D&B's Global Economic Outlook to 2017

2013 Mid-Year Update

Around the World – Regional Insights, Upgrades and Downgrades

North America (US, Canada) and Mexico ▪ Latin America ▪ Europe ▪ Eastern Europe and Central Asia ▪ Asia Pacific ▪ Middle East and North Africa ▪ Sub-Saharan Africa

Global Risk Insights

- The recovery from the late-2000s recession remains the most challenging in the past century.
- We have downgraded our 2013 global growth forecast due to uncertainty around the windup of quantitative easing, growing political risks, amplified risks on OECD debt levels, and structural rebalancing in emerging markets.
- We are slightly more optimistic about North America's growth, thanks to an accelerating healing process.
- Furthermore, we are more optimistic about 2014-to-2017 growth prospects than we were at the start of 2013.
- Nevertheless, headwinds remain in the form of the termination of monetary easing, fiscal rebalancing in the US, and Chinese rebalancing.

Global Economic Outlook: The First Half of 2013

Five years after the beginning of the late-2000s recession, the global economy remains far from trend growth, making this recovery the most lengthy of the past century. To put it in context, of the 132 countries D&B assesses, 94 now rate worse than at the beginning of 2008; 50 of those countries rate at least three quartiles lower. In contrast, a mere 17 economies were upgraded over the same period, and only two ranked more than two quartiles better. This far into the recovery, one would expect to raise the risk ratings for most of these countries. However, in the first half of 2013, D&B downgraded 17 countries (12.9 percent of all countries covered) and upgraded five (3.8 percent), underscoring the uncertain outlook.

D&B is also slightly more pessimistic about global prospects in 2013, lowering its forecast by 0.2 percentage points (pp) to 2 percent. Nevertheless, disparities exist across different regions. North America's growth prospects are improving, with a slightly brighter forecast of 2 percent, up from 1.9 percent earlier this year. And despite China's slowdown, Asia-Pacific also stands to grow, with a 0.2-pp uptick in its forecast to 4.1 percent. All other regions received downgrades: Europe (0.3 percent to 0.1 percent); Latin America (3.6 percent to 3.1 percent); Eastern Europe and Central Asia (3.3 percent to 2.7 percent); Middle East and North Africa (4 percent to 3.2 percent); and Sub-Saharan Africa (4.6 percent to 4.5 percent).

TABLE 1: REAL GDP BY REGION 2011-2017

REAL GDP GROWTH (%)	2011	2012E	2013F	2014F	2015F	2016F	2017F
North America	1.9	2.2	2.0	2.9	2.9	2.4	2.9
Europe	1.6	-0.3	-0.1	0.9	1.6	1.7	1.9
Asia Pacific	4.1	4.3	4.1	4.0	4.0	3.5	3.8
Latin America & Caribbean	4.2	2.9	3.1	3.3	3.5	3.7	3.7
Eastern Europe & Central Asia	5.5	2.7	2.7	3.2	3.6	3.9	4.2
Middle East & North Africa	3.6	4.6	3.2	3.6	4.2	4.1	4.5
Sub-Saharan Africa	4.4	4.5	4.5	4.8	4.9	5.0	5.0
World	**2.7**	**2.1**	**2.0**	**2.6**	**2.9**	**2.7**	**3.0**

In contrast, D&B predicts a slightly speedier global recovery between 2014 and 2017. The global economy is projected to grow by 2.8 percent over the period, up from a previous forecast of 2.7 percent but still below long-term trends. The US is well-positioned to recover from the late 2000s recession, thanks to its deleveraging process. Partly as a result, D&B's projected growth rate for North America between 2014 and 2017 has jumped from 2.3 percent to 2.8 percent. Sub-Saharan Africa's economy also stands to grow slightly during the same period (4.8 percent to 4.9 percent). The longer-term growth picture is not as bright for other countries, however: Europe (1.6 percent to 1.5 percent); Eastern Europe and Central Asia (4.3 percent to 3.7 percent); Middle East and North Africa (4.7 percent to 4.1 percent); and Latin America (3.8 percent to 3.5 percent). Asia-Pacific's anticipated growth rate remains the same: 3.8 percent.

Reasons for Changes in Our Outlook

Critical elements impacting D&B's economic outlook over the past six months include:

- Clear and consistent signs that the US private sector is well-positioned to continue to expand despite policy headwinds;
- Offsets to the positive signs in the world's largest economy, including increased political and social risks;
- Declining (but still-heightened) risks concerning high debt levels, particularly public sector debt in OECD countries; and
- Rebalancing in emerging economies.

The economic outlook for North America and some emerging markets might be more upbeat without lingering policy uncertainty, especially monetary policy. Central banks in advanced economies have utilized **quantitative easing (QE) policies** alongside record-low interest rates to help boost growth. While debate surrounds the short-term success of these policies, their unintended consequences have raised larger concerns. For instance, excessive risk-taking has driven enormous amounts of capital into emerging markets, thereby fuelling asset booms. In June 2013, US Federal Reserve Chairman Ben Bernanke said the US intended to phase out its QE program. His announcement sent global stock markets sinking: the MSCI Asia Pacific Index, Stoxx Europe 600, and Standard & Poor's 500 index fell by 3.9 percent, 2.6 percent, and 1.4 percent, respectively. To boot, government bond yields climbed: 10-year US bonds, Japan's 10-year bonds, and German bunds rose 3 basis points (bp), 4 bp, and 9 bp, respectively. And the price of gold fell below $1,300 per ounce for the first time since September 2010 (it nearly reached $1,800 per ounce in October 2012).

