Country Risk and the Global Outlook – June 2023

A timely US debt deal offers room for another 25-bps hike in June, but will the Fed bite?

Commentary:

"The U.S. Congress reached a last-minute deal on the country's debt ceiling, ensuring it will not fall into default and allowing markets to breathe a sigh of relief. The US posted better-than-expected Q1 2023 GDP figures (although still a slowdown from Q4 2022) and worries over another big bank failure are also dying down, which will give the Fed room to maneuver. The Fed may pursue another 25-bps rate hike at its June meeting before pausing, but we don't expect rate cuts this year. Inflation is proving stickier than expected round the world and central banks may continue to hike. Meanwhile, it is important to keep an eye on China. We expect strong growth of 5% this year, in line with official estimates, but a slowdown in the rest of the world might temper the country's growth prospects. Data coming in from Europe is giving mixed signals, with headline inflation consistently dropping in most European economies and lately also in the UK, but core inflation is proving to be stickier. Considering this, the European Central Bank (ECB) and the Bank of England (BoE) will likely pursue a moderate hiking trajectory, before possibly pausing in H2 2023. In India, the softening of inflationary pressures and the and the upside surprise to the growth in the fourth quarter of FY24 has created room for an extended pause in the policy interest rate. The RBI is expected to keep the policy rate unchanged for the remaining months of FY24, after it halted the rate hike during the last two policy meetings. Nonetheless, despite the increase in lending rates the bank credit to the commercial sector is strengthening underscoring the resilience of the growth momentum" said Dr. Arun Singh, Global Chief Economist, Dun & Bradstreet.

Introduction

First, the good news – the U.S. is not going to default on its debt after all. At the time of writing, the bill was yet to be signed into law by President Biden, but markets had already breathed a sigh of relief assuming that this would be done before the widely understood 'X date' when the Treasury runs out of money to pay its bills without issuing more debt. On top of this, revised data suggests that U.S. GDP growth in Q1 2023 was slightly stronger than previously thought (1.3% annualized, compared with 1.1% previously reported), and while some regional banks took a beating on their stocks, markets seem broadly relaxed about the prospect of another big bank failure. But all these seemingly positive developments mean that we may have to wait a bit longer for the widely anticipated U.S. Federal Reserve (the Fed) pause: another 25-bps rate hike in June is now back on the cards.

At the heart of these swinging sentiments on the Fed's rate path is the fact that the fight against inflation is proving harder than previously thought. April numbers on inflation, not only in the U.S. but also in other developed markets, came in strong. Together with the sustained strength in core inflation, it has given central banks that had already paused a reason to rethink – the Reserve Bank of Australia resumed its hiking cycle in May after standing by in April; the Bank of Canada might consider another hike as well. With the U.S. debt ceiling debate out of the way and the banking sector seemingly calm, the US Fed now has more room to act. It

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could be argued that a sure-footed hike might be better than a pause that keeps everyone guessing. After all, the markets had already priced in a 25-bps hike in June. There is a recency bias in market sentiment for another hike, and data coming in right up to the point of the actual meeting could alter the Fed's calculations. But one thing is more certain: rate cuts in 2023 are increasingly unlikely.

The latest data signals from Mainland China have tempered early enthusiasm about an economic rebound. The Chinese economy is growing and is likely to be an outperformer among the world's largest economies in 2023. But industrial activity is softening after an early spurt, and growth so far has been largely buoyed by exports, which are bound to suffer from a growth slowdown in the rest of the world. Our estimate of 5% real GDP growth (in line with the official estimate) is milder than the forecasts of several other agencies, including the IMF.

Dun & Bradstreet Country Risk Analysis			
Country	**April 2023**	**May 2023**	**Change**
Country Risk Rating Upgrades (risk level has improved)			
Gabon	DB5d	DB5c	1 Quartile
Country Risk Rating Downgrades (risk level has deteriorated)			
South Africa	DB5c	DB5d	1 Quartile
Outlook Upgrades (from/to)			
Uganda	Deteriorating	Stable	
Outlook Downgrades (from/to)			
Spain	Stable	Deteriorating	

REGIONAL SUMMARIES

North America

North America's regional outlook is maintained as 'deteriorating'. The regional economy is showing tentative signs of a slowdown; although U.S. Q1 2023 GDP was revised up to 1.3%, from an earlier estimate of 1.1%, this is still a slowdown in comparison to Q4 2022. Canada's economy grew strongly by 3.1% (annualized) in Q1 2023, well above analyst expectations, but almost entirely attributable to the jump in January, with growth remaining flat in the last two months of Q1.

