Country Risk and the Global Outlook – July 2023

Mid-year global data points to lower growth than 2022, but divergent monetary policies may now play out regionally

Commentary:

"At the half-way mark for the year, the global economy looks poised to post lower growth than what was recorded in 2022. However, at a regional level, the narrative is changing rather fast. The eurozone economies, which handled the winter season well, have slid into a recession; Asia Pacific's otherwise sound growth story has been marred by a decline in merchandise exports; Latin American economies are positioning to cut rates, while the Middle East is looking to leverage a positive geopolitical momentum.

In the current context, businesses should not only look to rationalize costs but also identify where their country and sector are in the credit cycle. It is important for them to not be myopic and position themselves well for the next upturn and leverage shifts in long-term trends. There needs to be a shift from the pre-pandemic trend of raising funds solely from cheap sources abroad to embracing domestic sources of funds. While existing sources of credit are expensive, it is readily available for sectors that align with regulatory and government priorities such as AI, EV batteries, and semiconductors.

In India, even as the Central Bank has paused its tightening cycle, lending rates are expected to continue to increase in 2023 and surpass the pre-pandemic level of 2019, given the lag in the monetary policy transmission. Although, the overall bank credit is growing strongly in double digits, the uneven pace of credit growth across different sectors evidences the underlying challenges faced by some of them. On the other hand, household credit has witnessed a robust growth as seen in the growth in personal loans, vehicle loans and credit card outstanding indicating resilient consumer demand. Combined with the steepest increase in the lending rates for personal loans, unsecured credit could see increase in bad assets," said Dr. Arun Singh, Global Chief Economist, Dun & Bradstreet.

Introduction

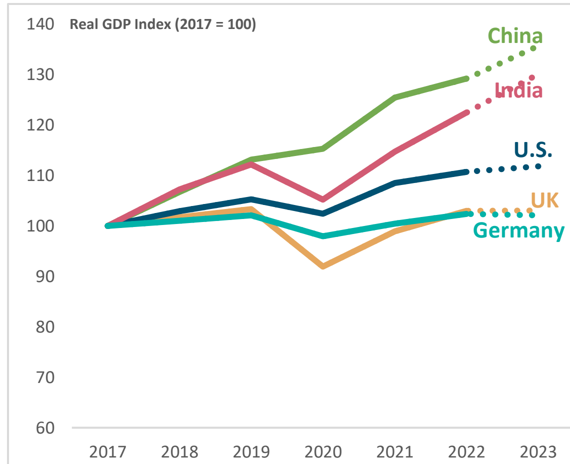
Entering Q3, the global economy is playing to the 'slowdown' script that central bankers around the world have written over the past year. At the halfway mark for 2023, it is clear that global growth will be lower than last year. However, from a regional perspective, we can see that there are stark contrasts and rapidly changing narratives.

Divergence in monetary policy paths and economic performances are becoming clearer.

Key central banks' recent rate decisions: Q2 2023

	April	May	June
Australia	Hold	Hike	Hike
Canada	Hold	-	Hike
China	Hold	Hold	Cut
Eurozone	-	Hike	Hike
India	Hold	-	Hold
Japan	Hold	-	Hold
Norway	-	Hike	Hike
Sweden	Hike	-	Hike
Switzerland	-	-	Hike
UK	-	Hike	Hike
U.S.	-	Hike	Hold

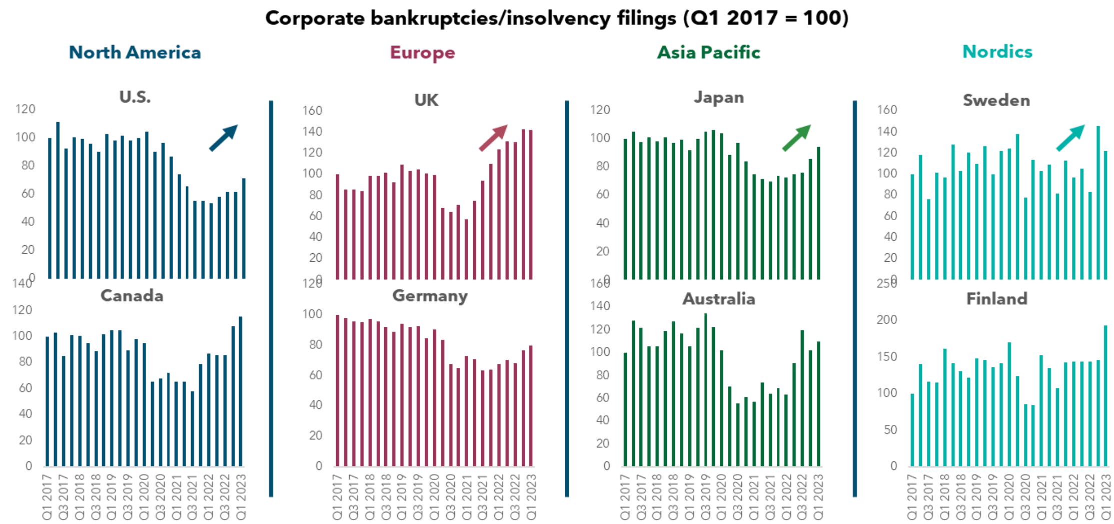
Developed markets, European economies in particular, are struggling to grow



Source: *Haver Analytics, Dun & Bradstreet*

We are either at, or near, the peak interest rates in the current cycle for most economies, but the theme of divergence is more evident in the monetary policy paths of key markets. The central banks of Canada, Australia, and Malaysia recently resumed rate hikes after pausing briefly. Around the same time, the U.S. Federal Reserve (the Fed) 'skipped' hiking at its June meeting (though with a promise of more to come); the European Central Bank (ECB) persisted with its incremental rate hike (followed closely by the Swiss and Danish central banks); the Bank of England (BoE) stepped up its hiking in response to inflation readings; Japan continued to hold rates in negative territory; and Mainland China and Vietnam cut their interest rates to support growth. Turkey, which had been a global outlier in keeping interest rates low even in the face of record-high inflation, chose to make an about-turn on its long-standing monetary policy instinct and embraced conventional economic wisdom by hiking rates – though not high enough to convince markets of its commitment. We expect this divergent approach towards monetary policy to widen even further over the next two quarters.

