Major Country Risk Developments
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By Byron Shoulton

Overview

2021 is the year of Covid-19 vaccine rollouts, when millions of people are expected to receive vaccines and hopefully by the end of which, an assessment of the effectiveness of the various vaccines will be possible. Already, the rollout is not going well in the U.S., Europe, UK - with actual numbers of people receiving the inoculation well below expectations. While the weekly numbers have improved, in state after state, and from one region to the next, reports are that only a fraction of people [less than 10%] who should have by now been vaccinated, did in fact receive the vaccine. If not corrected, logistical problems and reluctance to get immunized could pose a threat to the anticipated global economic recovery.

2021 is also the year during which many economies are hoping to begin registering a turnaround in manufacturing; a pick- up in demand for raw materials, intermediate goods and eventually growth in new hiring [by the second-half of the year]. This trend would provide the basis for a gradual improvement in confidence and hence improved consumer spending. However, the World Bank has warned that the global recovery from Covid-19 will rely heavily on the successful rollout of vaccines. Any delay risks undermining the 4% projected 2021 GDP global growth rate. To achieve this level of growth assumes rapid progress with vaccinations in advanced economies and in major emerging and developing countries. This progress was projected to take place by the second-half of 2021 when it was expected that vaccines would have seen widespread distribution. However, the rollout is already running into difficulty, making this timeline almost impossible to achieve. It appears that some advanced countries -including the U.S.- have bought vaccines beyond their capacity to distribute them.

The World Bank has outlined an extreme scenario, in which financial stress leads to widespread corporate and government defaults and in which the global economy could contract for a second consecutive year- if vaccination efforts are derailed. After an initial wave of economic optimism late last year, as the prospect of vaccinations became a reality, the challenges of implementing a mass rollout have become clearer. Authorities in the European Union are under fire for managing a sluggish start – France vaccinated 350 people in the first week, while German authorities are accused of failing to procure adequate doses of the vaccine. Nonetheless, most recent data show that the EU have so far administered more than a million doses of Covid-19 vaccines.

Meanwhile, the UK government has ordered its third lockdown to combat the spread of a more transmittable mutation of the virus, and worries are growing that a new South African strain could lead to vaccine-resistant variants.

Policymakers around the world face formidable challenges in public health, debt management, budget policies, central banking, and structural reforms – as they try to ensure that the still-fragile global recovery gains the traction needed to set a foundation for more robust growth over 2022-24. The outlook is equally bleak for advanced and emerging economies. In the World Bank's central scenario, growth in the advanced economies will average 3.3% in 2021. In emerging and developing economies [excluding China- where output is expected to rebound to a 7.9% expansion], it would average 3.4%.

According to the World Bank the many stimulus programs in advanced economies, including large-scale asset purchase programs, risk aggravating the problem of inequality among rich and poor in these countries. The bank points out that institutional

reforms to spur growth will be crucial once the immediate health crisis begins to ease because many countries already have high debt levels and weak fiscal positions. Even prior to the pandemic, global growth had been expected to slow over the next decade, due to under-investment and shrinking labor forces in advanced economies. The pandemic is likely to worsen this slowdown, doing lasting damage to health, education and corporate balance sheets. We should not confuse a rebound with economic recovery. While we will see a snapback from the collapse of output and employment caused by the pandemic, that is not the same as a sustainable recovery, supported by demand, investment, hiring, production, spending, revenue boost, and then profitability.

Recovery from the kind of economic contraction suffered since the pandemic hit will take time. But first, there needs to be an end to the pandemic. Furthermore, without comprehensive reforms, the global economy could be heading for a decade of under-performing growth.

