Trade Credit & Political Risk

Major Country Risk Developments
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Overview

A year ago, inflation was still too high, and investors were placing bets that interest rates would have to stay higher for longer. Today, inflation looks mostly subdued and central bankers have started cutting interest rates. According to a study by the Massachusetts Institute of Technology, the decline in inflation has been a remarkable success.

Contrary to the claim of some commentators, the Federal Reserve's ("the Fed") rate increases had been crucial to keeping inflation expectations under control. Before inflation spiked, many expected prices would continue to climb and believed the Fed would have failed to act appropriately - an expectation that would have caused the inflation problem to become entrenched. True, the public has been vexed by the almost 18% rise in consumer prices since 2020 and the interest-rate rises that were later required, but at least real wages rose to help cushion the effects of higher prices.

USA

Recently released data showed U.S. job openings fell in July to their lowest level in more than three years, boosting bets that the Fed would likely cut interest rates multiple times. The Fed already indicated that the time has come to begin cutting U.S. interest rates given inflation now tracking down at 2.9%. In addition, there is evidence of U.S. unemployment creeping upwards (4.2%), amidst news of pending layoffs. The housing market remains stalled given prolonged periods of inadequate new housing construction nationally, which has made it unaffordable for many families to enter the housing market due to excessively high home prices.

U.S. relations with China have become more troublesome pushing U.S. officials to dig in with additional high tariffs proposed on Chinese imports.

U.S. Steel, the iconic American steel manufacturer has remained steadfast in support of its proposed sale of the company to Nippon Steel of Japan. The company argues that steps by the U.S. government to block its sale to Nippon Steel would put thousands of jobs in jeopardy.

The U.S. government concluded that the $14.9 billion transaction posed a national security risk that could not be mitigated by the U.S. and Japanese groups. While the administration expressed its opposition to the proposed deal, shares in U.S. Steel fell sharply on the news that the government had finally blocked the sale, falling by 22%. Many U.S. officials in private have ridiculed the administration's decision. Japan is the most important American ally in the Indo-Pacific and has been working very closely with Washington on a range of efforts to counter China.

U.S. Steel shareholders approved the transaction earlier this year. This latest development puts a premium on anticipating the political risk associated with high-profile U.S. assets and developing a comprehensive strategy up front - because the political pressure can fundamentally change outcomes. U.S. Steel warned that thousands of jobs were at risk in Pennsylvania if the acquisition fell through, adding that the lack of a deal would raise serious questions about keeping the company headquartered in Pittsburgh.

Meanwhile, discount retailers offer a unique window into the health of U.S. consumers. From stores catering to suburban middle- and higher-income consumers, to chains primarily serving lower-income households shopping for necessities, sales have been trending down.

For the past few quarters, retailers have seen weak demand from stores like Family Dollar's core lower-income customer base. Now, the weakness has spread to better-off customers that frequent more upscale chains.

Shares in Family Dollar plunged 19% following worse-than-expected quarterly results. This followed disappointing results from competitor Dollar General, whose shares subsequently shed one-third of their value. Signs are that U.S. households have started shifting to "buying for need" from "buying for want," with the sales mix shifted heavily to necessities.

Consumers may have changed how they celebrate over the summer. Fewer guests and fewer parties seem to have become a trend. Some retailers have acknowledged they are navigating through one of the most challenging macro environments. Discount retailers report same-store sales increased 1.3% last quarter versus a year earlier, well below the 3% growth that analysts had expected. More retailers have lowered both annual top-line and bottom-line expectations for 2024. Many now expect same-store sales to grow by a low-single digit percentage across the country.

U.S. retailers' hopes that consumers would start spending more because of key selling periods such as back-to-school, Halloween and year-end holidays have waned. Many are trying to appeal to better-off households by introducing higher-priced products at more stores. That could prove an uphill battle. So far, middle- and high-income consumers have been searching for deals across the board. Recent poor results among retailers are a sign that U.S. consumers are getting even pickier about what they buy and what they are willing to pay.