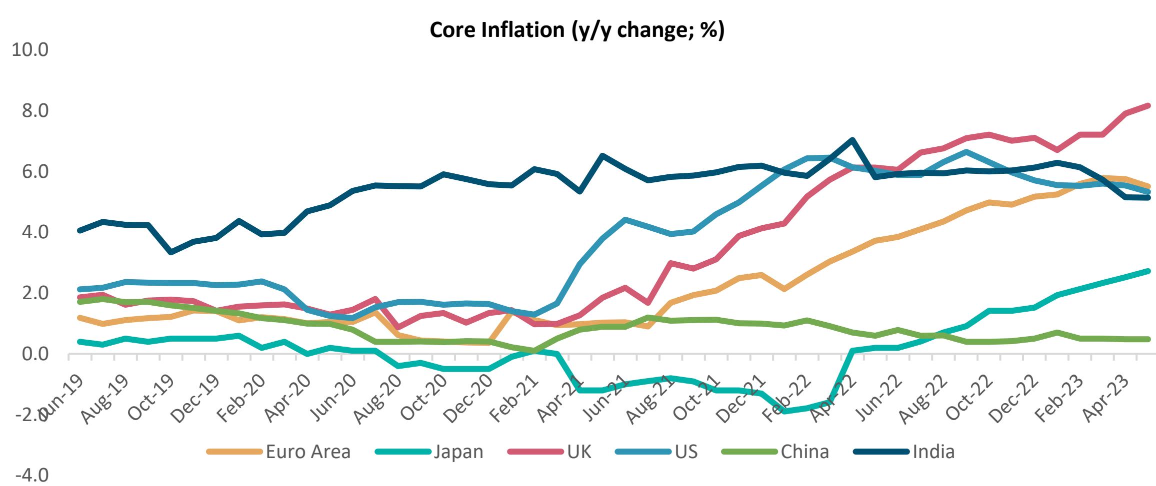
Corporate bankruptcies have begun climbing as we approach the peak of interest rate cycle



Source: *Haver Analytics, Dun & Bradstreet*

After more than a year of battling inflation, central bankers are slowly realizing that taming the inflation 'genie' is hard. Positively, headline inflation has peaked around the world, which means that the aggressive and synchronized monetary policy tightening over the past 18 months has delivered what it was supposed to, albeit to varying degrees. That said, three trends still advocate the 'glass is half empty' take on inflation: 1) Headline inflation is still above targets in most key developed markets; 2) Core inflation remains quite sticky, even rising in markets such as the United Kingdom; and 3) The decline is partly attributable to base effects. Simply put, lower inflation only means prices are still rising, but not as fast as they were last year, when prices went very high, very fast. If we view the falling inflation picture from this lens, it does not seem that impressive.

Inflation has peaked across most markets, cores inflation is still rising across some markets



Source: *Haver Analytics, Dun & Bradstreet*

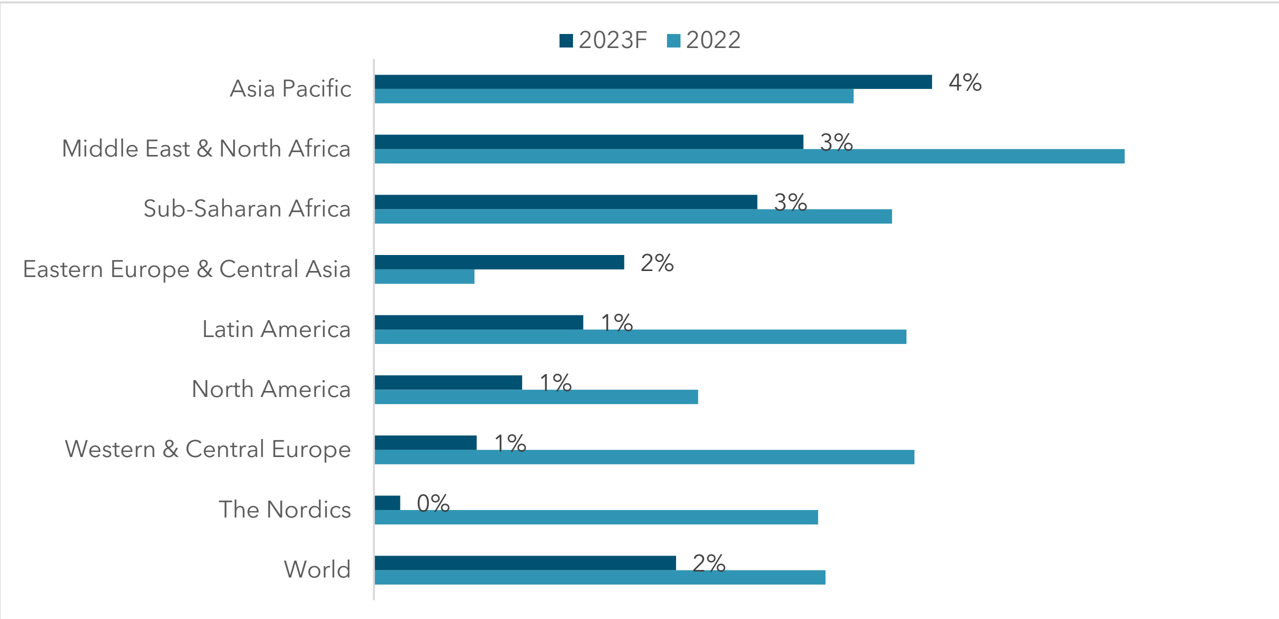
Despite the failure of three banks in two months and after narrowly avoiding a debt-ceiling debacle, the U.S. economy continues to hold up stronger than expected. On the other hand, the eurozone economy, which began the year on a positive note after dealing with the crucial winter months rather well, is now in a recession. In the Asia-Pacific region, faltering trade has begun raising concerns about an otherwise sound growth story. Economies in Latin America are positioning to start cutting rates; the region will likely lead the global economy on the climb down the interest rate ladder as it did on the way up. The Middle East is looking to build on the positive geopolitical momentum from the Saudi-Iran détente, while dealing with demand-constrained oil prices; and sub-Saharan Africa continues to struggle with conflict and high food prices, exacerbated by weakening currencies.

Businesses should look to rationalize costs, and to this end, it is important to identify where their country and sector are in the credit cycle. For instance, businesses in the emerging markets of Asia Pacific and Latin America can expect interest rates in their domestic economies to come down faster than in the U.S. or Europe. The pre-pandemic trend of relying on cheap funding from abroad might need a shift in mindset to tap sources of domestic capital instead. Even if capital returns to the shores of these economies, it will demand a higher return to reflect the risk premium. Whereas, in developed economies that are still reeling under high or rising core inflation, businesses may not be able to put off their capital demand any longer, as elevated rates seem to be a likely reality for the foreseeable future.

In the humdrum of economic data and recession forecasts, businesses should consider that the economic cycle will eventually turn. Preparing to take advantage of opportunities presented by shifts in long-term trends is equally important as avoiding pitfalls during the downcycle. Although credit might have become more expensive in the near term, it remains readily available for sectors that reflect regulatory and government priorities. And several sectors – AI, semiconductors, green technologies, EV batteries, and critical raw materials – have become high priorities for almost all markets simultaneously. In these sectors, money is flowing in and will continue to do so, either by market dynamics or through policy mandates. This presents some of the best opportunities available to businesses today.