USA

On January 7, 2021 the U.S. Congress certified the election victory of the president-elect, Joe Biden, despite the storming of the U.S. Capitol by supporters of outgoing president Trump, in a dramatic siege that threatened U.S. political stability. The process of certification was halted over several hours while police secured the nation's legislative center. Congress's certification of the votes cast in the November 2020 election removes the last obstacle to Mr. Biden's inauguration which takes place on January 20, 2021. While fringe groups could continue to spark episodes of social unrest in the U.S., the chaotic end to the Trump presidency will likely weaken his influence over the Republican Party in the coming years. This may help to ease political tensions, but the country remains deeply polarized and in shock over the unconstitutional and unlawful attack on the Capitol [meant to set aside election results], while legislators were in session to certify those results. The ease with which extremists were able to enter the heart of the U.S. government, disrupting constitutional deliberations while in session, should serve as an urgent wake-up call to U.S. law enforcement, to the political class and to the nation as a whole. The unprecedented security and constitutional breach could have long-term negative implications on the perception of U.S. security - without an equally forceful response from U.S. authorities.

The economy entered 2021 with little dynamism. Loss of 140,000 jobs in December for the first time since April, left the unemployment rate at a stubbornly high 6.7%. It was the first monthly job loss in the U.S. since the early stage of the pandemic. U.S. household spending declined for the first time since the spring as incomes fell and the number of Americans applying for unemployment benefits remains elevated [892,000 per week], underscoring how the pandemic continues to undermine the economy. Before the pandemic, unemployment filings averaged 225,000 per week and the highest single weekly tally was 695,000 in 1982. Currently, some 20.4 million people continue receiving unemployment benefits of some kind, ten months after the pandemic hit. As workers continued to apply for unemployment at an elevated level, holiday season demand for imported consumer products also pushed November's trade deficit in goods to a record.

According to the Bureau of Labor Statistics, leisure and hospitality sectors are among the hardest-hit sectors by far. This is followed by job losses in government, education, and healthcare in descending order. Meanwhile, the retail, manufacturing and construction sectors continued adding new positions. Restrictions intended to slow the latest surge in Covid-19 cases have dampened economic activity. This helped prompt passage of a new $900 billion stimulus bill that had been delayed for months. The package included nearly $300 billion in small business relief, a new round of payments of $600 to adults, and $300 per week in extra unemployment benefits until mid-March. The relief bill came too late

to avoid a slowdown in the labor market and a reduction in consumer spending.

The latest manufacturing data showed that while there is growth, it is at a slower pace than a few months ago. This means the incoming Biden administration will inherit a weak economy, making it a priority that additional fiscal stimulus will in all likelihood be contemplated soon. The incoming administration received an important lift when both run-off elections in Georgia on January 6th, provided two additional senate seats for the Democratic Party. This will allow the incoming vice-president to become the tie-breaker if a deadlock occurs in passing legislation (both Parties now hold 50 seats each in the senate). This newly created advantage could become a helpful tool in advancing a Biden agenda.

Forecasts toward economic stabilization in 2021-22 have been revised upwards after the Democratic Party secured control of the U.S. Senate, ensuring narrow control of both houses in Congress and a smoother path to more fiscal stimulus. Expectations are that a new spending package (similar in size to the one passed in December) could be enacted in a few months. If realized, this could potentially boost GDP growth in 2021 by about 1.5% points to 5.3%, and by 0.5% point in 2022 to 2.6%. If achieved, this could bring the level of GDP at year-end 2022 back to pre-pandemic levels.

With renewed Covid-19 restrictions in place, cold weather, and unfavorable seasonal adjustments, there are expectations that U.S. unemployment claims will climb in January-February. Job losses in the past year have been particularly severe among lower-paying service industries, including restaurant, hotel, and mall-retail workers. Meanwhile, workers in other areas were more likely to shift to working from home and have maintained incomes to help drive demand for goods, while spending less on dining out, travel and other services. While employment declined in retail stores, restaurants, and bars, hiring growth has been recorded in warehouse and transportation businesses that serve online customers. Courier and messenger service jobs have increased every month since February, growing the sector by more than 20% as of November.

The Institute for Supply Management's purchasing managers index for service industries remained well above the 50 mark -that separates expansion from contraction- for the seventh consecutive month. Underlying figures suggest a mixed outlook, with orders and production rising but employment trending down. Most respondents to the survey remain cautiously optimistic about business conditions because of recent approvals and impending distribution of vaccines. Meanwhile, factory activity has been strong as consumers shifted spending toward goods such as autos, appliances and other household goods.

The monthly trade deficit for goods was the highest on record going back to 1992, led by strong demand for cellphones, appliances, jewelry, and toys.