Separately, after holding up strongly, the labor markets in the region also seem to be showing the first signs of cracks. Notably, job openings have started coming down. Together with declines in wage growth, this makes the case that strong headline unemployment rates mask some underlying weakness. However, consumer spending remains buoyant across the region. The PCE inflation indices for the U.S. and Canada also ticked

higher in April, reviving chatter about a possible resumption of rate hikes in Canada and considerably raising market expectations of another rate hike by the Fed in the upcoming FOMC meeting in June.

A last-minute deal between Republican and Democrat leadership over extension of the U.S. debt ceiling has come as a relief to nervous markets. Although the bill must still pass a divided Congress for the issue to be settled completely, it continues to advance and looks set to be signed into law before the revised 'X date' of June 5. This has calmed nerves and, in our view, has given the Fed the necessary breathing room to act on a rate hike in its June meeting, if it deems fit.

Western & Central Europe

Western & Central Europe's regional outlook remains at 'deteriorating'. European data for H1 2023 reveals a mixed picture. Headline inflation has consistently dropped in most European economies and lately also in the UK. Encouragingly, producer price inflation has abated dramatically both in the euro area and in the UK, and in May has even contracted in countries like Italy (-3.5% y/y, the first negative print in two years), indicating that inflationary pressures continue to ease.

However, core inflation is proving stickier; for example, in Spain, it came in at 6.1% in May, while headline inflation declined to 3.2% y/y. In the UK, core inflation increased to 6.8%, from 6.2%. This will likely leave the European Central Bank (ECB) and the Bank of England (BoE) on a moderately hiking trajectory, before possibly pausing in the second half of the year.

On average, in 2023, the economies of the region will likely exhibit very different GDP performances, with strong growth in countries such as Ireland and Greece, with the latter's growth revival expected to continue, and near-zero growth in Germany, which has already fallen into recession between Q4 2022 and Q1 2023.

The Nordics

The Nordic regional outlook remains at 'deteriorating'. In Q4 2022, the region's economies displayed very different GDP performances, with strong growth in Iceland and Denmark (2.2% and 1.1%, respectively), mild growth in Norway (0.2%), and negative growth in both Finland (-0.2%) and Sweden (-0.6%). This multi-speed dynamic is likely to continue over the course of 2023, with Sweden and Finland's economies expected to contract.

Inflation remains well above target across the region but is likely to have peaked. In April, inflation ranged from 5.6% in Denmark to 8.3% in Iceland, possibly indicating that interest rates will have to increase further in H1 2023. Real wages are projected to fall by as much as 15% this year; along with the decline in real disposable income and downfall in retail sales, this further accentuates the recessionary pressure in the region.

More positively, consumer sentiment, despite still being negative, is improving across all economies in the region. However, business sentiment, which is also on average negative, does not show strong signs of improvement. We anticipate weak domestic demand, coupled with lower external demand, which will deteriorate economic activity.

Asia Pacific

The Asia Pacific region's outlook remains at 'stable'. In line with our expectations for 2023 as a whole, Q1 GDP confirmed a rebound for Mainland China, Hong Kong S.A.R., and Thailand, while the economies of South Korea, Vietnam, Malaysia, Taiwan Region, and Singapore witnessed marked slowdowns. However, gaps in China's recovery story have tempered expectations of a positive spillover. Headline inflation in most countries – with the notable exception of Singapore and Australia among high-income countries – has begun to recede.

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And while most central banks remain on the sidelines, the central banks of Australia and New Zealand remain on their hiking course. Economic weakness will remain a key driver in the region, potentially warranting rate cuts in the latter half of the year. However, the credit environment outlook has marginally worsened now that it is likely the Fed will raise rates again at its upcoming June meeting.

Thailand's election delivered a surprise lead for an upstart political party, in a strong rebuke to the incumbent junta-aligned government. However, factoring in institutional hurdles, political uncertainty has now increased. Similarly, mass rioting in Pakistan following the arrest of the populist ex-prime minister, Imran Khan, has elevated political risk in a country that is on the brink of default by pitting civilian factions against the powerful military institution. Bangladesh has benefitted from a comprehensive IMF support package, but pressures on external balances remain considerable.

