewer grocery items.

Brazil

The ruling Workers Party (PT) has filed a lawsuit against the head of the country's central bank as it steps up attacks on the bank's leader over the pace of interest rate cuts, while alleging political bias.

President Lula has publicly criticized the central bank chief for working "to harm the country than to help" by not cutting rates more quickly. The Brazilian president claims that the only thing that is wrong in Brazil right now is the behavior of the central bank. The legal action marks a sharp escalation of the war of words between the Workers Party and the head of the central bank – which has raged since Lula returned to office for a third term last year. Elected on pledges to kick-start the Brazilian economy and improve the livelihoods of its poorest citizens, President Lula has sought to blame the slow progress on the leadership of the central bank, thereby shifting the focus away from so far ineffective government policies.

The central bank has been gradually reducing the benchmark Selic interest rate for one year, cutting it from 13.75% to 10.5% currently. The central bank kept rates steady at 10.5% last month in a unanimous decision of its monetary committee. The bank's inflation target is 3% and inflation is currently running at 4%. The government criticizes the central bank for keeping rates too high, but the question remains why inflation is not back to target, with interest rates so high. Brazilian economists and bankers argue that the government's fiscal expansion is to blame, and Lula's new budget framework has so far failed to promote the necessary adjustments.

The unusually intense, prolonged and extensive flooding that has devastated southern Brazil is now adding to fiscal demands on state and federal governments alike. The recent heavy flooding in Rio Grande do Sul has hurt

agriculture and agrobusiness and caused extensive damages to infrastructure. The crisis in Rio Grande do Sul will demand new unplanned government spending outlays to help rebuild infrastructure, provide housing and relocation of thousands of displaced citizens. This will be a long-term undertaking and a vital priority as this southern State is considered the heart of Brazil's vast and important agricultural export sector.

Displaced citizens, farming cooperatives, financial institutions, small businesses, homeowners, etc., are expected to eventually benefit from financial and technical assistance to be provided by the World Bank, the Inter-American Development Bank, the UN, the Brazilian Development Bank (BNDES), in addition to emergency outlays from the Brazilian federal and Rio Grande do Sul's state governments.

In recent years, municipal governments cut investment in flood defense protections that this low-lying, deforested region needed. Warnings had been ignored that with five major rivers intersecting, this area was vulnerable to massive flooding. In addition to being incapable of halting rising waters, the state's capital's flood barriers trapped the flood waters, slowing the process of drying and recovery.

The process for rebuilding and relocation promises to be long, costly and complicated for the authorities. Governments' response to this crisis will be carefully watched and evaluated by voters and businesses alike.

South Africa

South Africa's currency and stock market both strengthened following the inauguration of Cyril Ramaphosa as the country's president for a second term in June. This seals a power-sharing agreement with the African National Congress (ANC) and the opposition Democratic Alliance (DA).

The ANC, which lost its majority for the first time since the end of white minority rule 30 years ago, avoided investors' nightmare scenario of forming a coalition with the Economic Freedom Fighters (EFF) and the new MK party of former president Jacob Zuma, both of which espouse a radical nationalization agenda. The EFF had promised to nationalize the central bank while MK said it would scrap the constitution.

The pro-business DA, which is now part of Ramaphosa's government of national unity, is expected to be given several positions in the new cabinet. The power shar-

ing deal has sparked confidence among leading private sector actors. The head of Business Unity South Africa, which represents most of the country's largest companies said businesses and investors believe the power sharing arrangement provides an opportunity to move the country forward.

The surge in new confidence marks a stark reversal for South Africa, which had been shunned by foreign investors over the past five years, as economic reforms stalled, and electricity blackouts hit production and profits. The election results and 86 consecutive days without power cuts raised hopes that the tide is turning.

JPMorgan analysts upgraded South Africa to "overweight" in a new report. The bank said it believed the best-case scenario for South African politics-the DA active participation in a government of national unity-would help boost the outlook. JPMorgan is anticipating significant foreign inflows of investment funds to South Africa equities in the near term.

Analyst have warned that the challenge for the new government would be to implement policies and deliver two years of more than 2% GDP growth that would potentially spur a change in market attitude toward South Africa over an extended period. S&P Global Ratings stated that it considered the election outcome "broadly favorable for the economic and fiscal outlook."

Nevertheless, we expect the government will face an uphill battle to revive growth and maintain fiscal discipline, while navigating the new realities of coalition politics. The partnership with the DA is broadly expected to help drive stronger reform momentum. However, there are vast ideological differences between the ANC and the DA, which could complicate governing effectively. This means both the ANC and the DA must work very hard to find common ground. The sinister, combined presence of the EFF and former president Zuma's MK party on the sidelines, still has the potential to destabilize the fragile governing status quo.