REGIONAL SUMMARIES

Global growth is expected to slowdown in 2023, with some growth opportunities in the Asia-Pacific region.



Source: Haver Analytics; Dun & Bradstreet

North America

North America's regional outlook is maintained as 'deteriorating'. Headline inflation in the U.S. peaked about a year ago, in June 2022, but markets are still revising peak interest rate forecasts upward. The Fed's breather at its June meeting, after a 15-month-long rate hiking spree, is being viewed as a foundation for a final dash on rates, with two more hikes in 2023 expected as per the Fed's own forecast. At the same time, the Bank of Canada, which in January became one of the first major central banks to pause rate hikes, resumed hiking at its June meeting, with another rate rise expected in Q3.

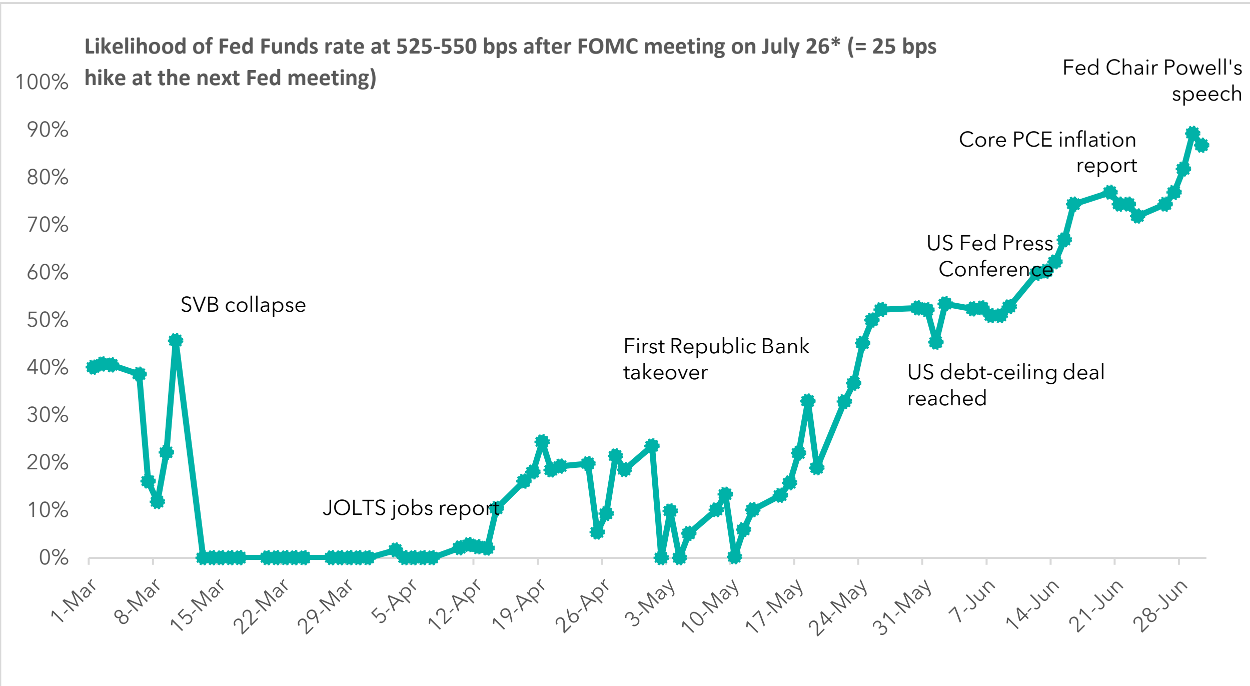
After slowing down in Q1 2023, data from Q2 indicates sustained resilience. Consumer spending remains strong across the two North American markets, with discretionary spending on services such as travel and hospitality remaining upbeat. Labor markets – a key factor underpinning economic resilience – in both the U.S. and Canada have begun showing the first signs of weakness, with job openings coming down and unemployment rates ticking marginally higher in their latest readings. However, these signs are only tentative. Evidence of labor markets' weakness remains faint, as the headline unemployment numbers in both markets are still near historically low levels. At the same time, in the U.S., the housing market has shown concrete signs of a rebound, with three consecutive months of residential home price increases.

We expect the regional economy to grow 1% on average through 2023, which is nearly half the pace of GDP growth achieved in 2022. Buoyant private consumption so far was bolstered by pandemic-era personal savings at a household level, and these have now come down considerably. In addition, many historically reliable indicators from credit markets suggest impending economic weakness – the U.S. Treasury yield curve has been inverted (spread between 10-year and 2-year bond yields) for nearly a year now. Moreover, other growth drivers such as exports and manufacturing continue to show weakness.

Finally, the U.S. federal government's debt ceiling deal will also limit the government's ability to spend its way out of a slowdown, further depressing growth prospects for the latter half of the year.

Businesses should prepare for a slowdown in H2 2023 but can expect quarterly contractions to be brief and swift. **Central** banks will continue to watch their respective preferred gauges of inflation and developments in the labor market before deciding to call an end to the rate hiking cycle.

Market expectations on future path of U.S. monetary policy have swung wildly since SVB's collapse