China

Ongoing efforts to assert Chinese maritime dominance not only in waters close to China's coastline but farther afield- has taken on more ominous tones. China's strident actions of intimidation at sea has increased sharply in recent months among its neighbors including the Philippines, Japan and Taiwan. The Chinese leadership appear to have hardened its stance vis a vis its pursuit of greater global military, economic and political influence. Its sway over maritime activity in the Indo-Pacific and elsewhere have taken on greater prominence as China's large naval fleet (the largest in the world) and a beefed-up, heavily armed coast guard apparatus have become increasingly aggressive and assertive.

Furthermore, the Japanese government on August 27th said an unprecedented incursion by a Chinese military plane into Japanese airspace was "totally unacceptable" and a threat to national security. Japan saw this not just a severe violation of its sovereignty but a threat to the nation's security. It vowed to take all possible measures to monitor and act against any future violations of its airspace.

Perceptions of a steadily rising threat from China were central to Japan's decision in 2022 to begin a significant increase in defense spending. Japan's military revealed earlier this year that it had scrambled jets on more than 660 occasions in the twelve months that ended in March 2024. Roughly two-thirds of those were in response to activities by Chinese aircraft or ships.

China says it welcomes other countries to follow its pathway to modernization. President Xi calls his one-party model efficient, equitable, and dignified. In other words, competent government, equality and order matter more than "freedom." The government boasts of "two major miracles" that shaped China's rise, "fast economic development and long-term social stability". Sino-U.S. rela-

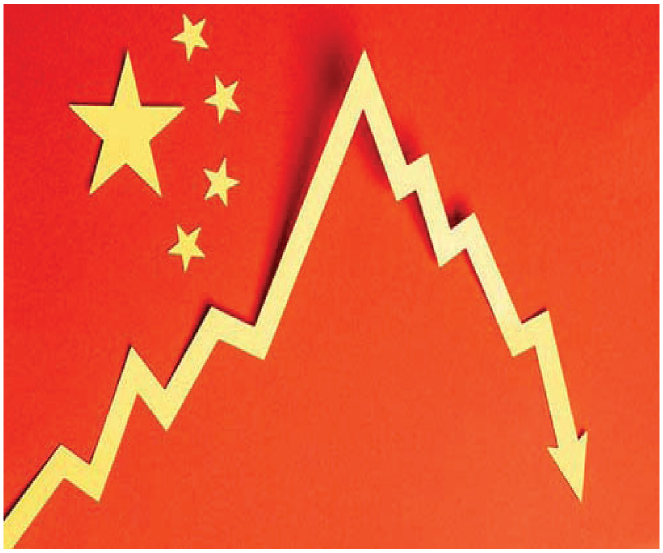
tions have become more intense, raising the prospect of a world divided into rival camps, even as other countries insist that they have no desire to pick sides. Wary but profitable coexistence has turned into a contest for primacy in the 21st century between both countries.

At the same time, Chinese leaders are preparing for the unfavorable choice between two known China hawks in the U.S. presidential race, Ms. Harris and Mr. Trump. While Mr. Trump is known in China, the rise of Ms. Harris is causing more uncertainty in an already aha crucial election for U.S.-China relations. Both candidates view China as a competitor and even an adversary. Trump launched the trade war, and both parties have pledged higher tariffs on Chinese goods - no matter who wins. Harris co-sponsored bills when she was a senator defending human rights in Hong Kong and Xinjiang, China's north-western region where nearly one million Ughur Moslem minorities are detained.

Chinese academics are watching to see if Ms. Harris is elected - would she retain members of Biden's foreign policy and national security team, and or other senior officials who have been instrumental in putting in place hawkish policies toward China? China is also curious if back-channel meetings that have been held between both countries over the past eighteen months would continue. Such meetings have helped prevent surprises or moves by either side that would have led to confrontation. While the Biden administration has rallied U.S. allies to impose export controls on advanced technology and components to China and deepened security cooperation in the region, officials have also tried to foster communication with Beijing, emphasizing that the U.S. doesn't want decoupling, but instead want de-risking from China.