The Fed will taper its $85 billion monthly bond-buying program near the end of 2013 and end it completely in 2014 as the national economy more fully recovers. While similar programs in Europe and Japan are not expected to end next year, the Fed's withdrawal will unsettle markets as liquidity (the degree to which an asset or security can be bought or sold in the market without affecting its price) is reduced. The impacts of this move will be multiple: emerging markets like Turkey will see bumps in terms of funding their current account deficits; stock markets and other asset bubbles, such as housing, could burst; credit growth could collapse as liquidity declines (Brazil is a prime candidate); and fluctuating commodity prices. In addition, exchange rates could become more volatile (exchange rates in countries with QE programs ensure their currencies remain artificially weak). Yet another unintended consequence of QE's termination could come in the form of capital control policies that attempt to mitigate the short-term impacts but nonetheless threaten trade and investment flows.

Political risks also abound, as evidenced by recent large-scale anti-government demonstrations in Argentina, Brazil, Egypt (resulting in a military coup against the democratically elected government), and Turkey. Additionally, Chilean students have demonstrated, public sector protests have spread across Romania, Mediterranean countries have seen widespread demonstrations, and the Arab Spring continues to ferment. Economic issues are the primary culprit behind these protests, as austerity measures and sluggish economic growth widen the gap between the rich and poor. Perhaps even more important, educated middle classes raised during the boom to 2008 can no longer have their expectations met.

The Turkish situation stems from deep-rooted divisions over the country's direction: whether it should follow President Mustafa Kemal Atatürk's legacy of separation of state and religion or shift to a scenario in which Islam is far more significant remains a central question. The Turkish demonstrations and overthrow of Egypt's democratically elected Islamist government are just two recent developments that continue to alienate Muslims from the democratic process – throughout the Middle East, North Africa, and the world over. Such alienation could prompt renewed support for radical Islamists, many of whom lost support in the Arab Spring. That potential development would raise political and security risks regionally and globally, particularly against western targets. Regional stability in the Middle East and North Africa is paramount to maintaining downward pressure on oil and energy prices, not to mention supply chain continuity.

Progress on the Healing Process in the Advanced Economies

Debt levels in advanced economies became a major risk issue during the late-2000s recession. Years of cheap credit led to unsustainable levels of household and corporate debt, while public sector debt shot up in light of falling tax revenues and government efforts to hike spending to fuel economic growth. The healing process is underway, albeit unevenly (see table for D&B's assessment).

US **household debt** levels have fallen from a peak of 97.4 percent of GDP in Q2 2009 to 80.1 percent in Q3 2013. UK household debt levels declined from 108.7 percent of GDP to 96.8 percent during the same period. In Japan, household debt dropped from 82.7 percent of GDP in Q2 2009 to 76.7 percent at the end of 2012. In contrast, other countries have not fared as well. The Netherlands saw household debt climb from 127.8 percent of GDP in Q1 2009 to 141.2 percent by the end of 2012, and Canada rose from 87.1 percent of GDP in Q1 2009 to 92 percent in Q1 2013.

Progress has been made in **non-financial sector corporation debt**: Japan (154.7 percent of GDP in Q1 2009 to 145.6 percent at the end of 2012); Spain (199.1 percent of GDP in Q1 2009 to 177.9 percent at the end of 2012); and the UK (118.5 percent of GDP in Q1 2009 to 105.7 percent in Q1 2013). However, non-financial sector corporation debt continues to grow alarmingly in other countries such as France (149.9 percent of GDP in Q1 2009 to 161.1 percent at the end of 2012). Meanwhile, some countries have seen greater progress in reducing **financial sector debt**, including the US (122.8 percent of GDP in Q1 2009 to 87.2 percent in Q1 2013) and Germany (123.7 percent of GDP in Q1 2009 to 97.8 percent at the end of 2012). However, Italy and Spain each saw financial sector debt rise from 90.5 percent of GDP to 109.1 percent and 109.3 percent of GDP to 118 percent, respectively, between Q1 2009 and the end of 2012.

Accumulating **public sector debt** has created the most concern. While most advanced countries have reduced public sector debt levels from 2009 peaks, Japan, Spain, and the UK each tallied levels in 2012 above those recorded in 2006. Furthermore, many countries boast public sector debt exceeding 100 percent of GDP, including Italy (124.1 percent), Japan (227.1 percent), the US (108.7 percent), the UK (110.3 percent), and Greece (156.9 percent). Many countries have introduced austerity measures to reduce public debt, resulting in curtailed short-term growth and rising political tensions.