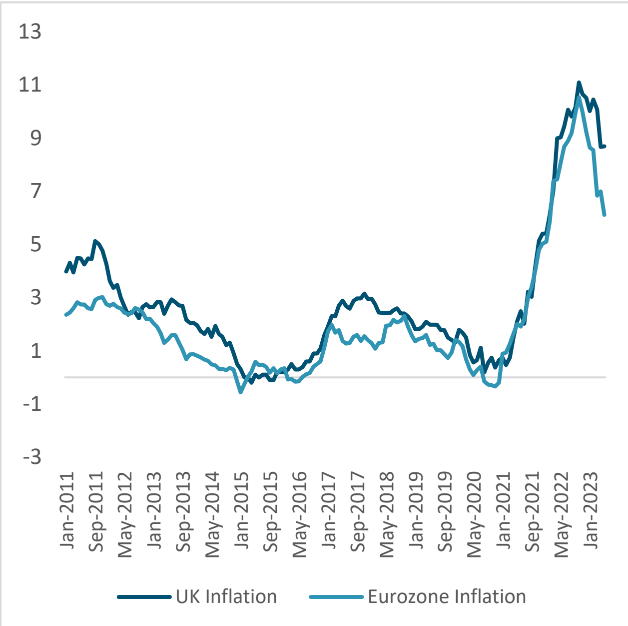
Source: CME; Dun & Bradstreet

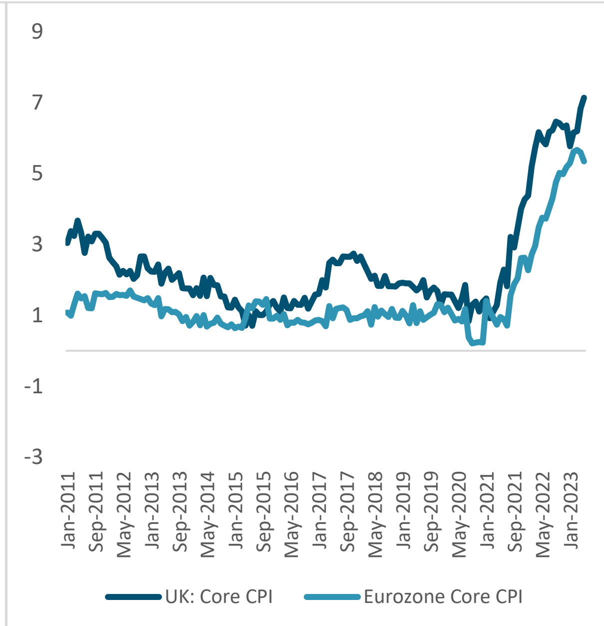
Western & Central Europe

Anemic or slightly negative GDP growth prevailed across European economies in Q1 2023, albeit with some significant differences across countries, which are likely to persist throughout the year. On one hand, countries like Greece are expected to continue with their growth revival. Moreover, the re-election, with a strong majority, of the pro-reform government headed by Kyriakos Mitsotakis may also have a positive impact on the country's long-term economic potential. On the other hand, near-zero growth will be recorded in countries such as Germany, which has already experienced a recession between Q4 2022 and Q1 2023.

Headline inflation has consistently declined from its double-digit peak to 6.1% y/y in the eurozone and 8.6% y/y in the UK in May (see LHS chart below), although at different speeds across economies. Encouragingly, lead indicators of consumer inflation like producer price inflation have also dramatically abated both in the eurozone and the UK, and in May, even contracted in countries like Italy (-3.5% y/y, the first negative print in two years), indicating that inflationary pressures continue to ease. After proving stickier than expected, core inflation in the eurozone might have peaked at 6.6% y/y in April (see RHS chart below). On the contrary, UK core inflation has accelerated strongly in recent months and has been constantly increasing since January, opening a possibly worrisome divergence between the UK and the continent, which could lead to a tighter monetary cycle in the UK relative to that in the eurozone.

Inflation has peaked but is not beaten, as a possibly worrisome divergence also emerges between the UK and the Eurozone.

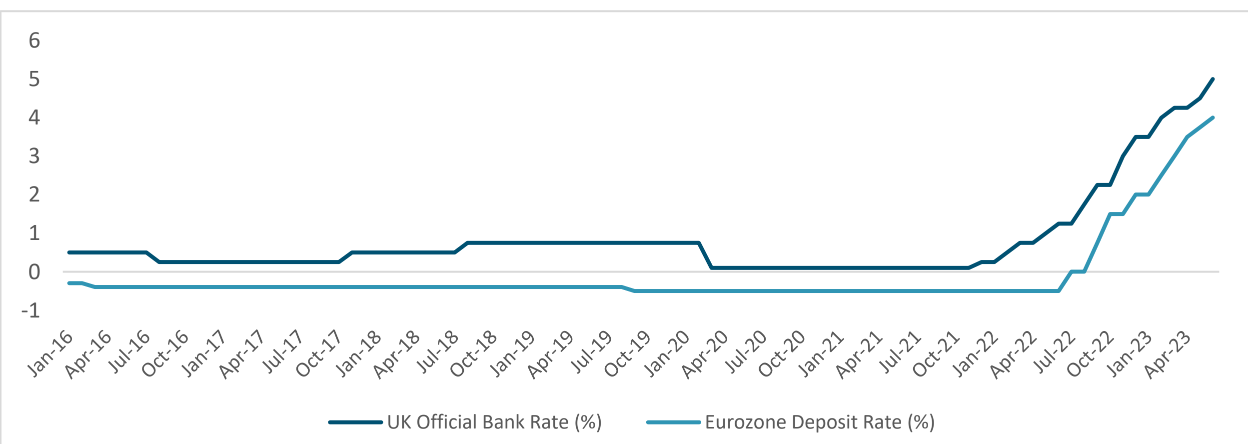




Source: Haver Analytics; Dun & Bradstreet

If the moderating inflation trajectory observed in the euro area persists, the ECB could follow a moderately hiking trajectory (from the current level at 4%), before possibly pausing towards the end of the year. A slightly different future seems likely for the BoE, which might instead have to hike more strongly than anticipated, pushing the 'terminal rate' to 6% or higher (rates are currently at 5%). As the chart below shows, over the past year, interests have risen dramatically in both the UK and the Eurozone, significantly increasing credit risk, with insolvencies rising both in the European Union (albeit from a low base) and, to a much greater extent, in the UK. Businesses should monitor the inflation outlook across Europe; while pressure on input prices has normalized, its lagging effect is likely to negatively impact demand in the coming months.

Interest rates are still rising in the region



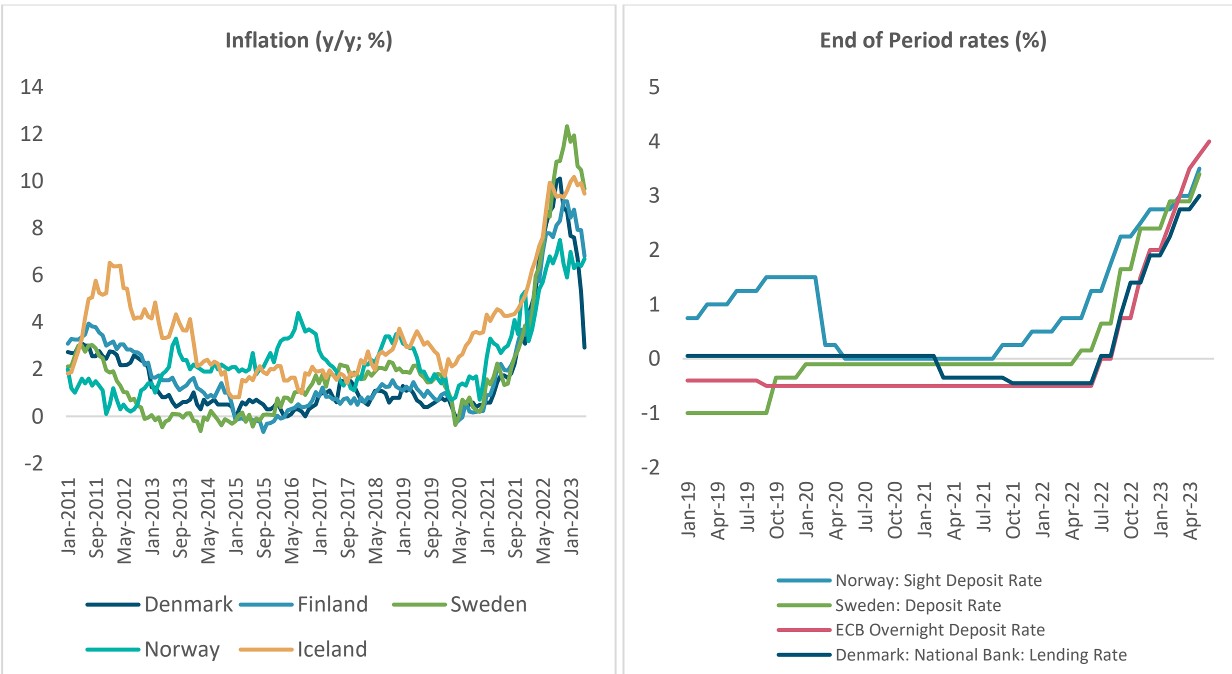
Source: Haver Analytics; Dun & Bradstreet