The virus which has killed over 360,400 people in the U.S., continues to spread rampantly across the country. New cases, hospitalizations and fatalities have hit new daily records. Although news of the rollout of vaccines initially brightened the economic outlook, fears that the country would miss its target of inoculating 20 million people by year-end 2020 proved to be conspicuously accurate. The near-term outlook has been clouded by an uptick in cases, the slow pace of vaccinations, and a rising threat of a more aggressive strain of the virus.

UK/European Union

Four years since Britons voted to leave the European Union [EU] the terms for future economic relations between the two were finally agreed. Surprisingly, most British goods will be allowed into the EU duty-free and will not be subject to quotas. This is a good start following 48 years during which the UK became closely integrated with and an important member of the trade block.

The agreement will ensure basic future alignment of power/energy and gas markets on both sides of the Channel. Trade in the sector is expected to continue smoothly going forward despite more red tape.

It is much too soon to tell how Brexit will work in practice. Raising barriers to travel and trade is never good for business or tourism. Many still suspect that ultimately the deal with the 27-member EU will be a poor one for the UK economy - when compared with remaining inside the EU. The end to Britain's membership in the EU's vast single market and customs union will bring inconvenience and higher costs for both individuals and businesses – from the need for tourists to have travel insurance to the millions of new customs declarations that firms will have to complete. EU officials stress that the agreement is "fair and balanced" and fully protects the fundamental interests of the EU and creates stability and predictability for citizens and companies.

Supporters see Brexit as an escape from a project that had fallen far behind global powers the U.S. and China. Opponents say it will weaken the West, further reduce Britain's global clout, undermine its economy, and lessen its appeal as a once cosmopolitan destination.

Support for Scottish independence has risen. Scotland predicts that Scottish firms will miss out on business opportunities in the world's largest trading block. They also expect the deal to hurt Scottish fishing, agriculture, and farming interests. The Scots could eventually vote to leave the UK.

The Irish view is that Brexit will shift Irish politics and law away from Britain as the relationship is expected to change significantly.

Meanwhile, the UK has reached several agreements with non-EU countries- such as Japan- to ensure continuity of trading arrangements with British companies. It will need to reach a deal with the U.S. as well.

German exports and industrial production posted better than expected results in November and December, suggesting underlying strength for Europe's biggest economy and the possibility of avoiding another full-blown downturn. Industry has come back as Germany's biggest hope against a double-dip recession. If not for the pandemic-related lockdowns, data all point to strong economic performance in Germany during Q4 2020. Industrial production, manufacturing orders, exports, employment and retail sales are all performing better than expected. The performance was supported by double-digit annual export growth to China, where the virus is largely under control. UK companies buying goods and parts ahead of the end of the Brexit transition period also contributed.

German industry was buoyed by exports in late 2020, fueling hopes that the eurozone's largest economy would avoid a further downturn, despite the latest restrictions to control a fresh surge in Covid-19 infections. The outlook has improved for 2021 as German exporters anticipate continued strong performance given manufacturing orders in the pipeline; a pick-up in demand for machinery, equipment (medical, engineering), autos, parts, etc. The strength of the German industrial sector, by far the largest in the eurozone accounting for a bigger share of the economy than in any other advanced country, is set to continue. However, the country introduced a national lockdown in mid-December that will hurt services; and tightened restrictions in early January, including school closures have been extended to the end of the month.

China

Recovery from the pandemic continued in China with manufacturing and non-manufacturing sectors expanding at a decent pace. However, data released for December 31, 2020, indicate logistics and purchasing trends softening during December. This suggests that the economic rebound from the pandemic may have peaked. Still, there is no doubt that momentum remains as the economy entered

2021, with GDP growth projected at around 7.9% for 2021, compared to 1.9% in 2020. Nevertheless, growth is considered as being unbalanced with the IMF urging China to aim new fiscal, monetary and structural policies toward strengthening private demand; to allow for more balanced medium-term growth.

