Country Risk and the Global Outlook – May 2023

Financial Tremors in the US Destabilize Another Bank; Worsening Credit Conditions May Assume Center Stage

Commentary:

"We had, in our previous edition, predicted more banking failures, so in a way the collapse of First Republic Bank on May 1 was not a surprise. However, what remains to be seen is how the authorities will now try and circumvent a panic situation across the market. One can argue that the presence of major banks will provide a safety net to their smaller counterparts should a domino effect emerge, but the bigger issue at hand is the worsening credit conditions in the U.S. Q1 data for all major economies has pointed towards a slowdown. Though the U.S. Federal Reserve (the Fed) and the European Central Bank (ECB) pushed ahead with a 25-bps hike in their latest meetings in May, we can expect rate hikes to pause, especially in the U.S. The ECB would have also paid heed to the financial tremors felt across the Atlantic and is expected to dial down the pace of rate increments. The armed conflict in Sudan is serving as a reminder that political instability is right behind economic instability in terms of the hurdles that the world must deal with. The development in Sudan will be worth monitoring from the greater standpoint of regional stability. In India, the softening of inflationary pressure is creating room for an extended pause in the policy interest rates. The bank credit to the commercial sector is strengthening, current account deficit has eased, and inflation pressures have subsided, all of which indicate growing macroeconomic stability and have further made the growth rate sustainable. It is, however, pertinent to remain vigilant against potential risks from increase in crude oil prices, probability of El Nino conditions to create droughts along with the increased global financial instability and unfavourable geopolitical developments", said Dr. Arun Singh, Global Chief Economist, Dun & Bradstreet.

Introduction

With JP Morgan's rescue of First Republic Bank on May 1, three out of the four largest U.S. bank failures have now happened in the past two months. This has put the spotlight back on the cracks in the global financial system. However, First Republic Bank's failure did not carry the same element of shock as was with the relatively smaller Silicon Valley Bank and Signature Bank. First Republic Bank, as we noted in our April edition of the Global Outlook, was among the banks that witnessed signs of trouble right after the first spell of bank failures in March. Its recently announced results confirmed what markets had suspected – close to $100 bn in deposits had left the bank in March and maintaining the remaining deposits was becoming costlier. It is important to add here that other banks have not reported anything seemingly problematic in their financial results and their depositors are not jumping ship; however, as far as investors are concerned, banks with a similar profile are not off the hook just yet. Importantly, neither the apparent 'lack of surprise' nor the safety net of large banks gives us any comfort from worsening credit conditions and its eventual impact on growth. The underlying sentiment is that more dominoes will fall and the panic that the authorities were trying to stave off takes center stage.

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Across economies, signs of an economic slowdown were evident in Q1 2023 GDP data. The Fed and the European Central Bank have pushed ahead with a 25-bps hike in their latest meetings (May); for the U.S., we expect a pause now. While inflation is still far from the Fed's stated target, it is largely moving in the right direction, discounting the frustratingly slow pace of growth. For the ECB, the banking jitters across the Atlantic have served as a cautionary tale, prompting them to dial down the pace of rate increments even when core inflation continues to remain high for the most part. If other central banks needed any indication to pause their aggressive hiking cycle, they now seem to have it.

After The Organization of the Petroleum Exporting Countries' (OPEC) decision to reduce production, the price of Brent crude oil appears to be stable at close to USD80/bbl; moreover, China's reopening has improved demand. Despite the resilience of Russian supply, around 1mb/d of Russian oil supply is at risk as the EU embargo on refined oil products came into force. Meanwhile, non-OPEC countries have limited spare capacity to offset OPEC's production cuts. Consequently, we could see oil prices edging higher toward USD100/bbl as the year progresses – which will be bad news for inflation and the global economy.

The armed conflict between rival factions in Sudan is a reminder of the risk posed by political instability in the region. This is especially critical in the wake of renewed global commercial interest for resource and commodity extraction. Apart from the humanitarian losses accompanying deadly violence, the conflict is also worth watching from the standpoint of regional stability.

Dun & Bradstreet Country Risk Analysis			
Country	**March 2023**	**April 2023**	**Change**
Country Risk Rating Upgrades (risk level has improved)			
Algeria	DB5d	DB5c	1 Quartile
Germany	DB3a	DB2d	1 Quartile
Country Risk Rating Downgrades (risk level has deteriorated)			
Sudan	DB6c	DB6d	1 Quartile
Outlook Upgrades (from/to)			
The Netherlands	Deteriorating	Stable	
Outlook Downgrades (from/to)			
Bolivia	Stable	Deteriorating	
Sudan	Stable	Deteriorating Rapidly	

REGIONAL SUMMARIES

North America

North America's regional outlook is maintained as 'deteriorating'. The region's economic narrative continues to give mixed signals. In the economies of both the U.S. and Canada, labor markets are driving a large part of the economic resilience, which is making it harder to ascertain which way the fight against inflation is going. Manufacturing in Canada is holding up better than in the U.S., while the housing market is weakening in both the economies.