Moreover, the divergent dynamics in core inflation between the UK and eurozone, if it persists in the coming months, could drive the BoE to tighten monetary policy for longer than the ECB, with possible implications for the EUR:GBP exchange rate. Businesses that transact in euro or sterling should assess their hedging strategies, as sterling could appreciate against the euro in the short term, before falling once the effects of higher interest rates have transmitted in the real economy.

The Nordics

The Nordic regional outlook remains at 'deteriorating'. GDP growth in the region continued to reveal a varied picture in Q1 2023. While q/q growth was positive in all five Nordic countries, it exhibited considerable variation across them, spanning from 0.2% in Sweden and Norway to 1.1% in Finland. Growth differences are expected to persist over the course of 2023, with Finland and Sweden ending the year with negative growth, and Norway, Iceland, and Denmark posting positive growth.

Inflation has peaked, but financial conditions remain tight.



Source: Haver Analytics; Dun & Bradstreet

The inflation outlook is varied too. While it seems clear that inflation peaked in the region in May, it grew more than 9% y/y in Iceland and Sweden (see the LHS chart above) and less than 3% y/y in Denmark. With the exception of Denmark, inflation remains well above target in all Nordic countries; thus, it is likely that interest rates, which rose dramatically in 2022 (see the RHS chart above), will be further hiked in Sweden and Iceland, but also in Finland, which is a member of the eurozone, and in Norway, where inflation in May was above 6% y/y.

Although no major financial contagion unfolded from the March turmoil, credit risk has increased significantly in a region that has relatively overheated and highly concentrated property markets, and higher interest rates feeding through. Businesses should remain vigilant. Growth is projected to be negative in Sweden and close to zero in Finland, and demand will weaken in these countries, with high but declining inflation levels. Positively, businesses can expect steady growth in Denmark, Iceland, and Norway.

Asia Pacific

The outlook for the Asia-Pacific region has been downgraded from 'stable' to 'deteriorating' as key trade-dependent economies – ASEAN-5, Greater China, and Vietnam – continue to witness successive months of declining merchandise exports (in y/y terms). The outlook for exports also remains weak as Western markets (U.S. and Europe) are struggling to generate demand.

Merchandise exports across the region are struggling.

Source: Haver Analytics; Duns & Bradstreet

In terms of interest rates, Malaysia joined Australia in resuming rate hikes after a pause; New Zealand, Taiwan Region, and Thailand retained their hawkish posture with additional rate hikes, and most other central banks maintained the status quo. Conversely, Vietnam's central bank has delivered three consecutive 50 bps rate cuts since March to support its fledgling economy (Q1 GDP contracted in both q/q and y/y terms), and lingering softness in Mainland China's leading economic indicators has raised expectations of a bigger fiscal and monetary stimulus to be deployed following a series of recent cuts in key policy rates.

It is worth highlighting that despite the change in outlook, Asia Pacific remains the only region (other than Eastern Europe where the Russia-Ukraine conflict is confounding data) that is expected to grow faster in 2023 compared with 2022. In large part, this is due to the GDP growth dynamic in some of the biggest economies of the region. Mainland China and Japan are likely to improve their growth performance in 2023, while India, the Philippines, and Indonesia will likely be among the fastest-growing large economies, even if growth is marginally below that witnessed in 2022.

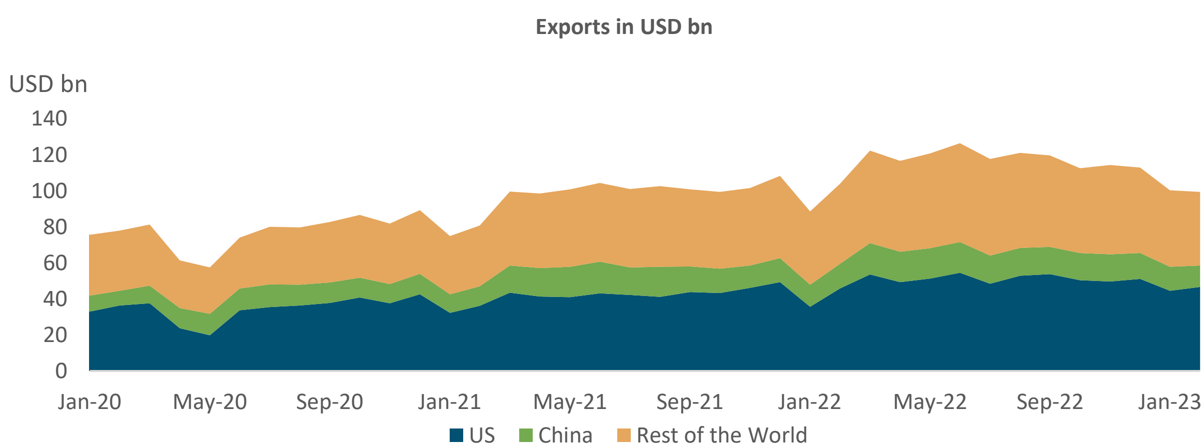
Across the region, private consumption continues to support the economy in the face of faltering trade. It helps that inflation in Asia Pacific has remained largely contained, with the latest monthly prints from May showing declines in headline numbers across all notable markets (expect Bangladesh and Pakistan). This continues to preserve consumers' purchasing power and sets the stage for rate cuts in H2 2023. However, currency stability concerns may prompt central banks to keep rates on hold, at elevated levels, especially if the U.S. Fed persists with its additional two rate hikes. Currencies have largely stabilized in 2023 but retain a depreciation bias against the U.S. dollar. Pakistan's bailout by the IMF will offer much needed respite to a country hit by multiple crises – climatic, political, and economic – since last year.