Some of China's uncertainty over Harris may have been calmed following recent overtures from the Harris campaign promising the Chinese leadership that a Harris presidency would manage the relationship in a "responsible" and "practical" manner. Now, some in China suggest that more continuity and predictability from a Harris presidency may be possible than "Trump 2.0." Some Chinese policymakers fear that a Trump administration, rather than pursuing a policy of "managing competition," would seek "victory" in a new cold war whose ultimate aim many suspect would be regime change. For the Chinese Communist Party, that would be an existential threat. Other analysts argue that another Trump presidency would benefit China by sowing domestic chaos in the U.S. and upend Washington's foreign alliances and trade partnerships. Trump's perceived warmth toward Russian President Putin would also blunt western efforts to put pressure on Beijing over its tacit support for Russia's war in Ukraine. Note that it was President Trump who revived the Quad alliance with Japan, Australia and India, enacted the Taiwan Act allowing high-level officials from each country to visit and initiated trade hostilities against China.

Meanwhile, in August, Chinese authorities restricted a key source of data on inward investment as global funds continue to pull money out of the country's stock market, threatening to make 2024 the first year of equity outflows. Data showing net investment flows from foreign funds into stocks in mainland China- so called northbound trades from Hong Kong- is no longer available.



The move comes as international investors have pulled more than $12 billion out of Chinese equities since the start of June, reversing earlier inflows that many analysts said were driven by offshore arms of state-backed institutions, and taking year-to-date net flows into the red. There has never been a full year of net outflows recorded since 2014.

The latest restrictions on investment data come as Beijing battles to shore up market confidence in the face of concerns about China's slowing economy and the impact of a slow-burning crisis in the country's real estate sector.

Canada

The Canadian economy is the tenth largest in the world and the smallest in the Group of Seven (G7) industrialized economies. Canada is highly integrated with the U.S., which is by far its biggest trading partner. While the economy is services based, Canada is among the world's largest oil exporters

The Bank of Canada has cut interest rates for a third consecutive move in the three last meetings of the central bank this year. The economy has slowed, but growth will pick up over the remainder of 2024, as the Bank of Canada continues to adjust rates. Real GDP growth of 1.3% in 2024 and 1.7% in 2025 is forecast. Neutral interest rates over 2026-28 should enable an average expansion of 2% a year.

Following the Canadian government's decision in late August to impose 100% tariffs on Chinese electric cars, the Chinese announced it had launched an anti-dumping probe into Canada's canola exports. Canada is the world's largest exporter of canola; a grain widely used to produce vegetable oil and counts China as its second-largest export market. China's commerce ministry reported that Canada had significantly increased exports of the agricultural product and was suspected of dumpling, adding that domestic manufacturers had incurred losses as a result. Canada had a week earlier imposed 100% tariffs on Chinese-made EV's and a 25% levy on Chinese steel and aluminum following similar measures this year by the U.S. and the European Union.

The U.S. proposed forming a united front as an effective way for it, its allies and partners to counter unfair Chinese trade practices.

China said it was extremely dissatisfied with Canada's use of "discriminatory unilateral restrictive measures," adding that it would complain to the world Trade Organization and open a domestic investigation into certain Canadian chemical imports. The move marked the latest escalation in trade tensions centered on China's booming EV industry, which has prompted fears abroad of excessive production and falling prices. In August, China filed a WTO complaint over the EU's planned tariff increases on Chinese-made EVs.

China also opened an anti-dumping investigation into imported dairy products from Europe after the Europeans announced the new levies on EV imports, prompting a backlash from EU trade bodies.

Canada's canola shipments to China were $3.7 billion in 2023, up 170% from a year earlier by volume. China's steel exports are set to surpass $100 billion this year, the highest level since 2016, threatening to further inflame trade tensions.