Inflation is expected to remain contained, trending below the pre-crisis target of 3% during 2021. Corporate leverage is expected to rise by about 10 percentage points of GDP, according to the IMF. China's 2020 current-account surplus is expected to widen to 1.9% of GDP for 2020, then narrowing to 1% of GDP in 2021. The 2020 increase reflects lower commodity prices, the collapse in outboard tourism, a surge in exports of pandemic -related and other goods supported by China's early recovery of production and higher export prices.

Macroeconomic and financial policies have supported the recovery. Policymakers have provided financial relief and fiscal support to protect the most affected firms while safeguarding financial stability, including providing liquidity to the banking system, expanding relending facilities to smaller enterprises, and introducing a repayment moratorium until Q1 2021. The authorities have also increased the disbursement and coverage of unemployment insurance to help vulnerable households and provide tax relief and waived social security contributions by employers. Against this backdrop, the general government deficit (including off-budget investment spending) is projected to rise to 18.2% of GDP in 2020 from 12.6% in 2019, according to IMF calculations.

Structural reforms have progressed despite the pandemic, but not evenly across key areas. The opening of the financial sector has advanced with further shortening of the negative lists for foreign investment and the removal of restrictions on the investment quota for foreign institutional investors. Labor market reforms, such as rules governing worker migration from the countryside, have improved labor mobility, and patent laws were amended to strengthen intellectual property protection and foster innovation. At the same time, progress in reform has been slow in the areas of state-owned enterprises and competitive neutrality between private and state-owned firms.

In recent weeks some Chinese factories, elevators and street lighting were shut down to save energy. Chinese energy and industrial groups say a ban on Australian coal has worsened a power shortage that began in early December. More than a dozen cities have imposed restrictions on electricity use as growing demand for energy owing to the country's post-Covid-19 economic recovery collides head on with a shortage of thermal coal. The shortage underscores the dilemma Chinese authorities face in balancing their muscular approach to international diplomacy with the needs of the economy. Chinese coal mines are struggling to make up the shortfall caused by the boycott of Australian coal because of tightening environmental regulations.

Thermal coal inventories are reportedly at a two-year low, while prices have surged by two-thirds since May 2020. That forced many power plants to cut back on production, with little hope of an early resolution given the poor state of relations between China and Australia. Power companies confirmed that the problem is partly due to an embargo on Australian coal imports, which many Chinese power plants depend on, as tensions between the two countries simmer.

In at least four Chinese provinces residents and businesses have been asked to cut electricity consumption. Some factories are operating only two days a week and half of the streets are dark at night in Hunan province, located in central China. Some high rise buildings in the province switched off power to elevators, forcing workers to climb stairs (some 20 flights) to get to their offices. In another province, factories were forced to cut working hours by 80% until year-end 2020.

There is little expectation that China will witness a significant boost in foreign investment in 2021. But having published a catalogue of new guidelines and qualified entities will serve as a useful guide for foreign firms to align their business plans with the Chinese authorities' development goals. There is little doubt that China's early economic recovery from the pandemic will help underpin investor interest in the country over the medium-term.

On December 30, 2020 China and the European Union announced a long-awaited agreement in principle to conclude a comprehensive agreement on investment (CAI) between both. While the CAI does not provide equal market access for Chinese or European companies to their respective markets (this was the original goal of the negotiations), it allows EU investment in new services sectors and improves transparency regarding Chinese government subsidies to certain industries.

Restrictions remain in place for investment in sensitive sectors (agriculture, energy, public services), while China retained the current level of market access for EU companies. The EU trade commissioner considers the deal to be the most ambitious outcome that China has ever agreed with in terms of market access, fair competition, and sustainable development. The EU expects that with this agreement European businesses will have more certainty and predictability for their operations in China.

The deal will remove some barriers to EU companies' possibilities for investing in China, such as specific joint-venture requirements and caps on foreign equity. Industries where the EU has secured improved access terms include automotive, private healthcare, cloud computing, and ancillary services for air transport. The improved market access arrangements for car manufacturing cover electric vehicles and hybrids.