TABLE 2: HEALING PROCESS IN SELECTED ADVANCED ECONOMIES

REGION	COUNTRY	PROGRESS	TREND
North America	US	G	↑
North America	Canada	A	→
Europe	Germany	G	→
Europe	France	A	↓
Europe	Italy	A	↓
Europe	Spain	A	↓
Asia Pacific	Japan	A	→

G Considerable progress made since 2008
A Little/some progress made since 2008
↑ Progress made in past 12 months
→ Static in past 12 months
↓ Policy gone into reverse in past 12 months

Progress on Restructuring in the Emerging Markets

Resurgent growth in emerging markets has proved a key driver of global economic recovery following the late-2000s recession. However, their success before and after the recession has masked the need for economic restructuring. As global growth has struggled, the challenges facing many emerging markets are all the more apparent and urgent. Table 3 highlights the limited progress of governments in emerging markets – of the selected countries, only Mexico has consistently pressed for reforms in the last six months.

TABLE 3: RESTRUCTURING PROGRESS IN SELECTED EMERGING ECONOMIES

REGION	COUNTRY	PROGRESS	TREND
Latin America	Argentina	R	↓
Latin America	Brazil	A	↓
Latin America	Mexico	A	↑
Eastern Europe & Central Asia	Russian Federation	R	↓
Eastern Europe & Central Asia	Kazakhstan	R	↓
Eastern Europe & Central Asia	Ukraine	R	↓
Middle East & North Africa	Saudi Arabia	A	↓
Middle East & North Africa	Iran	A	→
Middle East & North Africa	UAE	A	→
Asia Pacific	China	A	↓
Asia Pacific	India	A	↓
Sub-Saharan Africa	South Africa	R	→
Sub-Saharan Africa	Nigeria	A	↓
Sub-Saharan Africa	Angola	A	→

A Little/some progress made since 2008
R Reversal/no progress since 2008
↑ Progress made in past 12 months
→ Static in past 12 months
↓ Policy gone into reverse in past 12 months

Most **Latin American economies** have their fair share of struggles, not limited to achieving foreign exchange (FX) equilibrium, reducing supply-side bottlenecks, increasing domestic savings rates, curbing burgeoning current-account deficits, cooling inflationary pressures, increasing labor productivity to match real wage growth, reducing institutional and regulatory impediments in the commercial environment, and reducing trade protectionism. Mexico is a notable exception. Despite recent cross-party political tensions, President Enrique Peña Nieto continues to advance his "Pact for Mexico," promising (among other things) to increase competition within Mexico's private business community (particularly the energy, telecommunications, and broadcast sectors). He has also vowed to improve the efficiency of state-owned oil firm Pemex by amending legislation to enable the company to enter into partnerships with the private sector.

In the **Asia-Pacific region**, China's government faces a number of challenges resulting from recent policies. The easing of credit conditions during the recession has produced upstream industrial overcapacity and a growing real estate bubble. That, in turn, has led to capital misallocation and other hidden financial threats. Non-performing loan ratios of 1 percent are significantly under-provisioned; the maturing of CNY10-20 trillion of local government financing vehicle loans by 2015 will strain the financial sector, particularly mid-level banks. In addition, interest rates are kept artificially low, benefitting powerful state-owned enterprises and the officials who control their assets. Meanwhile, India suffers from supply-side constraints resulting from subsidies and investment approval processes. Populist economic policies such as extending a food safety net from 300 million to 800 million people during the lead-up to the 2014 election will likely pause, if not reverse progress on restructuring in India.

In the **Middle East and North Africa**, strong oil revenues have reduced the pressure for change, while the Arab Spring has actually encouraged governments to increase their role in the economy and either suspend or reverse reforms in some cases. Oil-rich economies face key challenges, including: developing the non-hydrocarbon economy; building a private sector independent from government contracts; reducing government employment; improving labor productivity; reducing dependency on migrant workers, particularly in the private sector; building an education system that meets modern business needs; fully opening the economy to foreign investment; and achieving international standards in the legal and regulatory business fields.

Likewise, strong hydrocarbon revenues have reduced pressure on governments for reform in **Eastern Europe and Central Asia**. Russia remains highly dependent on oil and gas revenue (comprising 50 percent of its federal budget), even though capital flight is evident. Kazakhstan is also increasingly dependent on the hydrocarbon sector, while Ukraine has signed an unconventional gas deal with Royal Dutch Shell. No progress has been made on banking sector reform in either country, and household subsidies in Ukraine continue to distort market prices.

Sub-Saharan Africa has similarly failed to wean itself off oil revenues, particularly in the second and third largest economies of Nigeria and Angola. As with other hydrocarbon-based economies, downward pressure on oil and gas prices (and therefore revenues) triggered by the US's shale oil and gas boom, as well as other new sources of supply, will prompt more calls for reform. Poor infrastructure also requires attention across much of the continent. South Africa has attempted to address the infrastructure issue, though its efforts consistently fall short of targets. That country must additionally address labor sector reforms to combat a significant skill shortage, labor market rigidity, and periodic labor unrest (particularly involving collective wage bargaining). Both South Africa (National Development Plan) and Nigeria (The Nigeria Vision 20:2020 Plan) have produced long-term plans to address structural issues facing their economies.

Ten Key Risks Emanating from the Regions

The D&B Overall Global Business Impact Score for July 2013 is 274. Of the top 10 risks facing global business over the next 18 months, three of the top four involve the US – as the world's largest economy, supporting economic recovery in the US will be critical to fostering global growth. **The greatest risk stems from the transition of US monetary policy**. So far, the transition has resulted in substantial disruption in global stock, bond, and currency markets (with a score of 45 out of a maximum of 100), either due to poor timing or ineffective signalling.