Finally, the Indo-Pacific Economic Framework (IPEF) – the Biden administration's flagship program for the Asia Pacific region – has produced its first deal on supply chain resilience, with 14 countries agreeing to work on crisis response, recovery, and labor standards in supply chains. This was a relatively low-hanging fruit – tough negotiations on trade and tariffs lie ahead.

Latin America & Caribbean

Across Latin America, pressure is mounting on central banks to cut interest rates as inflation slows. Countries such as Uruguay and Costa Rica have already initiated rate cuts, and Peru and Chile may follow suit soon. Labor markets have remained relatively stable, with unemployment rates at pre-pandemic levels. Stronger services and overall activity measures have surpassed market expectations of slower economic growth. Balancing monetary conditions with economic stimulation will be crucial for sustainable recovery in the region.

Argentina's enduring struggle with inflation has resulted in a significant decline in the value of its currency. The country recently introduced a fresh 2,000-peso banknote, which holds twice the value of the previously highest-denomination note in circulation. However, it is equivalent to merely $8.21 at the official exchange rate and $4.08 in unofficial markets. As a result of strict capital controls, access to the official foreign exchange market is severely restricted, further diminishing the value of the peso in parallel markets. Although the government has raised interest rates to tackle inflation, low confidence in the economy hampers the inflow of investments. With a possible default on the horizon, Argentina's economic situation remains precarious. In the realm of politics, Paraguay recently held its presidential election, resulting in a victory for Santiago Peña of the ruling Colorado Party. Peña faces the challenge of reviving Paraguay's farm-driven economy, reducing a significant fiscal deficit, and navigating pressures from soy and beef producers to forge closer ties with China.

Eastern Europe & Central Asia

Growth has slowed down significantly for the Eastern Europe & Central Asia (EECA) region in 2023 and is expected to recover only by mid-2024. The region is facing persistently high inflation, especially high foodgrain prices, and is also at heightened risk of financial instability, particularly in advanced economies; these factors are fueling the fear of contagion to local firms and banks.

The World Bank upgraded its 2023 economic growth forecast for the region to 1.4%, from 0.1%, citing improved outlooks for both Russia and Ukraine, despite their ongoing conflict. As per the IMF, annual regional growth is expected to rebound in 2024, from 1.1% to 3.0%, in emerging European economies (excluding Belarus, Russia, Türkiye, and Ukraine); the IMF report pegs average inflation at 11.7% in 2023 and 5.5% in 2024 in these economies.

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Central banks in the region are left with very few policy choices – on one hand, they are striving hard to control core inflation without risking financial distress among vulnerable sectors; on the other, these institutions are trying to avoid excessive tightening and extend fiscal support to their respective economies, while maintaining debt sustainability and fiscal consolidation. Many Eastern European nations are yet to see their inflation trajectory peak, despite being ahead of the ECB in raising interest rates.

As budget deficit across Eastern Europe widens, foreign borrowings are near their all-time high despite significantly higher borrowing costs. Real household income across Eastern Europe has been consistently

Declining since June 2022. The lack of structural reforms and slow pace of financial democratization are hampering the region's integration with the rest of the financial world, despite its significant dependence on the external sector; this affects the region's ability to withstand financial turmoil in global markets, leading to high debt servicing costs and slow GDP growth.

The troubled large economies in the region – Russia, Ukraine, and Türkiye – have all shown remarkable resilience and are turning back to the growth path. The archaic issue of hyperinflation in Türkiye is now diminishing, though it was still at 39.3% in May. Russia and Ukraine are both inching toward growth in 2023, with high but manageable inflation. While Ukraine is still battling economic and infrastructural devastation, the reopening of Ukraine's Black Sea ports and resumption of grain trade, as well as substantial donor support, are likely to partially revive the economy in 2023.

Central Asian countries depend heavily on external factors such as impact of high interest rates, liquidity crunch, slow demand from advanced trading partners (the EU and Russia), and sluggish private sector consumption. Moreover, the economies are increasingly vulnerable due to the Russia-Ukraine conflict, high inflation, unsustainably high external debt, slowdown in consumption and weakened export sector.

Middle East & North Africa

A divergent recovery continues to play out between oil-exporting and importing nations in the MENA region. Headline and core inflation in several oil-exporting countries (Bahrain, Iraq, Kuwait, Oman, Qatar, and Saudi Arabia) have decelerated due to subsidies and caps on essential products, the strengthening of the U.S. dollar, and the limited share of food in the consumer price index basket. However, countries such as Egypt, Morocco, and Tunisia are experiencing upward trends in headline inflation because of currency depreciations and still-high global food prices.