Germany

Post-pandemic labor hoarding and strong employee-protection rules are masking worrying changes in Germany's market for high -paying manufacturing jobs.

After hitting an all-time low of 4.9% in the spring of 2019, the unemployment rate in the Eurozone's largest economy has risen to 6%. While that is still below the Eurozone average-and less than half the rate seen towards the turn of the 21st century- it appears the state of the labor market is worse than the headline number suggests. Some warn that the figures mask a drop off in highly skilled and well-paid manufacturing work, with more trouble to come as industrial giants struggle with high energy prices, lackluster exports and technological change.

Volkswagen ("VW") has warned of expected jobs cuts and layoffs to begin shortly, highlighting the negative impact of Chinese automobile exports on European automakers. German automakers' vulnerability to Chinese competition and specifically Chinese dumping of electric vehicles, steel, electronics and solar technology has been dramatic.

VW, Europe's largest carmaker says it has one or maybe two years to adapt to lower sales in the region, as it plans to close factories in Germany faced fierce resistance from workers and politicians. The company has taken drastic measures including job cuts, as it does not expect pre-Covid demand for cars to return to Europe. VW expects to sell 500,000 fewer cars in Europe each year, compared with pre-pandemic levels. The carmaker, along with its German peers, faces a painful transition to the era of electric vehicles. Lower than expected demand for EV's in Europe has hit the regions carmakers, while many, including VW, are also struggling with a shrinking market share in China, its most profitable market.

The future of German carmakers has become a growing concern for the government, which has seen its large industrial base struggle amid higher energy prices and generous subsidies offered in China and the U.S.

The German government, which abruptly ended its EV subsidy late last year, was also discussing new tax incentives, according to one official. The German government says it is determined to make concrete improvements to the existing framework.

VW has in its 87-year history never closed a plant in Germany, and its latest announcement comes after a savings program launched last year has fallen short by several billion euros as the company has only been able to cut overheads through early retirement and voluntary redundancy packages because of agreements with its influential works council. The drastic plans revealed have sparked anger from the company's works council, which holds half of supervisory board seats.

Germany's deputy Chancellor has warned VW that it had a responsibility towards its 300,000 workers in Germany. The automotive industry is a cornerstone of Germany as an industrial center and should remain so, he declared.
Carmakers' homegrown network of suppliers have been hard hit. In August, a survey of 50 suppliers revealed that 60% are planning to reduce their German workforce over the next five years.

Continental, Germany's third-largest supplier with $48 billion in annual revenue, has decided to exit the car parts business and focus on tires. It will axe thousands of jobs as it prepares to spin off its sensors and brake unit.
German industry leaders and government officials now face the urgent need to hit reset, increasing investment in new cutting edge technology- while it and the EU investigate suspected violations of trade, technology transfer laws and anti-dumping guidelines by Chinese entities.
In other sectors, large companies such as SAP, Miele and Bayer have announced more than 55,000 job cuts this year so far. Other industrial giants such as Thyssenkrupp and BASF are negotiating with unions ahead of a still undisclosed number of layoffs.

In the steel industry, German, European, and emerging market countries all share one thing in common: Chinese government subsidized [and hence underpriced] exports including steel, electronics, supplies of sensitive components and rare earth raw materials, among others. The rise in unemployment can also, at least in part, be explained by the inflow of 1 million refugees from Ukraine, three quarters of them of working age. Though 200,000 have found jobs, 210,000 are receiving unemployment benefits and another 300,000 are in training.

German exporters and industries have seen a slump from previously robust demand by Chinese companies since 2023. Despite a desire among some German businesses for a return to brisk business with China, neither weak economic conditions in China, or the state of the bilateral relationship are supportive of an immediate uptick in business.