Ghana

The country obtained an agreement with international bondholders than will wipe almost 40% off the value of $13 billion in outstanding debt. This puts Ghana on a path to end two years in default on its sovereign debt. Leading bondholders including Neuberger Berman, Abrdn, Greylock Capital Management and Amundi have agreed to give up $4.7 billion of their original claim to the government of Ghana.

The deal is the latest sovereign debt restructuring launched under a G20-approved "common framework" to limp to the finish line, after the process was beset by delays.

Bondholders also finally voted to approve a restructuring by Zambia in May under the framework, almost four years after that country defaulted.

Ghana's deal entails important concessions from bondholders, while it provides the required debt relief to the country. In addition, the deal is reportedly in compliance with IMF-set debt targets.

Ghana has been in talks with official lenders which are now expected to assess whether the terms offered to private bondholders match the scale of relief they are negotiating. Most of the bonds will lose 37% of their face value as they are restructured into debts with longer maturities that pay interest of 5% over four years. Up to $1.6 billion worth of the new bonds will not be subject to a reduction in face value but will carry lower interest rates of 1.5%. The international bondholder committee owns 40% of the debt, while a regional bondholder committee owns another 15%.

The agreement sets Ghana on a course to leave default by the time of elections in December in which sitting President Nana Akufo-Addo will not seek re-election.

Ghana fell behind on paying external debts of nearly $30 billion at the end of 2022, after double-digit inflation and turmoil in the country's key exports of gold, cocoa and oil ravaged the economy. The country received a $3 billion bailout from the IMF that required debt relief talks

with creditors, which the Ghanaian government opted to conduct via the then-new G20 process. However, the common framework has largely failed to streamline sovereign debt restructuring negotiations, particularly in countries that have built up a much wider array of creditors than in past debt crises, making coordination harder.

Ghana's bondholder talks also hit a hurdle in April when the IMF judged an initial deal would have failed to meet debt targets. In a reflection of how recent restructurings have had to navigate tensions between creditors, the Ghana deal also includes a so-called most favored creditor clause that will prevent the government giving other lenders better terms than the bondholders. Ghana will also be required to publish certain public debt information on a semi-annual basis and be barred from legal challenges to the bonds. The international bondholder committee informs that these debt clauses are part of the package of measures to normalize relations with bondholder investors and to progress towards restoring Ghana's access to international credit markets.

Democratic Republic of Congo

China holds significant investments in the DRC, where it predominantly controls the lucrative mining sector through entities like Sicomines. During a state visit to China in May 2023 President Tshisekedi and his Chinese counterpart Xi announced the elevation of the bilateral relationship from a mutually beneficial strategic cooperative partnership to a comprehensive strategic cooperative partnership.

However, President Tshisekedi has publicly committed to revisiting Congolese mining contracts, particularly a 2008 agreement signed by his predecessor Joseph Kabila (2001-2019)- with the aim of securing improved terms for the DRC. The DRC is aiming to change past practice and enter into bilateral agreements involving the states, rather than individual agreements with Chinese mining companies.

Given vast cobalt reserves in the DRC and China's bid to leverage its ability to fund infrastructure in one of the least developed countries, there is jostling with the west for influence. President Felix Tshisekedi, in office since 2019 represents a resource-rich country in the heart of Africa with a population of nearly 100 million and a GDP per capita of $657 as of 2022, according to the World Bank.

Catering to over 70% of the global demand for cobalt, the DRC is sitting on an opportunity to contribute to low-carbon transition and leverage its comparative advantage in cobalt to meet its developmental objectives, reduce poverty and boost prosperity. For this to happen it needed global partners. China was ready and willing to be that partner. The DRC plays an important role in China emerging electric vehicle industry – over three-quarters of China's cobalt imports from the DRC are directed towards this sector. Cobalt is vital for lithium-ion batteries, which power most all-electric or plug-in hybrid EV's.

At the same time, China also aims to bolster domestic consumption and production in line with its 'Dual Circulation Strategy,' adapting to a less globally intercon-

nected economy while promoting internal growth.

Beijing's climate commitments are also at stake, crucial for its strategic positioning. Control of mining in DRC, in whatever measure, significantly enhances China's competitive edge in energy and tech sectors, posing a challenge to U.S. ambitions for clean energy. The Chinese mining company CMOC Group, viewed as the world's second largest cobalt producer, holds an 80% stake in the Tenke Fungurume Mining (TFM) copper-cobalt ore project in the DRC. The relationship between the DRC and China is said to be mainly an extractive one, marked by deals for minerals in exchange for infrastructure development.

The bigger picture is not just a matter of who controls the value chains but also how African countries' developmental partners could support value addition of commodities and tend to local markets in the region.