The third-place risk (score of 32) involves the political uncertainty of the US budget deficit. Until resolved, global markets will be prone to volatility whenever activity in Washington, DC heats up. Also of concern are US regulators' attempts to set restrictions on non-US banks under the Dodd-Frank Act, which could lead to retaliation by the governments of those banks (score of 30). Escalating tit-for-tat actions would have serious implications for the global financial system as well as trade and investment flows.

Other risks warrant attention outside the US. **China's structural imbalances** top the list, resulting in a sharp correction in home prices and climbing local government debt credit risk. This constitutes the second most important risk (score of 33). The corrections would impair China's growth, thereby reducing demand across a range of imports and curtailing global growth.

Meanwhile, the ongoing civil war in Syria has a 70 percent chance of dividing the country into warlord-led mini-fiefdoms; some warlords will undoubtedly espouse radical Islamist sympathies (score of 28). The instability of such fiefdoms will spread into Jordan, Lebanon, and Iraq, creating further regional instability and pushing oil prices to record highs. Violence also offers a vital training ground for militant Islamists, and the fiefdoms may serve as bases from which to launch attacks on western interests.

TABLE 4: TOP 10 RISKS BY D&B GLOBAL BUSINESS IMPACT SCORE FOR THE GLOBAL BUSINESS ENVIRONMENT

REGION	RISK	LIKLIHOOD OF EVENT (%)	GLOBAL IMPACT (1-5)	GLOBAL BUSINESS IMPACT SCORE (1-100)
North America	Transitional phase of US monetary policy results in substantial disruption in global financial markets	45	5	45
Asia Pacific	Structural imbalances in China result in a substantial correction in property market prices and local government debt credit risk	55	3	33
North America	Political standoff over fiscal rebalancing fosters continued policy uncertainty	40	4	32
North America	US regulatory restrictions on non-US banks sets off retaliatory measures	50	3	30
Middle East & North Africa	Syria breaks up into mini-fiefdoms and violence spreads into neighboring countries	70	2	28
Latin America	A US Supreme Court ruling against Argentina results in global re-pricing of sovereign risk	40	3	24
Europe	Deviation from fiscal rebalancing results in rising government bond yields	60	2	24
Asia Pacific	Japanese government bond market collapse creates simultaneous fiscal and financial crisis	25	4	20
Europe	A total disintegration of the Eurozone results in political, economic, and legal chaos across Europe	20	5	20
Latin America	Anti-government protests inspired by Brazil spread through emerging markets, damaging policy stability and global investor sentiment	30	3	18

Other concerning risks include efforts by US courts to force Argentina to pay $1.3 billion to holdout bond holders who did not accept the terms of the US's $100 billion debt default in 2002 (score of 24). If the courts find against Argentina, it will be difficult, if not impossible for other deeply indebted governments to implement any debt write-offs, thus triggering a global re-pricing of sovereign risk debt and potentially undermining any further sovereign debt restructuring.

EU governments' failure to continue fiscal rebalancing has earned a Global Business Impact Score of 24. As a result, the cost of government borrowing could rise, putting national budgets under pressure and prolonging any recovery in Europe.

The threat of collapse of the Japanese bond market constitutes the eighth-highest risk (score of 20). The impact on the world's third-largest economy would be two-fold: first, the government would no longer be able to finance itself; and second, institutions holding governments, such as banks and pension funds, would be left with assets of declining value and a significant capital gap to rebuild.

A disintegration of the Eurozone represents a second threat facing Europe. Consequently, a 20-percent chance exists of a major global impact resulting from the political, economic, and legal chaos in the EU (score of 20).

Finally, a 30-percent chance exists that Brazil's political unrest will spread into other emerging markets. Such turmoil is the result of unfulfilled middle-class aspirations following the global downturn. While the trigger will likely be different in each country, the results would be the same: damaged policy stability, eroded investor confidence, and new outflows of capital.

Key Observations

- Global rebalancing is underway but medium-term growth will remain below trend
- The recovery process will not be a straight line and businesses should be prepared for ups and downs
- The end of quantitative easing programs will bring further uncertainty, particularly if timed badly or signaled poorly
- The importance of the recovery becoming embedded in the US is supported by the D&B Global Business
- Impact Scores in relation to the transitory phases of monetary easing and fiscal rebalancing
- In addition, structural imbalances in China and other emerging economies require careful attention, not just for the Chinese economy but for businesses across the globe

North America and Mexico 2013–17

Risk Insights

- US real-GDP growth will oscillate within the 2-3 percent range from 2013 to 2017
- Healthy corporate finances, rising housing and labor markets, and pent-up consumer demand will support stronger growth
- Headwinds remain, including shaky public finances, slower export growth, and US household deleveraging
- Canada's high consumer indebtedness and overvalued housing market leave its economy vulnerable to an external shock, but US growth should ultimately shield it
- ***Deteriorating:*** Canada
- ***Stable:*** US

Outlook

We expect 2% GDP growth in US in 2013, lower than 2.8% (recently revised by Bureau of Economic Analysis up from 2.2% for methodological reasons) achieved in 2012 but higher than in other developed economies, especially stagnating Europe. Key factors are driving US recovery, including a rebound in the housing market, surging home sales and construction, and rising employment. A healthier corporate sector has also made a difference, as the high rate of capital investment expansion has driven optimism about the sustainability of the economic healing process.