Economies in the Asia-Pacific region continue to pursue deeper economic integration in a difficult geopolitical environment, providing businesses an opportunity to benefit from such initiatives. To begin with, there is a renewed thrust among ASEAN members to conduct and settle regional trade in local currencies. In a bid to improve the payments experience, Singapore, Malaysia, Indonesia, and India are working on using cross-border QR payments. Additionally, economies continue to ratify the instruments of the Regional Comprehensive Economic Partnership (RCEP), expanding market access through the regional free-trade bloc. Businesses should closely follow and review their supply chain protocols in line with guidelines that are likely to follow the recent agreement on improving supply chain resilience under the U.S.-led Indo Pacific Economic Framework for Prosperity (IPEF).

Latin America & the Caribbean

The near-term economic outlook for the Latin American region carries several risks and uncertainties. One of the main concerns stems from the potential slowdown in the U.S., which is expected in H2 2023 due to weaknesses in both the manufacturing and services sectors. The slower-than-expected recovery in Mainland China, the biggest consumer of commodities and a significant trade partner for Brazil and Argentina, also has negative implications for the region.

Latin American exports by destination



Source: IMF, Dun & Bradstreet

In 2022, Latin America posted a real GDP growth rate of 3.7%, surpassing its potential growth range of 2-2.5%. However, the growth forecast for 2023 is more modest, with an expected growth rate of 1.2%, hindered by factors such as high interest rates and lower average commodity prices. Growth prospects in the region have turned slightly more optimistic than anticipated in our last quarterly report due to stronger-than-expected data in several key economies. One such example is Mexico, where the economy showed positive growth in Q1, increasing 1.0%, driven by growth in both the services and manufacturing sectors. The Bank of Mexico also raised its growth forecast for 2023 and maintained its benchmark interest rate, which contributed to a slight appreciation of the peso.

Argentina remains a notable exception, with the real GPD growth forecast for 2023 pulled down to -3.0% as sharp increases in inflation and interest rates weigh heavily on domestic demand. Inflation in the country jumped to the highest on record in April (108.8% y/y) even as the central bank hiked the Leliq by 600 bps to 97% in the latest meeting. The outlook for exports is also significantly more downbeat as drought hurts the agriculture sector (soy and corn). Inflation rates across the rest of Latin America are expected to decrease over the remainder of the year with the exception of Venezuela.

While interest rates in Latin America are anticipated to reach their terminal levels in H2, the potential for aggressive monetary tightening in the U.S. could trigger sell-offs in emerging-market assets, posing risks to the region's economies. Chile is expected to witness a 25-bps cut in the next three months, while Mexico and Colombia are likely to initiate rate cuts in early 2024, but they may act earlier if signs of a significant recession in the U.S. emerge.

Policy risks and political turbulence have been persistent concerns in the Andean markets. The volatility in leadership and potential policy changes – triggered by protests, changes in government, impeachments, or radical policymaking – have created uncertainty and adversely affected financial markets. The anti-incumbent trend has been particularly prevalent in countries such as Peru, Chile, and Colombia, where frequent changes in leadership and public discontent could lead to further policy shifts in future elections.

Eastern Europe & Central Asia

The Eastern Europe and Central Asia region is facing the impact of an economic slowdown in Western Europe (its main trading partner), high inflation and demand slowdown in domestic economies, and repercussions of geopolitical tensions due to the Russia-Ukraine conflict. Economic growth in Eastern Europe is set to remain muted in 2023 compared with 2022, with the exception of the Russian and Ukrainian economies that are both showing signs of revival. Surging inflation, energy and value chain disruptions, and monetary tightening are the main themes of the region's economic sluggishness.

The Russia-Ukraine conflict has had a profound impact on the region's economy and its geopolitical landscape.

For Eastern Europe, a constant trend seems to be the apparent peaking of interest rate cycles, and there are early signs of rate cuts to salvage economic growth, as inflation is taking a back seat at the moment. Interest rates appear to have peaked in the countries of this region, although they are expected to remain high and central banks are not in a hurry to ease policy until price growth is reined in.

As the real interest rate seems still higher than in advanced economies such as the U.S. and the EU, the main currencies in Eastern Europe – those of Hungary, the Czech Republic, Romania, and Poland – are staying strong and even appreciating, boosted by high real interest rates, falling energy prices, and a strong euro.

In recent quarters, Eastern European countries have witnessed a noticeable improvement in current account balances and exports, as well as a decrease in commodity prices, which has lowered the import burden. Germany is their most important trading partner, and its slowdown is impacting the region's export and manufacturing sectors.

Despite a growth slowdown, Poland remains one of the main stars of economic stability in Europe. At 6.75%, the central bank of Poland has kept its interest rate consistent since September 2022, while inflation has been moderating over the past six months. The bank expects headline inflation to moderate to the single digits by September, rekindling hopes of the first rate cut since the current tightening cycle began.

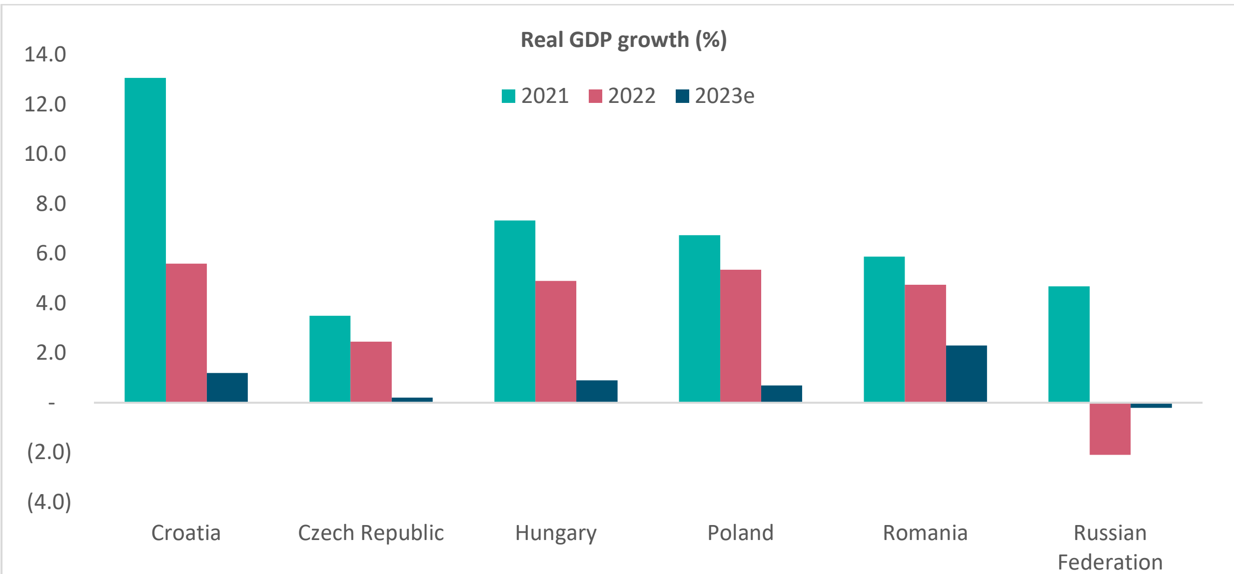
The National Bank of Hungary has left the interest rate unchanged at 13% since October 2022, with hopes of a first rate cut by the end of 2023. The country has struggled with a technical recession (three consecutive quarters of negative growth) but is expected to return to growth by Q2 2023.