The EU has indicated imposing higher tariffs on Chinese exports to the region and is seeking to increase pressure on China's unfair trade practices. This is a theme that a growing number of countries [from industrialized democracies to medium sized and developing countries] seem united on. China knowingly poses a threat to global trade practices, which it aims to change into its own likeness (with ample assistance from Russia).

India

Russia continues to access sensitive electronics and other vital supplies from India and has been able to secure many components and other supplies for its war effort via the Indian market.

Russia's industry and trade ministry, which oversees defense production to support the invasion of Ukraine drew up confidential plans back in October 2022 to spend $1 billion on securing critical electronics through channels hidden from western governments. The plans aimed to use significant reserves of rupees amassed by Russian banks from booming oil sales in India.

Russia has used India as an alternative market to source crucial goods previously supplied from "unfriendly" countries. Russia and its Indian partners targeted dual-use technologies – goods with civilian and military applications- that are subject to western export controls, according to documents recently revealed, and confirmed by western officials and businesses formerly involved in the trade.

Russia has pumped investments into Russian-Indian electronics development and production facilities. A paper trail shows how Russia turned to India, influenced officials in New Delhi and even Prime Minister Modi into becoming an integral part of an alternative to continue trading and importing vital inputs for the war effort as well as for the Russian economy. Most important, the efforts have paid off handsomely for both the Russians and Indian companies and officials who remain engaged (behind the scenes). Like Russia's deepening and expanding trade ties with China, Turkey, the Middle East, several eastern European and countries in Asia.

The data suggests that the relationship between Russia and India has grown deeper since the Ukraine war in the specific categories of goods identified. The deepening Indian ties with Moscow have been a growing source of friction with the U.S. One U.S. official wrote in July to top Indian business organizations warning that any foreign financial institution that does business with Russia's military industrial base, risks being sanctioned itself by OFAC and other Western agencies.

Colombia

Ongoing protests by truckers in Colombia who are angry over an increase in diesel prices, have cut off the country's largest cities and are threatening fuel supplies. The government insists the price increase is fair. The ongoing truckers strike and roadblocks, combined with attacks on the Cano Limon-Covenas oil pipelines, also threaten operations at the state-run oil company Ecopetrol.

The truckers are protesting an increase of 45 U.S. cents (1,904 Colombian pesos) per gallon to diesel prices which began on August 30, arguing the price rise will affect logistics costs and national competitiveness. The National Transporters Association, one of the main industry groups, said it had not called a national strike but supported the truckers' protest. The government of President Gustavo Petro has maintained the price increase is fair and that the government- financed subsidy in diesel prices should never have been granted. The Finance Ministry has explained that the increase is necessary as diesel prices have been held steady at an average of $2 per gallon for over four years. Government subsidies cost 1 trillion pesos per month according to Colombia's Finance Minister. The costs were "unsustainable" he asserted.

Production of hydrocarbons could be affected in the coming days, weeks, according to Ecopetrol. That situation is compounded by ongoing social conflict at the company's Gibraltar gas field.

The country's largest cities were cut off from the rest of the country a week into the protests – due to road blockades, as mayors warned of the prospect of food and fuel shortages. Fresh food supplies have been cut off on the outskirts of the capital Bogota with the certainty that most products would be spoiled. Re-supplies are impossible if highways, roads and access to major cities remain disrupted.

In Bogota, schools and university classes were cancelled as public transport faced severe disruptions, and some closures.

The effect of the protests on the agriculture sector promises to be severe. The sector remains on high alert due to the likelihood of shortages of necessary products used daily by households in big cities especially. The larger cities are the most affected. The situation is not just about the expected shortages but the possible rise in food prices, which will have an immediate impact depending on how long the protests and blockades continue. Based on the experience of a 2021 strike which caused havoc and heavy losses in the agricultural sector, the most worrying concern are the effects on the availability of chicken and eggs over the short-term. The national association of poultry farmers pointed to approximately 1.7 billion chickens that consume a minimum of 1,000 tons of feed grain per day -which are currently at risk. The state of Santander is currently cut off from transportation, and accounts for 20% of Colombia's poultry population, 17% of its eggs and 23% of all chicken consumed nationally. Poultry farming is expected to take a huge hit if the current protests are extended for even a few more days, according to industry experts.

