Newsletter issue 2/2017

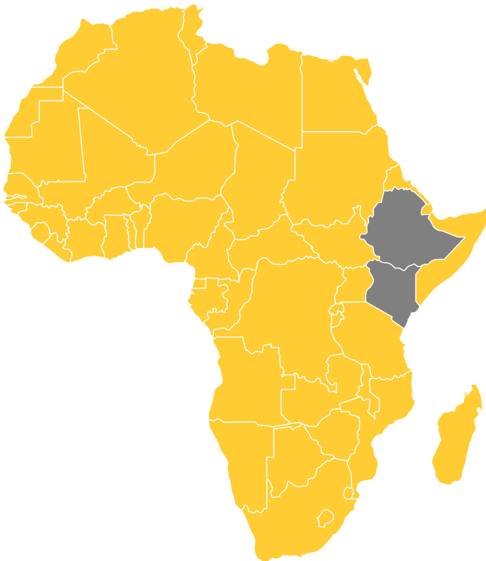
Commerzbank Country Risk RADAR

Clear and practical – all the latest country information at a glance

Country risk topics from around the world, put together by the Commerzbank experts. Our country specialists permanently monitor political and economic developments around the globe. You can read their latest assessments at any time in our Country Risk Radar.

Building regional integration **vital in Africa**

Kenya and Ethiopia have been among the standout economic performers on the African stage over the past decade. Now recognised by the World Bank as a "middle-income country", Kenya has recorded an average of almost 6 % GDP growth per year since 2010. In the same period, Ethiopia's average has been pushing the 10 % mark, making this economy one of the fastest-expanding in the world.



Yet with average economic growth across Sub-Saharan Africa having only been a modest 3.4 % in 2015 – and 1.5 % last year – the two East African countries have clearly bucked broader trends. The question is: why?

Buttressing growth

A major reason is the diversification of their economies, which has provided some much-needed resilience to the downturn in commodity prices since mid-2014. Thanks to a relatively broad export profile and mixed composition of economic sectors – from higher-value manufacturing industries, to services such as telecommunications, finance and tourism – Kenya and Ethiopia have had to rely less on dwindling revenues from raw material exports.

Another explanation is the healthy investment in infrastructure, which has spurred domestic demand. In Kenya, huge electricity generation, road and port expansion projects have served to boost the economy. Ethiopia, similarly, has benefitted from investment in power generation and distribution, rail networks, airports and industrial parks.

The need to grow closer

But there remains more to be done. Both countries need to help East Africa integrate more as a region. Southern Africa is already relatively advanced in this respect, utilising common tax rates, for instance, and with local currencies pegged to the South African rand. If the countries of East Africa can follow in these footsteps and improve regionalisation – whether that is by further developing transport, energy, communications or regulatory infrastructure – they could better attract international investment to support business and boost trade flows.

Kenya and Ethiopia are certainly well poised to entice new global business. Interest from Asian trading companies is on the rise. East Africa already has close business links with India, and could also take advantage of its prime location in China's "One Belt, One Road" programme as it increases its presence. Importantly, European FDI flows to both countries are increasing.

As East Africa's financial and transport hub, Kenya especially would do well to pursue regional integration. For instance, the continued growth of its middle class depends on reducing the high unemployment rate: the World Bank has estimated youth unemployment alone at over 22%. Greater trade flows and investment from abroad in the services and industrial sectors – facilitated by further improved infrastructure – would therefore support badly needed new jobs and reduce dependence on agriculture.

Ethiopia, too, increasingly needs greater ties with its neighbours: the landlocked country's commerce depends on Djibouti's Red Sea port facilities. (Djibouti, for its part, is heavily dependent on Ethiopia's own flows of imports and exports.) Despite having posted considerable economic growth, Ethiopia does in fact remain one of the world's poorest countries – so would do well to pursue regionalisation as a way of boosting its trade-led growth.

Positive signs

Encouraging developments are underway. Ethiopia and Djibouti have now agreed to streamline customs procedures, align tariffs and use new technologies to enhance cross-border payments. Along with the completion of a new railway between the two countries, this will greatly enhance their cross-border trade.

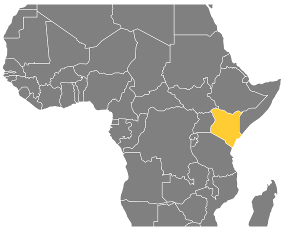
Kenya, meanwhile, has enlisted Chinese capital and engineering to develop a major new railway from Nairobi to Mombasa, thus opening up more crucial access to the coast. The project, Kenya's largest since independence, is intended to connect landlocked South Sudan, the Democratic Republic of the Congo, Rwanda, Burundi and Ethiopia to the Indian Ocean, and forms a vital part of China's Belt and Road initiative.