There is a growing perception that China's investments in Africa are not necessarily ones driven by mutual benefits but based on extracting most value for Chinese industries. For example, Zambia in 2021 became the first African country to default on its sovereign debt, a large part of which was owed to China.

In January, the DRC confirmed that it was set to receive $7 billion in financing under a renewed 'minerals-for-infrastructure' contract between a group of Chinese state-owned construction firms and the DRC's state-owned copper company, Gecamines.

With Chinese entities as primary stakeholders, this venture obtained considerable copper and cobalt reserves in the Kataga province. This was viewed as a revival of the Sino-Congolese mining enterprise, Sicomines. The agreement came close on the heels of the formation of the national cabinet after a six-month delay, with President Tshisekedi securing his second term in office.

Against this backdrop revival of the Sicomines agreement in the DRC indicates the appetite for African countries to seek infrastructure aid from China in the form of Belt and Road Initiative (BRI) projects or otherwise.

The renewed agreement gives impetus to China's relationship with the DRC as well as other African countries by extension. As part of the renewed 'minerals-for-infrastructure' agreement, the DRC will receive 1.2% royalty from Sicomines copper-cobalt mine while Gercamines will market 32% of the mine's production. In May the DRC indicated that it aimed to boost its stake in the venture from 32% to 70%, considering concerns that the deal gave away too much of its resources to the Chinese with little material benefit to the DRC.

In March, President Tshisekedi established an ad hoc commission to align the negotiating positions of Congolese institutions in the execution of such deals. The commission asserted that the DRC should seek a larger stake in Sicomines, citing the 2008 agreement which failed to consider an estimated $90.9 billion in reserves brought by Gecamines to the original deal. Consequently, the panel proposed doubling the infrastructure financing from $3 billion to $6 billion, citing the inadequate allocation relative to Gecamines' mineral reserves. In addition, it advocated pushing for larger compensation in renegotiation talks, including a $2 billion lump sum, due to alleged undervaluation of mineral sales by Sicomines. Figures available from AidData indicate that the DRC has undertaken as many as 253 projects in the region with Chinese funding to the tune of $13.7 billion. While it is the world's top cobalt producer, the DRC supplies barely 1% of refined cobalt used worldwide.

Separately, many observers have noted a substantial influx of funds to state coffers, with little or no improvement in the living standards of the country's 100 million inhabitants.

President Tshisekedi has in the past faced criticism for his inability to effectively harness the DRC's abundant mineral resources, estimated to be worth trillions of dollars, and uplifting the impoverished population. According to the World Bank the DRC ranks among the five poorest nations globally. Furthermore, the country is hemorrhaging wealth due to ongoing conflict in its eastern regions, which has endured for nearly three decades.

Spain

Spain is a developed, high-income country and the fourth-largest economy in the eurozone, behind Germany, France and Italy. It is mostly a services-oriented economy, with tourism an important contributor to growth and employment. The industrial sector is also important, accounting for 22% of GDP.

The business environment outlook has improved gradually since the covid pandemic. A rebound in global tourism has been good for the sector in Spain. That momentum is expected to remain positive this year.

Access to European funds should help boost investment in infrastructure and the digitalization of the economy going forward. Nevertheless, structural weaknesses persist.

In November 2023 the leader of the center-left Spanish

Socialist Workers Party (PSOE), Pedro Sanchez, was re-elected as prime minister by an absolute majority of lawmakers. This should allow him to remain in power until 2027, although the risk of policy paralysis is high, as Sanchez will be dependent on a mixed coalition to get legislation passed.

The government's policy platform is like that of his previous government, with priorities including addressing income inequality, redistribution, and social and green policies. An income-tax increase for high-net-worth individuals introduced in 2022 has been extended until at least the end of this year. Taxes on banks and energy companies were raised in the last administration and are unlikely to be lowered. The re-elected Sanchez government will continue to invest Spain's allocation from the EU recovery fund and implement reforms to that address his party's priorities.

Economic activity in Spain has been above the eurozone average and is expected to remain that way during 2024-25, supported by easing inflation and strong wage growth on the back of a tight labor market. Economic growth is being held back by still-high interest rates and a subdued external environment, with U.S. and Chinese growth slowing. Industrial production is projected to rebound slightly in 2024 by 0.5%, after contracting by 1.5% in 2023.

The European Central Bank (ECB) began easing monetary policy in June, after raising rates by a record 450 basis points since 2022. Spanish households and companies will continue to face high borrowing costs this year.

The ECB is expected to cut rates by a cumulative 75 basis points during 2024. The government's fiscal stance will remain loose, and Spain's public debt/GDP ratio remains high (the fourth highest in the eurozone after Greece, Italy and Portugal).

Risks to political stability are expected to decline in the short term, although Mr. Sanchez's minority left-wing government remain intrinsically unstable owing to the high number of regional political parties on which it will depend.

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