Similarly, in Romania, the central bank kept the benchmark interest rate on hold at 7% for the second consecutive month in April, with expectations of the interest rate cycle peaking. At 0.1% q/q, Czechia has come out of a technical recession, although growth is still fragile despite stronger trade volumes. The koruna has remained robust in 2023, though it retreated in mid-April from a 15-year high against the euro.

The Central Asian economies have proven resilient to the global economic slowdown, as well as geopolitical tensions arising from the Russia-Ukraine conflict. The region is benefiting from increased trade with Russia, as well as higher integration with Europe as a replacement for Russian commodities exports. Central Asian countries are also increasing their exports to Russia, filling the vacuum created by the withdrawal of Western firms from the Russian market.

More integration with Russia has also led to higher money transfers to Central Asia from Russia, with increasing deposits in the banking sector. The relocation of Russian companies and citizens has increased demand across the retail, real estate, and hospitality sectors.

The IMF projects the Central Asian region to grow 4.2% in 2023 and 4.5% in 2024, from 4.8% in 2022. High regional trade, high oil revenue for oil-exporting countries, and a surge in money transfer inflows, including due to immigration from Russia, are key positives for the region. The IMF has pegged inflation at 11.8% in 2023 and 8.5% in 2024, compared with 13% in 2022. Central banks across the region have raised their policy rates in response to continued inflationary pressures.

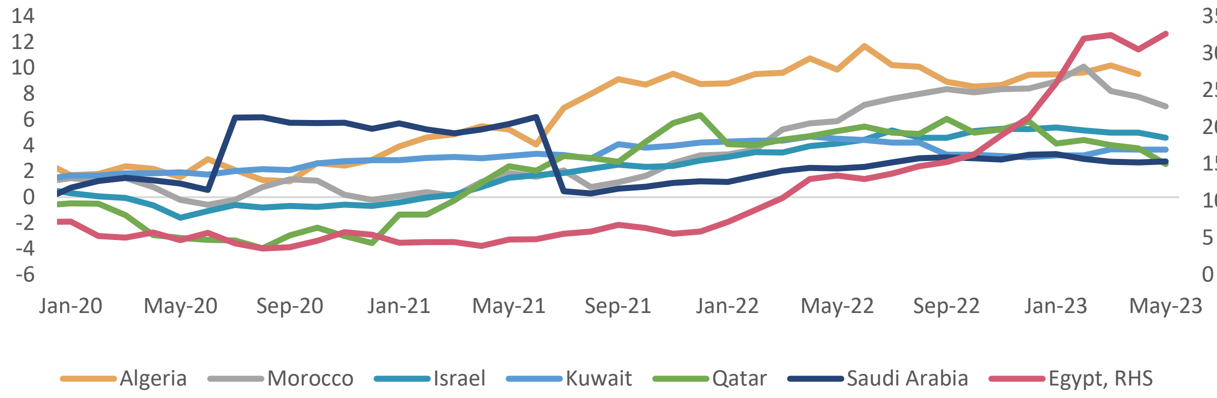


Source: Haver Analytics; Dun & Bradstreet forecasts for 2023

Middle East & North Africa

The outlook for the Middle East and North Africa (MENA) region is at 'stable'. The economic outlook in the near term is marked by various factors that will shape its growth trajectory. GDP growth is projected to be below the average of the past decade due to a combination of challenges. At the onset of the summer harvest season in the Maghreb region of North Africa, a severe drought has severely damaged the production outlook, raising food prices, increasing reliance on food imports, and escalating the risks of political unpredictability, social unrest, and economic instability in the entire region. Additionally, the region will be influenced by rate hikes and a soft global economy. We expect inflationary pressures to persist in much of the MENA region in 2023, driven by currency weakness and leading to higher prices in countries such as Egypt, Iran, and Lebanon. However, it is anticipated that most countries in the Middle East will experience lower inflation. It will be crucial to monitor the implications of the Ukraine grain deal and the recent drought on food prices.

Inflation (% y/y)



Source: Haver Analytics; Dun & Bradstreet

The growth of oil producers in the region has been significantly impacted by fading high oil prices and wavering global demand. Oil production growth has slowed rapidly, with Saudi Arabia and Qatar experiencing a notable deceleration. Oil-importing economies continue to face their own challenges, particularly Egypt and Morocco. These economies are particularly vulnerable to shifts in market sentiment due to their higher government debt levels and lower foreign exchange reserves. Oil-exporting economies, meanwhile, remain highly dependent on oil revenues, leaving them exposed to any unexpected drop in fossil fuel demand that may arise from a global push towards green energy.

Geopolitical developments have sparked economic and political discussions. Indirect talks between the U.S. and Iran regarding Tehran's nuclear program have taken place; these could potentially lead to a new nuclear deal that involves freezing Iran's nuclear program while unfreezing its funds. However, there is a risk that this would antagonize Israel, which has stressed unilateral action under the increasing threat of a nuclear Iran. The domestic situation in Israel remains complicated; recently, an opposition candidate was voted onto the Judicial Selection Committee, exposing divisions within the ruling coalition.

Tensions between the U.S. and key Persian Gulf allies, including the UAE, have been highlighted by the Emirates' decision to cease participation in a U.S.-led maritime security force. In increasing evidence of a 'Look to the East' policy, the UAE and Saudi Arabia have shown increased willingness to engage with Russia and China, respectively, seeking avenues for economic cooperation and diversification.

Sub-Saharan Africa

We have kept the outlook for sub-Saharan Africa at 'deteriorating'. The region's prospects this year are driven by countries with less dependence on commodities and natural resources. Growth is constrained by high inflation, slowing global growth, and tighter global financing conditions, which have sent borrowing and debt servicing costs soaring. We expect 2.6% regional growth this year and around 3.4% in 2024.

The impact of high food prices is a leading risk in Africa this year, given the heavy weighting of food in inflation baskets. Staple foods such as wheat and rice are largely imported and so prices are higher because of local currency depreciations, while domestic supply disruptions and high fertilizer and input costs have also exerted upward pressure. The IMF reports that prices of staple foods in sub-Saharan Africa rose almost 24% between 2020 and 2022.