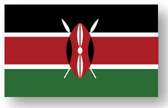
At Commerzbank, we're keen to track and play a part in the continuing growth story of East Africa and indeed the continent as a whole – whether that is by facilitating trade on the ground from our representative office in Addis Ababa (one of six bases in Africa), collecting macroeconomic insights from our research hub in Ivory Coast, or briefing our clients on all the latest developments and opportunities in our Africa Research Bulletins.

Kenya and Ethiopia have developed significantly but they cannot afford to rest on their laurels. As elsewhere in Africa, embracing regionalisation will be a major priority.

At a glance: **Kenya**

Kenya: Facts





Capital	Nairobi
Population	46.8 million
Currency	Shilling
GDP growth, 2016	6%
GDP composition, by sector	• Agriculture: 32.7% • Industry: 18.0% • Services: 49.3%
Major exports	• Horticultural produce • Tea • Textiles • Coffee • Tobacco • Iron and steel products • Petroleum products • Cement
Major export partners	• Uganda • United Kingdom • Tanzania • Netherlands • United States • Pakistan • United Arab Emirates
Major import partners	• India • China • United Arab Emirates • Japan • South Africa • United States • United Kingdom

Kenyan risks

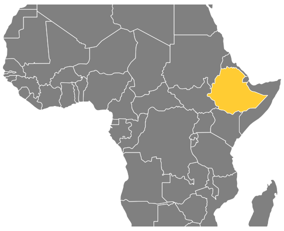
Kenya's elections have been making the headlines in recent months. A hotly contested general election in August saw Uhuru Kenyatta, the son of the independent country's first president, re-elected for a second term as premier, winning 54% of the popular vote. Yet the plebiscite was subsequently challenged by Kenyatta's rival, Raila Odinga; the Supreme Court found the election unsound. With turnout of just over one in three, Kenyatta won 98% of the vote in a re-run held on 26th October – an election boycotted by the opposition and criticised by some external commentators.

Rioting by protestors has since taken place in parts of Nairobi, and the risk to the economy has prompted the Kenyan Treasury to revise its growth forecasts for the year from nearly 6% down to 5%.

The political instability comes just as Kenya has been facing other challenges, including a drought in February declared a national disaster by the government, and an ongoing security threat posed by Al Shabab.

At a glance: **Ethiopia**

Ethiopia: Facts



Capital	Addis Ababa
Population	102.4 million
Currency	Birr
GDP growth, 2016	8 %
GDP composition, by sector	• Agriculture: 36.2 % • Industry: 17.0 % • Services: 46.8 %
Major exports	• Gold • Coffee • Live animals • Oilseeds • Flowers • Khat
Major export partners	• United States • Saudi Arabia • Germany • Switzerland • China • United Arab Emirates • Pakistan
Major import partners	• China • United States • India • Kuwait • Japan • Italy • Turkey

Ethiopian risks

In October last year, a six-month state of emergency was declared by the authorities after anti-government protests that turned violent. Disturbances continued over 2017, and the state of emergency was only lifted in August. International observers suggested that political unrest has had an effect on economic growth, which in 2016 declined to 8 % from the previous average of 10 %.