There is concern that the EU-China investment agreement in principle may create friction with the incoming U.S. Biden administration, which has stressed the need for transatlantic cooperation to put pressure on China. However, it's worth pointing out that the deal will secure the same benefits for the EU as the U.S. obtained in its Phase 1 trade deal with China, including openings in insurance and asset management sectors. Other parts of the agreement seek to ensure transparency of subsidies and to set clear rules against forced technology transfer. EU officials note that Brussels has also secured guarantees of non-discrimination compared to Chinese state-owned enterprises. All of these points have been core EU grievances in its trade relationship with China. For Beijing, the new EU deal locks in existing market access rights while securing some openings of manufacturing and renewable energy. The EU has pressed ahead with the agreement despite the incoming Biden administration making it clear that it wants a multilateral alliance with the EU and other partners to put pressure on Beijing over human rights and trade. China made important last minute concessions in an effort to have an agreement in place before Mr. Biden takes office.

Latin America

The economic and social fallout from the pandemic has hit Latin America hard. The region was home to seven of the world's 12 deadliest outbreaks as measured by confirmed deaths per capita. Despite containing just 8% of the world's population, the region has accounted for 30% of known Covid-19 deaths globally. Latin America's economies are projected to have shrunk by more than 8%, on average, in 2020, worse than any other region (except the eurozone). Joblessness and hunger in Latin America have soared as a result.

According the IMF, almost all the progress the region made in reducing poverty over the previous 20 years is at risk of coming undone. Investors and ordinary citizens worry that the region is on the verge of a "lost decade" similar to the 1980's, when Latin America suffered high inflation, debt defaults, soaring crime, and a crippling long-term decline in per capita income.

The policy agenda this year will be dominated by efforts to roll out vaccines, restore economic activity to something closer to normal and start to close burgeoning fiscal gaps that risk causing real problems with creditworthiness. However, 2021 is also likely to be the year when some longer-term consequences of the Covid-19 crisis start to emerge, in the form of political change and economic policy reform.

This year will be a busy one for Latin America politically. General elections will take place in Peru, Honduras and Nicaragua. Mid-term polls are scheduled in Mexico and Argentina. The entrenched problems that produced anti-incumbent sentiment at the 2018 polls, and social unrest – have been joined by new, pandemic-related concerns around public health, a desire to return to normalcy and a need for public support for the millions hit hard economically. This could be a recipe for more anti-incumbent sentiment and a return to social unrest. In most general elections this year, the incumbent cannot run anyway, so a change of administration is guaranteed. There are risks that changes of government in Ecuador, Peru and Chile could produce changes in the broad orthodox economic policy framework in those countries.

Elsewhere, with no electoral release for pent-up anger, and policymaking likely to become a lot more complicated owing to the need to withdraw fiscal stimulus, the risk of social unrest will be high and rising.

The vaccine rollout process will be uneven and slow in the region, amid problems of access to and distribution of the vaccine. Compounding the problem of access to Covid-19 vaccine, all Latin American countries face bureaucratic, political, and logistical challenges to the rollout process. Weak healthcare systems across the region will complicate vaccination campaigns, as will difficulties in handling ultra-cold storage and distribution capabilities in many countries. The region's largest economies are, by virtue of their purchasing power, production capabilities and participation in vaccine trials, comparatively well placed to secure dose commitments in sufficient quantities. The region now confronts a post-holiday surge in Covid-19 cases.

Economic recovery in the region has been slow but steady; and by year-end seem to be flattening out at levels that in most cases are still well below pre-crisis levels. There is little reason to expect a shift in this pattern. Growth is expected to continue in quarter-to-quarter terms with the adaptation to new working practices, the boost in sentiment from the start of the vaccine rollout, and a rosier picture for export demand, particularly from Asia, as the global recovery gathers pace. Projections for regional GDP growth of 3.9% reflects base effects. Most economies will grow only modestly, considering the scale of last year's collapse.

Still, there are reasons for pessimism. Vaccines will not be widely available to the general population this year, and the virus will in many cases not be well controlled. This will likely contain any recovery in consumer sentiment and could force some governments to return to harsher lockdown measures. Furthermore, Latin American governments have dwindling fiscal space for stimulus and face the prospect of the gradual withdrawal of support measures, including direct cash transfers that proved vital in bolstering consumption in 2020. The countries that do have the fiscal space such as Chile and Peru can be expected to continue to use it.