Oil-importing countries in the MENA region, except for Egypt, saw improvements in their primary fiscal deficits in 2022 compared with the previous year. Higher tax revenues partially offset the impact of rising commodity prices, but managing fiscal policies is important to maintain stability. In addition, rising borrowing costs and widening sovereign bond spreads pose significant challenges for countries such as Lebanon and Tunisia. In May, Israel passed a two-year state budget after substantive negotiations with its right-wing allies, thereby weakening threats to the new government. However, prime minister Benjamin Netanyahu might look to rekindle the legislation aimed at judicial reform, which has caused mass protests ever since its inception.

Sub-Saharan Africa

Growth across sub-Saharan Africa remains sluggish, dragged down by underperformance from the region's largest economies, high inflation, and a sharp deceleration of inward investment. Tighter global financing conditions have caused borrowing costs and debt servicing costs to surge. We expect 3.0% regional growth this year and around 3.4% in 2024.

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Nigeria and South Africa, sub-Saharan Africa's largest economies, are set to register below-par growth this year. We expect Nigeria to grow 2.7% – strong by recent standards but significantly slower than during 2000-2015, when growth averaged 7.5% a year. In late May, Nigeria's new president, Bola Tinubu, was inaugurated. His priorities will be to fix flagging economic growth and reform the exchange rate system that has led to a currency shortage and weak foreign investment, hindering businesses.

Similarly, South Africa grew 3.0% per year on average over the long-run historical period, but we now forecast a -0.5% contraction this year. Eskom, the state-owned electricity provider, has warned that further – and longer – planned power cuts may be necessary to prevent the grid collapsing entirely. The likely impact will weigh heavily on activity. Shadowing the crumpling power grid, the rand has sunk to a three-year low, exacerbating the fuel and food shortages with higher imported prices.

Despite several rounds of partially observed ceasefires, persistent fighting has hampered humanitarian efforts and progress restoring essential services. The latest truce fell apart on 1 June because of serious violations. The ongoing violence in Sudan poses a significant risk to the country's stability; the latest suspension of ceasefire talks on 1 June heightens the risk of broader regional repercussions.

DUN & BRADSTREET RISK INDICATOR

Dun & Bradstreet's Country Risk Indicator provides a comparative, cross-border assessment of the risk of doing business in a country. The risk indicator is divided into seven bands, ranging from DB1 to DB7 – DB1 is the lowest risk, DB7 is the highest risk. Each band is subdivided into quartiles (a-d), with 'a' representing slightly less risk than 'b' (and so on). Only the DB7 indicator is not divided into quartiles.

The individual DB risk indicators denote the following degrees of risk:

DB1	Lowest Risk	Lowest degree of uncertainty associated with expected returns, such as export payments and foreign debt servicing.
DB2	Low Risk	Lowest degree of uncertainty associated with expected returns. However, country-wide factors may result in higher volatility of returns at a future date.
DB3	Slight risk	Enough uncertainty over expected returns to warrant close monitoring of country risk. Customers should actively manage their risk exposures.
DB4	Moderate Risk	Significant uncertainty over expected returns. Risk-averse customers are advised to protect against potential losses.
DB5	High Risk	Considerable uncertainty associated with expected returns. Businesses are advised to limit their exposure and/or select high-return transactions only.
DB6	Very High Risk	Expected returns subject to large degree of volatility. A very high expected return is required to compensate for the additional risk or the cost of hedging such risk.
DB7	Highest Risk	Returns are almost impossible to predict with any accuracy. Business infrastructure has, in effect, broken down.

Rating and Outlook Changes:

Rating changes: Changes in rating are made when we judge that there has been a significant alteration in a country's overall circumstances – this could stem from a one-off event (e.g., a major natural disaster) or from a change in something structural/cyclical (e.g., an important shift in growth prospects). An upgrade indicates a significant change for the better, a downgrade a significant change for the worse. The number of quartiles of change indicates the extent of the improvement/deterioration in circumstances.

Outlook changes: The outlook trend indicates whether we think a country's next rating change is likely to be a downgrade ('Deteriorating' trend) or an upgrade ('Improving' trend). A 'Stable' outlook trend indicates that we do not currently anticipate a rating change in the near future.

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