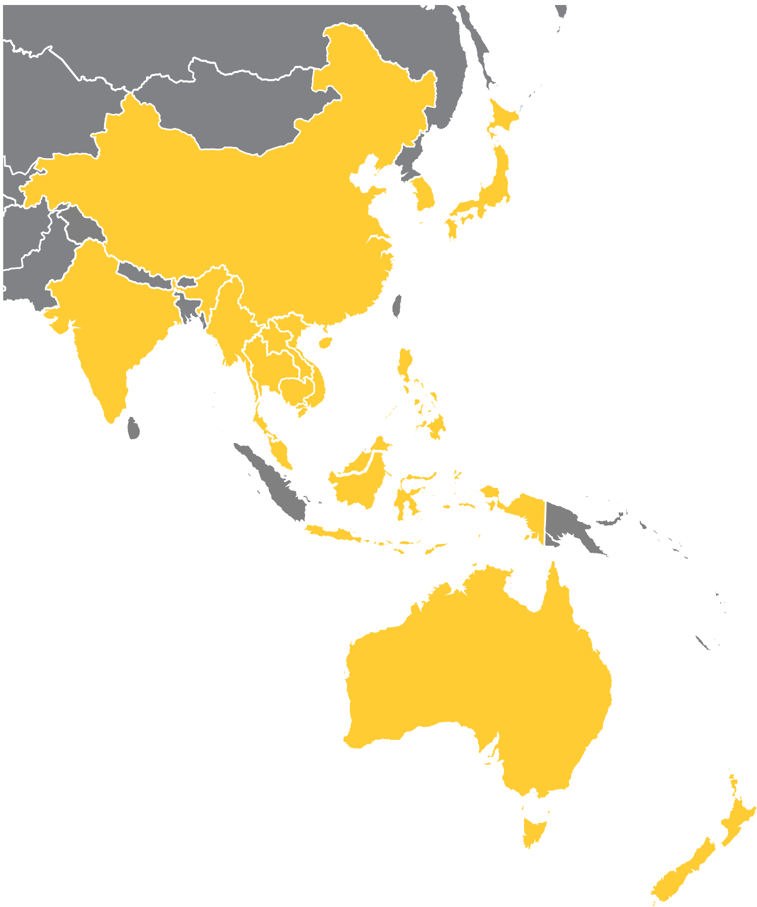
However, the downturn is, for sure, also based on drought in some areas of the country – rainfall remaining vital to Ethiopia's agriculture-based economy. In October 2017, the central bank devalued the local currency, the birr, by 15 % and raised interest rates by 2 % in order to try to boost exports of key agricultural commodities such as flowers and coffee and make them more competitive against other African producers, including Kenya. By supporting exports, the move was intended to mitigate the risk of hard currency shortages. Yet the devaluation of the Birr is likely to increase the costs of importing goods, such as consumer goods, as well as machine parts and fuel.

Source: Christian Toben, Commerzbank AG, Financial Institutions Africa, December 2017

The Regional Comprehensive Economic Partnership's (RCEP) promise: **renewed global trade, with Asia leading**

Global trade growth has been somewhat lacklustre of late. The World Trade Organization (WTO) has predicted that, for the first time in 15 years, world trade is likely to have grown more slowly than global GDP in 2017. The Asian Development Bank has also estimated that a huge $1.6 trillion of global trade remains unfinanced.

Risks only increased in January 2017, when the United States announced its withdrawal from the Trans-Pacific Partnership (TPP), an ambitious trade agreement originally signed in February 2016 with Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam.



Renewed trading impetus from Asian countries

November 2017 has, encouragingly, seen these countries determine to press on with the deal without American participation. But it is Asia's trading performance that has bolstered recent global trade growth. After the 2008 crash, Asia did more than any other region for the recovery of world trade, by contributing significantly to merchandise export volume growth in the post-crisis years. The WTO predicted 3.4% export growth for Asia in 2016: this was the fastest of any region that year, and in spite of China's economic slowdown.

So it is in Asia that chances for reviving global trade lie – with many looking to the Regional Comprehensive Economic Partnership (RCEP) especially to stand up for globalisation.

The RCEP is a proposed free trade agreement (FTA), which if realised would constitute the largest in the world. It is tasked with the economic integration of 16 nations and – to do this – it aims to lower import/export tariffs and increase trade flows. Under the RCEP's mandate are the 10 countries of the ASEAN (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam) and the 6 countries with which the ASEAN has existing FTAs (Australia, China, India, Japan, South Korea and New Zealand).

As a combined market, the potential might of the RCEP cannot be underestimated. The free trade area would cover a population of 3.5 billion, and boast a GDP of $23.8 trillion – that is equivalent to 1/3 of the global whole. With such an extensive scope, the RCEP may well be the key to reinvigorating global trade.

How the RCEP might boost commerce
One specific target of the RCEP is to support SME growth and inclusion in the international business landscape. According to OECD statistics, SMEs account for 95-99% of all businesses in the ASEAN – they truly are the key drivers of economic growth in the region. And it must be remembered that it is SMEs that have been hit hardest by the trade finance gap: some 56% of trade finance transaction requests from SMEs are rejected worldwide. So if the RCEP can boost financial inclusion by opening up new markets it could benefit both the intra-Asian and international trade landscapes. In light of Commerzbank's own history of financing SMEs and facilitating their global expansion, this is certainly something the Bank will be watching closely.

Progress continues – but hurdles remain
Five years, five ministerial meetings and twenty rounds of negotiations on since the deal was first mooted, where is progress with the RCEP?

Negotiations have been subject to delays and talks have now missed deadlines for three years in a row, 2017 included. This year, for instance, was intended to be the year of the RCEP – something which now seems out of reach.