Nevertheless, investment growth has eased in the face of demand-killing headwinds. The ongoing deleveraging process and its ensuing constraints on consumer spending have produced weak internal demand. Externally, recessionary pressures in Europe and a slowdown in emerging markets have made an impact. At this stage of recovery it is critical for the Federal Reserve to correctly time is moderation of the monthly pace of QE purchases. Given the state of the US economy, D&B expects QE purchases will continue at the pace of $85 billion a month until the end of 2013 before tapering starts in the first half of 2014. However, the exact impact of QE tapering is subject to considerable political uncertainty over the appropriate measures and timing of fiscal consolidation.

The US stands out among developed countries with the deepest financial market in the world, a unique record of innovation (including the discovery and development of shale oil, which could make the country the world's largest oil producer by 2020), and relatively dynamic demographics for an OECD country. In a normal recovery cycle, the US would post real-GDP growth surpassing 3 percent between 2013 and 2015; however, it has trended between 2.7 and 2.9 percent over the past few quarters, due to the unique properties of the current cycle and the condition of the public sector. In fact, public sector circumstances may cut 0.5 to 0.7 pp from annual real-GDP growth through 2017. Fiscal consolidation that involves rising taxes and spending cuts will be required to cut high public debt (state and federal debt total 106 percent of GDP). The budget deficit is also expected to slim in 2013, thanks to higher tax revenue from a buoyant private sector.

Implications

- The Federal Reserve's conditions for raising policy interest rates (an unemployment rate under 6.5 percent and inflation over 2.5 percent) are unlikely to be met before Q1 2015
- More fiscal policy standoffs loom, but the household and business sectors will endure
- In 2017 the NAFTA economy will be at least 10 percent larger in real terms than in 2012
- US recovery has a positive impact on Canada; any economic weakness will be due to domestic or non-US factors

Recommendations

- Prepare to set more generous credit terms for high-growth sectors in the US economy and in close tempo with the recovery as credit risk falls
- Consider caution given Canada's low growth trajectory and high household debt, as recent export revenue and housing statistics pose concern

Latin America 2013-17

Risk Insights

- Lower commodity prices and softer domestic demand dampen second-half 2013 prospects, but regional growth will average 3.5 percent from 2014 to 2017 as external conditions improve
- Portfolio outflows will rise as the US tapers its QE program, further weakening current account balances and local currencies. Foreign reserves remain generally robust
- Growing public protests against unmet socio-economic needs keep political risks elevated in major regional economies
- ***Deteriorating:*** Argentina and Venezuela
- ***Stable:*** Chile

Outlook

D&B's 2013 growth forecast for Latin America has declined from 3.6 percent to 3.1 percent amid varying deceleration rates across the region. Sharp first-half declines in output from Brazil and Mexico – coupled with a weak second-half outlook hounded by a decelerating Chinese economy – will contribute to relatively flat real-GDP growth of 3.1 percent, up from 2.9 percent in 2012. As the US recovery gains traction, Mexico will rebound by 3.2 percent to 3.8 percent between 2014 and 2017. Improved external conditions and domestic rebalancing augment Brazil's growth prospects, expanding by 2.8 percent to 3.5 percent during the same period.

Meanwhile, persistent political and institutional challenges have dimmed Argentina's outlook, as the continued risk of expropriation and foreign currency imbalances threaten that country's business environment. As such, Argentina will register real-GDP growth of 3 to 3.3 percent between 2014 and 2017. In the short term, external current accounts will deteriorate as portfolio outflows rise in response to the tapering of the US QE program. Commodity prices will also soften, but domestic demand remains strong. Moreover, moderate depreciation of local currencies underscores the need for adequate FX buffers, which remain strong with the notable exception of Argentina. D&B projects regional annual average real-GDP growth to rebound to 3.5 percent between 2014 and 2017. Downside risks could come in the form of inadequate policy reforms, external price shocks, and domestic supply constraints.

As inflationary pressures cool (with Brazil, Argentina, and Venezuela being notable outliers), D&B expects interest rates to remain relatively low in Mexico, Chile, and Colombia in the short term. The lagged effect of higher government spending, particularly on infrastructure and mega-projects in the second half of 2013, will finally hit home in 2014. On a positive note, Chile, which is experiencing moderate growth, will record real-GDP growth of 4.5 percent during the forecast period.