The expectation is that inflationary pressures caused by the disruption in basic supplies will see a surge in food prices as consumers maintain consumption. Highways that normally transport large supplies of bananas, pigs, fruits and vegetables to the main cities are blocked. The instability caused was already being felt after five days of protests. Colombia's Ministry of Agriculture made an urgent call on leaders of the protests to guarantee a priority corridor or passage without restrictions – for vehicles transporting food, livestock, feedstock and a host of essential goods.

Rice production is also being negatively impacted due to the increase in the price of fuel. This translates into higher production costs, since rice production consumes between 24 and 28 gallons of diesel per hectare for essential tasks, including land preparation, input applications and harvesting. This amounts to around 5% of additional total costs, which will be added to the increase in freight for inputs and for getting products to the consumer. The industry is currently in the harvesting phase. That begun in August and extends to October.

Milk producers have joined the chorus of those expecting blowback from the protests. Milk cannot be collected or transported from farms for delivery to processing plants. Raw milk is perishable and therefore is already negatively impacting producers' income and the dairy

chain, homes and businesses - which will only worsen if the roads remain blocked.

Mexico

After six years ruling Mexico, President Andres Manuel Lopez Obrador (Amlo) is about to step down - but his biggest impact on the country could spring from his final month in office.

Lopez Obrador, who has become more radical in power, needs to recruit just one more lawmaker to achieve a two-thirds supermajority in the senate that convened this month. This follows elections in June, in which Amlo's party also won more than two-thirds of the lower house. Wielding that power, Amlo has begun ramming through significant constitutional changes before he cedes the presidency to his handpicked successor on October 1, 2024.

At the heart of Lopez Obrador's plans, also endorsed by his successor Claudia Sheinbaum, is a move to replace all judges and the supreme court with directly elected individuals. But Mexicans, along with U.S. and investors, has been left especially on edge because it is not clear which other of his proposals Lopez Obrador could put forward. The lower house approved the outline of the judicial overhaul in early September after being forced to relocate to a sports hall by protesters at the legislature. Some 359 lawmakers voted in favor, to 135 against.

Lawmakers approved the constitutional change in the face of an outcry from foreign governments and investors-who had previously absorbed with relatively little pushback Lopez Obrador's changes to investment rules, empowerment of the military and weakening of checks on his own power.

During his term in power, Lopez Obrador escalated his attacks on the judiciary as it blocked legislation his lawmakers had approved, sometimes over basic procedural errors. That turned the supreme court president into a hate figure among Amlo supporters.

Many critics of the latest reforms warn that judicial independence and even democracy are at risk in this country of 130 million people. Mexico is the U.S.'s largest trading partner and has had a multiparty democracy for less than 25 years. Some Mexicans see signs of a grave democratic regression taking place in Mexico today.

The U.S. Chamber of Commerce has described the reforms as a risk undermining of the rule of law and the guarantees of protection for business operations in Mexico.

Large numbers of the judiciary, including supreme court justices, have gone on strike; Mexican and international legal experts have panned the idea of elected judges, saying it risks politicians or even organized criminals in effect taking control over them. These are not concerns that can be taken lightly, especially given the growing influence and control that organized drug cartels already wield over large portions of Mexico territory, institutions and over civil society.

Mexicans gave Lopez Obrador's Morena party a landslide win in June as they cheered his minimum wage rises and social programs. But since the vote, the peso has plummeted 13% against the dollar after several years as one of the strongest emerging market currencies.

In his final month Lopez Obrador also wants to cement military control of the National Guard, and he has proposed that the government absorb multiple independent regulators. Instability and cronyism in Mexico could well follow the departure of this president from the scene.

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