The Canadian economy's early rebound in January has helped it clock a 0.6% GDP expansion in Q1 2023, but with muted growth in February and March, the economic momentum entering Q2 is weak. The economy is set to cool further in mid-2023 as consumers start feeling the impact of tight monetary policy.

In the U.S., Q1 GDP growth at 1.1% (annualized) came in lower than expected, underlining a slowdown over the previous quarter. This was followed by the news of JP Morgan's takeover of First Republic Bank, resurfacing the risk of a systemic banking crisis and a warning from Treasury Secretary Yellen that the 'X' date – by which date the U.S. Congress must approve a suspension or increase in debt issuance ceiling – may arrive sooner than previously anticipated. While these signals do not bode for well the economy, the Fed persisted with a 25-bps rate hike to tame inflation.

Bank failures will further squeeze credit flow in the economy, and the risk to financial market stability has given the Fed a reason to pause rate increments sooner than what inflation dynamics would probably warrant (likely at the next meeting). As credit conditions tighten further, downside risks to the economy will become more prominent, although an outright recession is still not our base case scenario.

Western & Central Europe

After avoiding a recession in 2022, lead indicators of economic growth for the Eurozone and UK economies continue to provide businesses with reasons for remaining mildly optimistic about H1 2023. However, headwinds continue to cloud the outlook.

First, while headline inflation is dropping rapidly in many Eurozone economies, core inflation is rising, which signals that the ECB will continue to increase interest rates, before possibly pausing in the second half of the year. Second, while being on a downward trajectory, the UK's headline inflation is taking longer than expected to come down and remains in double-digit territory, which will lead the Bank of England (BoE) on a hiking trajectory.

While higher interest rates feed through European economies and credit risk increases, insolvencies become more frequent. In the EU, they rose 27% in Q4 2022, relative to Q3. In the UK, business liquidations continue to fare at substantially higher levels than in pre-pandemic years, consolidating a trend that started in 2021.

The Nordics

On average, the Nordic economies weathered the energy crise relatively well in 2022. However, in Q4 2022, the regional economies exhibited vastly 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%).

Although inflation seems to have peaked, it remains well above the target in all the economies of the region (around 8% YoY in March), possibly indicating that interest rates will rise further in H1 2023. At the same time, a prolonged banking turmoil represents an important risk for some economies, which are characterized by vulnerable housing markets.

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A multi-speed dynamic is likely to persist in the Nordic region in 2023, with demand remaining subdued and core inflation still upwards and possibly outpacing wage rates.

Asia Pacific

The outlook for the Asia Pacific region is retained as 'stable'. Growth in 2023 is set to be slower than 2022, with the notable exceptions of Mainland China, Hong Kong SAR, and Thailand. China is consolidating its gains from reopening and is likely to achieve its growth target of around 5% for 2023.

China's reopening and the clouded economic environment in the U.S. and Europe will set the tone for growth divergence in the region. In the near term, economies closely levered to the Chinese economy will gain from the reopening boost, while those exporting heavily to European and U.S. markets will see a drag on external demand. It is worth highlighting though, that beyond that, China's growth dividends will be limited for the rest of the world.

Economies of Taiwan Region, South Korea, Vietnam, and Malaysia have all witnessed a slowdown in Q1 2023, accompanied by weak exports. The slowdown in Vietnam has even prompted the central bank to cut interest rates. Elsewhere, most central banks (except for Australia) have either hit the pause button or have given indications for one. Given our expectation of a potential U.S. Fed pause following the 25-bps hike in May and economic weakness taking hold in the region, chances are that we could witness a swift pivot to rate cuts as early as the next quarter.

The region's banking sector has, thus far, proved resilient to the financial market turmoil witnessed in the U.S. and Europe following the failures of First Republic Bank, Silicon Valley Bank, Signature Bank, and Credit Suisse; however, given the considerable global linkages in the financial system, a contagion in case of further distress cannot be ruled out.

Latin America & Caribbean

The growth rate in Latin America is expected to slow down markedly in 2023. This is due to the implementation of restrictive monetary policies, weaker economic momentum in developed countries, and lower average prices for major commodity exports. Our projected growth for the region is 1.3% in 2023, before it picks up slightly to 2.1% in 2024. Considering the above factors, we have maintained the outlook for Latin America at 'deteriorating'.

There will likely be some support in the form of increased visitor arrivals and recovering demand from China. However, there are risks from socio-political unrest and tighter monetary policies than expected. Inflation rates fell in March in most countries except Argentina and Colombia. Inflation in the region has already peaked and is expected to decrease later this year in most countries. However, Argentina and Venezuela will experience higher price pressures due to currency depreciation. There are also potential risks from further foreign exchange depreciation, extreme weather events, and socio-political instability that could increase inflation.