Implications

- Brazil's anti-government protests could ignite similar action across the region, impairing business operations. Elevated political risks persist in Venezuela and Argentina through 2015 due to stubborn shortages in basic items, spiraling inflation, and other unmet socio-economic needs
- Rapidly falling foreign reserves (20 percent year-over-year in the first half of 2013) in Argentina will prompt more stringent exchange controls that further restrict repatriation of profits and dividends. In addition, despite recent FX auctions, dollar-availability will remain low in Venezuela
- Lower demand from major emerging markets and easing of commodity prices will take some of the shine off the region's natural resources sector through at least 2015

Recommendations

- Tighter exchange controls could make repatriation of profits and dividends more difficult, particularly from Argentina and Venezuela. Expect trade relations with regional partners to deteriorate as a consequence
- Secure cover against expropriation and political risks. Include international arbitration clauses in contracts with local governments and business entities
- Watch for new investment opportunities in infrastructure development and the telecommunications and energy sectors in Mexico, given the government's reform agenda aimed at encouraging greater private sector investment/participation

Europe 2013–17
(EU + Iceland, Norway and Switzerland)

Risk Insights

- The regional risk outlook depends on future developments in the Eurozone crisis
- Positively, no breakup of the European area is anticipated in the forecast period
- However, the region will experience below-trend growth in 2013 and very uneven growth until 2017
- Payment and credit risk will remain elevated until at least 2014, especially in southern European member states
- ***Deteriorating:*** France, Belgium, Cyprus, Netherlands, Spain (12 out of 30 in total)
- ***Improving:*** Romania, Slovenia, Iceland

Outlook

Europe's risk outlook depends largely on the resolution of the ongoing Eurozone crisis. Given the close economic links between the Eurozone and non-Eurozone Europe (in addition to North Africa and Eastern Europe), the crisis in the common currency area will continue to influence regional and global growth over the next few years. Encouragingly, D&B expects no Eurozone breakup in the forecast period; on the contrary, policymakers will likely introduce much-needed reforms of the EU's legal framework in 2013. Nevertheless, implementation risks are high, due in part to elections in Austria and Germany in 2013. If member states and the EU cannot agree on treaty changes, the Eurozone could at least partially disintegrate between 2013 and 2014. The region, and potentially the global economy, would consequently fall into a severe prolonged recession.

D&B also expects continued austerity measures in countries such as Greece, Italy, and Spain over the next few years. France, Germany, Austria, and the Netherlands will additionally reduce government spending and/or raise taxes in 2013 to meet deficit targets laid out in European or national law. This will weigh on the region's growth potential and lead to a period of higher payment and credit risks. The EU should move toward trend growth after 2014 if these painful, but necessary, measures are not abandoned by newly elected governments. Growth will also come if the EU implements a new fiscal framework and the European Central Bank follows through on its already-announced supportive monetary policy. Overall, D&B expects Europe's real-GDP to grow by an average 1.5 percent over 2014 to 2017, after contracting by 0.1 percent in 2013.

Implications

- Economic growth will be uneven; growth in Northern Europe (i.e., Germany and Sweden) will be higher than in Southern Europe (i.e., Italy and Portugal); however, growth is likely to be exposed to severe downside risks in better-performing countries
- Uncertainty stemming from the Eurozone crisis and the questionable survival of the common currency will impact the exchange rate and threaten further volatility
- Currencies of countries like Norway, Sweden, and Switzerland will remain under appreciation pressure, arising from safe-haven investment inflows from the Eurozone
- If much-needed reforms are not implemented in due time and/or national governments abandon the austerity path (a precondition for financial help from donor countries such as Austria, Finland, Germany, and Luxembourg), a breakup of the Eurozone is the most likely outcome
- Beyond 2017, poor demographic development undermines growth prospects, but rule of law and the quality of infrastructure remain world-class

Recommendations

- Between 2013 and 2014, companies doing business in the fragile peripheral economies of the Eurozone should expect a higher frequency of payment delays and might consider tighter trade terms
- Although it is not D&B's core scenario, a breakup of the Eurozone cannot be ruled out. D&B advises businesses to stay out of Greece until late 2014 at the earliest
- Make decisions based on low growth between 2013 and 2014 and stronger growth between 2015 and 2017. Of course, this scenario is subject to politicians' ability to save the Eurozone

Eastern Europe and Central Asia 2013–17

Risk Insights

- Resumption of structural reforms is urgently required to ensure more robust growth in the region
- External factors will keep economic growth below the pre-crisis level
- Russia's slowdown worsens the outlook for the majority of regional economies
- Easing inflation will provide some support to domestic demand
- Risk of doing business remains high across the region
- ***Improving:*** Turkmenistan
- ***Deteriorating:*** Azerbaijan, Belarus, Tajikistan, Turkey, Ukraine

Outlook

International market conditions that supported this region during the first half of 2013 turned sour upon the Federal Reserve's decision to taper QE. Changing market sentiments produced a drop in market capitalization (reflecting capital outflows to the safe haven) and depreciation of major currencies such as those in Russia, Turkey, and Kazakhstan. Another consequence is widened credit-default swap spreads. That development especially damaged Ukraine after it refused IMF funding and instead tapped international markets to cover its high financing needs. Falling commodity prices have additionally plagued Ukraine's current account deficit. The capital outflow will likely continue, although countries like Kazakhstan are better endowed with foreign direct investment (FDI) than portfolio investments to weather the downturn.

Europe's bumpy recovery and China's deceleration will weigh on the region through trade and depressed commodity prices, oil prices being one exception. Anticipated to stay above $100 per barrel during the forecast period, oil prices will support Kazakhstan, Azerbaijan, Uzbekistan, Turkmenistan, and Russia. Domestic demand, a driving force of post-crisis growth, will weaken for various reasons in European Commonwealth of Independent States countries but remain buoyant in Central Asia. Furthermore, growth in Russia's systemic regional economy will decelerate owing to internal imbalances, particularly under-investment in non-energy sectors. Slowing Russian growth will further block growth through trade and FDI flows in most countries throughout the region. Moreover, Kyrgyz Republic and Tajikistan will see remittance inflows weaken.