Elsewhere in the region, there will be pressure to address the growing burden of public debt, and the growing difficulty of financing it. In this context of weaker macroeconomic policy support and a long time still to wait for a post-vaccine return to normality, we can expect a generally weak first quarter, with GDP fairly flat. In a few countries, we expect some more serious setbacks over the course of 2021.

In **Chile** for example, GDP is likely to falter in at least

one quarter this year amid an extremely important presidential election and constitutional reform process. With a rapid acceleration of growth not "in the cards" this year even after a weak first quarter, GDP in many of the region's economies will be as much as 5% below pre-pandemic levels even in the fourth quarter. Chile's health ministry reported the highest number of daily infections, 4,201, since the peak of the outbreak in June last year. In December the authorities reinstated lockdowns in parts of the country and suspended flights from the UK over concerns about the new strain. Chile's deal with Pfizer for 10 million vaccine doses is over a 15-month period, with just 1.6 million doses promised in the first quarter of 2021.

In **Brazil** the Bolsonaro's administration has backed away from its criticism of Chinese vaccines [after active trials have been in progress with good results] and agreed to buy up to 100 million doses of a shot being developed by China's Sinovac. Over the past few months, the Chinese vaccine has emerged as one of Brazil's best bets to fight the pandemic – which has cost the country over 200,000 lives so far, second only to the U.S.

Brazil's health ministry has signed a contract with a Sao Paulo state research center to secure 46 million doses of the Chinese vaccine, with an option to buy a further 54 million doses. Together these would be enough to immunize about half of Brazil's population. Latin America is racing to secure doses as Covid-19 cases surge across the region.

Hundreds of thousands more people tested positive in Latin America during the first week of January, after many defied government warnings and held big family gatherings over the holidays and packed beaches at the start of the Southern Hemisphere's summer. According to leading clinical specialists in Brazil, it will take more than six months before the country will start to get back to anything like normalcy.

In **Colombia,** which has the second -highest number of cases in Latin America, infections have been on the rise since mid-December, setting new daily records and prompting major cities to expand strict quarantine orders. The country of 50 million is expected to begin a national vaccination program in February, with the expected delivery of nearly two million doses of the Pfizer-BioNTech vaccine.

The Economist Intelligence Unit projects that over 2021-25, Colombia will fall one place in its global ranking, to 52nd. GDP growth will likely gather over the medium term, supported by a positive business environment. Deficiencies in financing and infrastructure, as well as a complex tax regime, continue to be cited as weaknesses in doing business in this market.

Peru is now beginning to see a rise in cases and deaths after one of the world's worst breakouts last year. Doctors in Lima and provincial cities say their intensive-care units are already overwhelmed. The government is under fire for delays in securing vaccines. In response it announced that a contract was just signed to receive 38 million doses from China's Sinopharm, which is conducting clinical trials in Peru. The first batch is expected to arrive in late January.

In December, the Peruvian Congress approved legislation allowing for a one-time withdrawal from the public pension system despite opposition from the executive branch. Lawmakers argued that contributors need the funds to help deal with the economic consequences of the pandemic. The law allows workers enrolled in the public pension system to withdraw funds. It also allows for those who have reached 65, but who have not satisfied the requirements to access a pension, the ability to withdraw the entirety of their pension contributions. Consequently, the government will have to increase current expenditure to cover the withdrawals. A wider fiscal deficit is forecast as a result.

Protests by agricultural workers forced the repeal of 20-year old Agrarian Promotion Law, which was originally intended to provide temporary incentives to invest in Peru's agricultural sector. It set a cap of daily wages and granted firms in the sector low tax rates. The government now seeks a new law that increases workers' rights but also maintains a pro-business regulatory framework. The revocation of the agricultural promotion law does not lower GDP or the export forecast for 2021, as an increase in demand in agricultural exports will likely offset any disruption in the sector. However, tax increases in response to public protests will hurt the investment environment, introducing downside risks to Peru's medium-term investment and GDP forecasts. Future tax policy developments in Peru will be monitored; as well as the election outlook for increased risk to the assumption that a business-friendly government and Congress will be maintained over 2021-24.

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