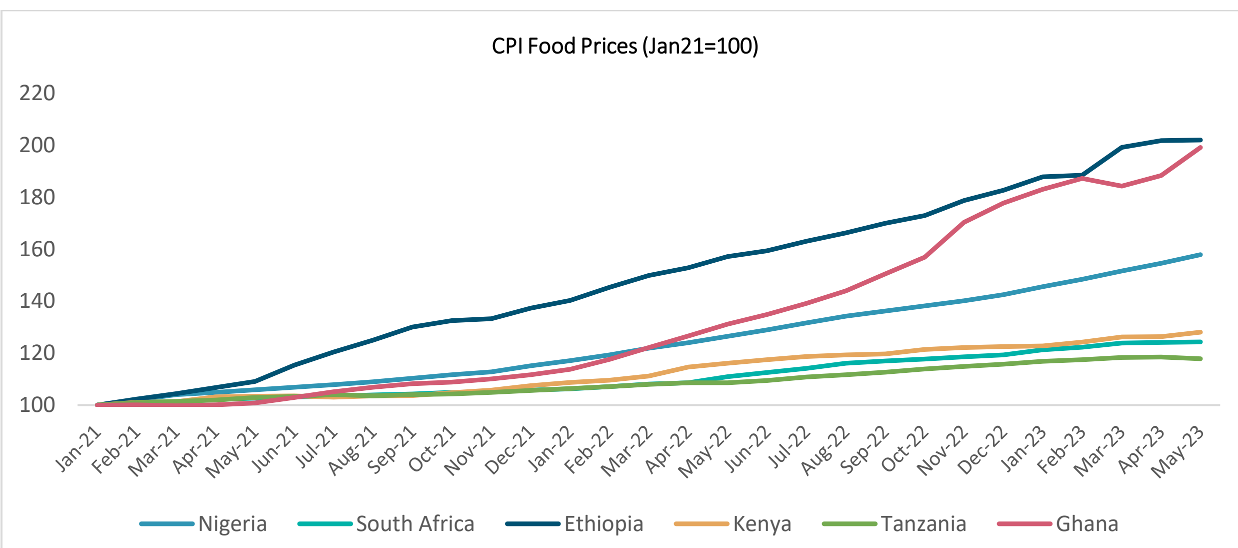
Rising food prices are a pressing issue for the new president of Nigeria, Bola Tinubu, whose first major policy decision was to end 50 years of fuel subsidies. The move has sent pump prices soaring and adds to general inflationary pressure, which may lead to demonstrations, strike action, and social instability. On June 14, the Central Bank of Nigeria adopted a new floating currency regime that will likely further strengthen inflation. The unification of the official and parallel naira exchange rates has closed the gap between them, resulting in a short-term 65% devaluation of the naira against the U.S. dollar. We now expect annual inflation in Nigeria to average around 26% this year. President Tinubu has announced that government spending will instead be channeled to improve infrastructure, education, healthcare, and power supplies.

Businesses are also under financial strain in South Africa. The fall in value of the rand to a three-year low, supply chain disruption, and infrastructure challenges that center on the substandard electricity grid are factors driving rising costs in South Africa. In June, Eskom, the state-owned electricity provider, warned that longer planned power cuts may be necessary to prevent the grid from entirely collapsing. Power interruption will weigh heavily on business activity. Shadowing the crumpling power grid, we now expect the economy to contract 0.5% this year. Zimbabwe, Botswana, and Namibia all rely on South Africa for electricity and the disruption increases the likelihood of business continuity risks.

Fighting continues in Sudan. The cycle of varyingly well-observed rounds of ceasefire followed by fresh outbreaks of violence continues to shape the country's prospects. The latest truce took place over Eid festivities beginning June 28. Supply chain and trade flow disruptions create considerable risks for businesses. Sudan's size and location – beside the Red Sea – mean the country is not only a large market for exporters but also acts as a gateway into Africa. An escalation of tensions in Sudan would threaten peace and stability in the region, given its geopolitical importance.

Violence is also a risk for businesses in the Democratic Republic of the Congo. Expectations in DRC were high at the start of 2023, as the country joined the East African Community (EAC), which can potentially offer economic benefits through its common market for goods, labor, and capital. However, the most tangible benefit so far has been the deployment of an EAC-led regional force in the east of the country to deal with the rebel M23 movement terrorizing the area. Fighting increased in June, and the security situation remains volatile.

High and rising food prices are a key risk in Sub-Saharan Africa



Source: Haver Analytics; Dun & Bradstreet

Key Commodity Outlook: Oil

Recent developments in the oil market have had a mixed impact on prices, leading to uncertainty about how they will behave in the near term, specifically over the next two to three months. Over the past 18 months, quotas have been reduced by 3.1m barrels/day (b/d). However, the lingering effects of previous supply agreements have meant that most producers have not had to significantly reduce supply. Furthermore, concerns about weak oil demand resurfaced as central banks began tightening monetary policy to address high inflation. In April, OPEC reduced oil supply quotas by 1.1m b/d, with the aim of creating a tighter oil market, but the actual cuts have fallen short of expectations, with May production figures indicating that output dropped slightly less than promised. In addition, there is a disparity between Russia's promised and actual cuts, with production falling by only 400,000 b/d instead of the announced 500,000 b/d reduction. Russia's exports have also continued to rise, raising supply levels. Unexpected sources like Venezuela and Iran, both of which have had positive dialogue with the U.S. recently, have also contributed to the increased supply in the market.

In terms of market dynamics, destocking has become evident as rising interest rates have reduced the incentive to hold oil stocks. Commercial inventories have decreased since their peak in January, mainly in onshore crude stocks outside China. The shift in the futures curve, indicating weaker demand, is more likely a result of higher interest rates, which increase the cost of holding oil. This has been observed during previous periods of significant interest rate increases. Moreover, easing inflation has reduced investor appetite for commodities like oil, which were used as a hedge against inflation. Speculative positioning in the oil market has plummeted, with non-commercial investors holding the lowest net long position since 2016. These non-fundamental factors, such as interest rates and inflation, have played a role in shaping market sentiments.

The impact of these supply factors is expected to diminish as underlying fundamentals improve. The potential for further gains in supply from Russia and non-alliance OPEC producers is limited. Venezuela's exports are unlikely to increase significantly in the short term due to factors such as debt repayment, and Iran's supply increase may be constrained by export capacity. OPEC's ongoing supply management efforts aim to support the oil market, and Saudi Arabia is expected to extend its output cut plan.

Nonetheless, it will likely be non-fundamental factors that trigger a shift in the oil market. The outlook for inflation, interest rates, and the performance of the U.S. dollar will play a significant role. If inflation falls, it could lead to expectations of fewer rate hikes, which may impact the performance of the U.S. dollar and, consequently, the oil market. Additionally, stronger mobility indicators in Mainland China and a potential re-rating in demand prospects could influence oil prices positively.