Finally, Turkey's political tensions will continue to undermine the risk outlook. Bureaucracy, rampant corruption, weak contract enforcement, and politically biased judicial systems persist in hampering the region's trade and commercial environment.

Implications

- Easing inflation will enable some monetary loosening in Russia, which, together with measures to improve the business climate, may provide some support for growth. Nevertheless, supply constraints will limit potential growth at around 3 percent
- The availability of credit in Kazakhstan and Ukraine will remain poor
- Reinforced capital control measures in Ukraine will lift the immediate pressure on FX reserves, but offer no long-term solution for the country's current account crises

Recommendations

- Downside risks for doing business in the region prevail; different combinations of downside risks in different locations require an in-depth assessment of particular countries (and particular industries therein).
- Hedging against the volatility of some local currencies should be considered
- Strict trade terms are recommended when doing business with counterparties in the region; cash in advance is D&B's recommended trade policy in the majority of countries
- Adequate political risk-trade credit insurance should be considered

Asia/Pacific 2013–17

Risk Insights

- China's opaque financial system, industrial overcapacity, and property market bubble threaten a stable real-GDP growth path surpassing 6 percent a year between 2014 and 2017
- Japan's monetary experiment will bring a short-term stimulus, but solutions to its fiscal and demographic challenges after 2014 remain remote
- The region's domestic demand drivers have survived Chinese deceleration and Eurozone stresses, but a post-QE global environment could rock credit and asset markets.
- ***Deteriorating:*** China, India, Singapore
- ***Stable:*** Japan, New Zealand, Philippines

Outlook

India, China, and Japan – the region's three key low-, mid-, and high-income economies – all approach the limits of their existing business and policy models. Deep changes are necessary to stopping cyclical and structural problems from spurring volatility in output, price, and asset markets. Such a result could scar public finances, productivity, and confidence during the forecast period. So far, reforms are uneven. Meanwhile, smaller economies face a number of threats, including: stalled or lower merchandise growth; monthly uncertainty over the trajectory of liquidity provision by central banks; and risk of an unwinding of any asset and credit bubbles triggered by confidence shocks to currencies and export markets.

Three important changes impacted the region during the first half of 2013. First, a concerted policy easing of the Japanese government and central bank has dropped the yen back to pre-crisis levels against the US dollar, inflating Japanese asset prices. Second, China is approaching sub-8 percent real-GDP growth as that country suffers from severe capital misallocation, spiralling property market speculation, opaque datasets, and hidden problem loans that are significant on a macroeconomic level. Third, smaller economies with shallow FX and local capital markets (including India) have changed their sentiment and policy stances. Instead of battling financial inflows and currency appreciation, they are now raising interest rates and defending exchange rates with FX reserves and transfer regulations.

Policymakers have predominantly been spared from non-FX supply shocks (where prices rise, output falls, and monetary policy cannot help) in most countries. The absence of tightness in commodity markets, given the net commodity importer status of many Asian countries, is most likely a positive indicator. India, with inflation nearing 10 percent and the rupee at INR60 per US dollar, requires a mildly disinflationary global environment. Meanwhile, the muted outlook for commodity pricing will weigh on Australia and Indonesia's export earnings and reduce regional mining project pipelines over the medium term. However, the diverging resource boom is a welcome relief for Australia's other sectors, and Indonesia enjoys sufficient sources of demand growth.

In spite of weathering the trade slowdown, more serious challenges are imminent for the region. China and South Korea's household and business sectors are highly leveraged, at 170 percent and 200 percent of GDP, respectively, close to pre-crisis European levels. Singapore meanwhile suffers steadily falling productivity. Its four Southeast Asian neighbors could see more than $100 billion in net portfolio inflows since 2009 reverse. And falling producer prices in Southeast Asia, China, and South Korea in Q2 2013 hint at continued overcapacity.

Implications

- China faces a high probability of sub-7 percent annual growth from 2014, as credit risks from manufacturing increase and CNY3.5 trillion in local government debt matures in 2015
- Consumer and business confidence in Japan are improving as the Bank of Japan's policy activism affects the yen and inflation expectations; but growth will fall in 2014
- India is mired in political and institutional barriers to pro-growth structural adjustment

Recommendations

- Services and household-oriented sectors still offer growth prospects until at least 2014
- Watch your customer base and supply chains for signs of change in market sentiment—as "crash" phases unwind faster than "bubble" phases grew—once market agents realign.