The left-leaning government of Honduras intends to terminate the country's diplomatic relations with Taiwan, bringing it closer to China. This decision will further isolate Taiwan, as China has been successful in attracting several of its allies in Central America and the Caribbean over the past few years, including El Salvador, Nicaragua, Panama, and the Dominican Republic. One of the presidential candidates in Paraguay has also prioritized improving ties with China, making it the next country to possibly sever its relationship with Taiwan Region.

Eastern Europe & Central Asia

The World Bank has raised its 2023 economic growth forecast for the EECA region to 1.4% from an earlier 0.1%, citing improved outlooks for both Russia and Ukraine despite their ongoing war. Supply chain has significantly improved due to lower energy prices and easing supply bottlenecks. As per the International Monetary Fund (IMF), annual 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 the average inflation at 11.7% in 2023 and 5.5% in 2024 in emerging European economies.

Many countries in Eastern Europe are yet to see their inflation trajectory peak despite being ahead of the European Central Bank in raising interest rates. For Eastern European and Central Asian countries, financial stability is a key challenge in the wake of high and rising public debt, further accentuated by the high cost of debt servicing amid expectations of lower economic growth. As the budget deficit across Eastern Europe widens, the foreign borrowings have been near their all-time high, despite significantly higher borrowing costs. Real household income for all Eastern European nations has consistently declined since June 2022. Having said that, an all-out recession was avoided this winter thanks to low energy prices and government relief measures. Output in Eastern Europe, although expected to slow down sharply in 2023, would still be higher than average for Europe.

Middle East & North Africa

In a surprise move in April, OPEC+ reduced oil production, which will keep prices above the $80/bbl limit and retain GDP growth in the Middle East and North Africa (MENA) region above trend. We still expect notable moderation from 2022, especially in the oil exporting Gulf Cooperation Council (GCC) countries. The removal of COVID restrictions in China will increase demand for oil and boost tourism in MENA.

However, the non-oil sectors may face headwinds due to a variety of factors, including rising inflation, labor shortages, and political instability. In particular, the ongoing conflict in Yemen and the recent political turmoil in Lebanon are potential risks to the region's stability and economic growth. In addition, an escalation in the fighting in Sudan between the forces of two rival generals could draw in foreign armed groups and regional powers, triggering a new refugee crisis.

Saudi Arabia is likely to continue its efforts to diversify its economy away from oil, with a focus on sectors such as tourism and entertainment. Meanwhile, the United Arab Emirates (UAE) is likely to continue to attract foreign investment, particularly in its rapidly growing technology sector. The Israeli government recently put on hold its intention to push through a legislation aimed at reforming the judicial system. If the plans for the judiciary proceed in their current form, Israel is likely to face an unprecedented constitutional crisis, in which the Supreme Court could strike down all or parts of the legislation designed to curb its powers, and the government could choose not to comply.

Sub-Saharan Africa

Economic recovery in Sub-Saharan Africa has been restricted by the wider global slowdown and persistent inflation. While fuel prices are easing, 80% of economies in the region are experiencing double-digit food inflation, causing currency depreciation against the U.S. dollar – particularly across commodity-exporting countries such as Nigeria and South Africa. In turn, fall in local currency value has raised external debt costs and contributed to higher government debts. Inflation will ease through the coming quarters in some countries more than others. Senegal and Ethiopia are phasing out subsidies and here prices will likely remain more elevated.

Violence has erupted in Sudan as the transitional government collapsed over disagreements on the integration of the paramilitary force, headed by Mohamed Hamdan Dagalo, into the national army, led by the President, Abdel Fattah al-Burhan. Infrastructure is failing and vital supplies are fast eroding, amid fuel, food, and medicine shortages and the withdrawal of internet and phone services. Should the fighting escalate, the conflict will have regional repercussions, adding to instability in an already volatile province, especially around the

important trade route of the Red Sea. We have recently revised our forecast for Sudan, including lowering 2023 GDP growth to -7.5%.

Given this difficult environment, growth in most other countries in Sub-Saharan Africa will slow this year. Policy space to address these challenges is thin since fiscal positions have deteriorated during the COVID crisis and monetary policy has had to contend with global central banks. The outlook for the region is maintained at 'deteriorating', and we anticipate that key Sub-Saharan economies will weigh down on overall growth for the region, but there are large variations in growth outlooks for this year. At the top end of our distribution are Cote d'Ivoire and Ethiopia, which should see around 6.0% growth; Angola, Kenya, and Botswana are expected to clock 3.5-4.5%; and towards the end of our range is Gabon just shy of 2.0% growth and South Africa at less than 1.0%.

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

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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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