Middle East and North Africa 2013–17

Risk Insights

- Extreme political and commercial risks face Egypt, Iran, Iraq, Syria, and Yemen, and are elevated in Algeria, Bahrain, Jordan, Lebanon, and Libya
- Strong hydrocarbon revenues will impede governments from addressing fundamental structural issues needed to improve the business environment
- The commercial environment will remain challenging in most countries
- Opportunities exist in infrastructural development in oil-rich economies
- ***Deteriorating:*** Algeria, Egypt, Israel, Kuwait, Lebanon, Morocco, Tunisia
- ***Improving:*** United Arab Emirates (UAE)

Outlook

Political and security issues across the Middle East and North Africa continue to dominate the risk environment against the uncertain short-term global economic outlook. D&B expects that position to worsen over the next year, with most countries suffering to some degree from the impact of the Arab Spring. The risk outlook is further undermined by continuing uncertainty in neighboring Europe, which is curtailing trade, investment, and migrant job opportunities. Furthermore, flat oil prices will limit growth in the next three years. Most economies will fall far short of achieving full growth potential, owing to a failure to address impediments to the commercial environment, such as corruption and a weak legal and regulatory atmosphere.

Countries poised to see strong growth include Iraq (average annual growth of 9.5 percent between 2013 and 2017) and Libya (average annual growth of 7.9 percent between 2013 and 2017) as both emerge from conflict. Government spending of hydrocarbon revenues will boost growth in the oil-rich Arabian peninsula (Kuwait, Saudi Arabia, Qatar, the UAE, and Oman).

Implications

- Tighter international sanctions against Iran will undermine the economic outlook and expected returns from trade and investment in the short term
- Instability in Egypt, Iraq, Lebanon, Libya, Syria, and Yemen will be significant, while Algeria, Bahrain, Jordan, and Tunisia will experience elevated instability
- However, business opportunities will increase over the forecast period in conflict-transition countries such as Egypt, Iraq, Libya, and Syria
- Furthermore, construction and service companies in oil-rich countries will benefit from strong government spending
- D&B expects payment performance in government-related companies in oil-rich countries to deteriorate. In turn, this will impact cash flow, payment performance, profits, and bankruptcies in the private sector
- Slower growth in oil-rich countries means slower investment, remittances, aid, and trade flows to oil-poor countries, undermining growth; however, these countries will see lower import bills as energy costs fall

Recommendations

- Companies dealing with firms based in Algeria, Bahrain, Egypt, Iraq, Jordan, Lebanon, Libya, Syria, and Yemen should exercise extreme caution, owing to the weak and/or deteriorating political and commercial risk outlook
- In view of the increase in international sanctions targeting the financial and hydrocarbon sectors, D&B advises customers to remain vigilant toward companies with ties to Iran
- Increase monitoring on the payment performance of government-related businesses in oil-rich states as governments delay payments
- Opportunities in the upstream and downstream hydrocarbon sectors and in infrastructure development will be available in the oil-rich countries

Sub-Saharan Africa 2013–17

Risk Insights

- The slowdown of the Chinese economy will weigh on commodity prices and moderate regional growth, particularly in countries dependent on non-oil exports
- Energy exporters face less threat, but need to be wary of the shale oil boom in the US and its impact on demand for African crude
- Inflationary pressures are subsiding across most of the region as favorable harvests have cooled food price inflation. Fiscal challenges remain manageable.
- ***Deteriorating:*** South Africa, Ghana, Ethiopia
- ***Improving:*** Nigeria, Angola, Kenya

Outlook

Sub-Saharan Africa is poised for healthy growth in the near term. While the region's growth in 2013 is expected to outpace 2012, significant acceleration that had been anticipated will not come anytime soon. As headwinds diminish in 2014 and global economic expansion gains traction, demand for sub-Saharan Africa's exports will pick up through the forecast period. However, China's slowdown tops the list of immediate threats to regional growth. In particular, exporters of non-oil commodities will see a sizable reduction in earnings as global prices weaken in response to waning demand in China. D&B forecasts the price of oil will weaken marginally in 2013 before picking up in 2014. Oil exporters are therefore slightly better positioned than other exporters. Nonetheless, the US shale oil boom poses a growing risk that could harm crude prices and export volumes.

Despite solid regional growth, the country-to-country outlook varies significantly. South Africa's economy – the largest in the region – faces deceleration and a pessimistic outlook. In addition to a sluggish Chinese economy weighing on demand for the country's resources, it faces a number of domestic problems, including labor disputes. Kenya's outlook has improved, by contrast, and political stability is expected to drive growth following largely peaceful elections earlier in 2013.

Implications

- Sub-Saharan Africa's fiscal position remains satisfactory, but countries need to exercise fiscal discipline to maintain adequate buffers, especially in the event of protracted weakness in commodity prices
- Global risk aversion toward sovereign debt will also put pressure on African governments to improve their budget positions
- On the other hand, capital inflows looking for higher returns than in developed markets could increase the debt burden for countries over the long term, raising external financing risks
- In recent months, a number of the regional frontier economies have issued international sovereign bonds. This signals that the global investment community remains optimistic about the region's growth potential
- Governments need to ensure that obtained funding is put to the most rewarding use and does not jeopardize the countries' long-term debt sustainability
- D&B recommends using such funds for building much-needed critical infrastructure, particularly in sectors not related to commodity extraction

Recommendations

- Despite near-term volatility, commercial opportunities in businesses in the commodities sector will remain strong throughout the period
- However, investors should be aware of the possibility of forced contract renewals as governments attempt to maximize short-term returns in this sector
- Building domestic contacts can help offset the challenging business environment.
- Companies should take out adequate security and political risk insurance coverage

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