Yet there has been renewed impetus to talks in recent months – with productive rounds of negotiations in Manila in May and Hyderabad in July. The latest talks held in Manila in November, at a dedicated RCEP summit following the city's hosting of the 31st ASEAN summit, saw ministers from the constituent nations determine that negotiations on the deal be wrapped up as early as 2018. We shall have to wait to see what progress the new year will bring.

Country focus: emerging markets poised to benefit
The less-developed economies in the RCEP – Myanmar, Cambodia, and Laos in particular – are best placed to gain from the trade agreement. The reasons are three-fold.

First, these economies are largely reliant on low-cost manufacturing sectors – especially the textile industry. As part of the RCEP, therefore, exporters in these countries stand to enjoy increased market access to the deep markets of wealthy consumers in Australia, New Zealand and China.

Second is the flexibility of the RCEP deal itself. With 16 nations involved in the deal, there is little existing standardisation when it comes to regulations. But the agreement is being designed in such a way as to protect less-developed nations from having to match larger economies' tariff reductions for intellectual property, copyright and patents (TRIPS provisions) and others.

Country focus: the rise of Chinese trading influence
A third benefit these emerging markets will gain is a strengthened economic relationship with China. As a result, they could attract increased flows of foreign direct investment (FDI) from capital-rich investors eager for new, untapped opportunities abroad.

With the US' exit from leadership of the TPP, of course, comes the rise in importance of the RCEP – as well as the increased influence on the global stage of its Chinese patron. Indeed, it was a sign of the times that China's premier, Xi Jinping, delivered a landmark speech in praise of globalisation and free trade at the World Economic Forum in Davos in January 2017 – the very same month in which President Trump announced the US' withdrawal from in the TPP. Therefore, while emerging economies such as Vietnam, Brunei and Malaysia have fallen victim to the stalling of the TPP, they stand to gain enormously from the RCEP.

Notably, seven RCEP nations are also members of the TPP, some of which stood to gain enormously from that deal. Vietnam, for example, had been predicted to enjoy an 11% GDP increase from the TPP alone. Despite signatories' determination to carry on with the TPP, given the increased degree of risk arising from the US' departure, success with the RCEP will be increasingly on Vietnam, Brunei and Malaysia's agendas. China, for its own part, will doubtless strive to make progress with the RCEP as Japan and the 10 other Asian-Pacific countries throw a lifeline to the TPP – a trade deal from which Beijing is conspicuously absent.

Country focus: Political will demanded from the Philippines
As the most recent host of talks on the RCEP, and this year's chair of the ASEAN, the Philippines has been among the most vocal for making progress with the deal. President Rodrigo Duterte has exhorted fellow leaders to show the political will necessary to finish talks, explaining that the "changing global economic landscape requires us to urgently bring the negotiations to a close", but that he is "optimistic" of building the "much-needed political momentum".

The Philippine premier also explained that the RCEP is intended to be more than a mere free trade area: "[The RCEP] is not simply an added trade agreement, but a trade agreement that could provide the size and scale to unleash new growth potentials and write the new rules of the game of the international trade order."

Country focus: India's reservations
One particular obstacle facing the deal, it seems, is India's reservations about high tariff cuts. Both Singapore and Malaysia boast near 90% negligible trade tariffs. Yet export and import duties account for a significant amount of government revenue, and ratification of the RCEP at present would require a considerable reduction for India's, which are currently relatively high.

> "The RCEP is a trade agreement that could provide the size and scale to unleash new growth potentials."
>
> Rodrigo Duterte,
> President, RCEP

Another Indian concern seems to rest with the prospect of opening up its service industries to competition from the other more developed nations, and its manufacturing sector to foreign investment. While committed to the RCEP, it is evident that India seeks a "balanced" outcome to the talks.

However, the RCEP has been careful to include a great number of caveats. These ensure that nations with unequally sized economies are not dealt an unfair hand. Thanks to such versatility, the RCEP's member nations hope to reconcile with India's concerns very soon.

Source: Agnes Vargas, Commerzbank AG,
Financial Institutions Greater China & ASEAN
December 2017

Keeping the faith in **Brazil**

Brazil's economy is emerging from a difficult few years. Fiscal pressures and a beleaguered export trade have seen the country struggle through the deepest recession in its recorded history.

Recovery has been a long time coming, but buoyed by the reformist efforts of a more market-friendly government, foreign investors are again showing tentative optimism.

Short-term fiscal challenges certainly persist. Yet in the long term, Brazil will continue to play a crucial role in global trade flows – encouraging some to keep their faith in the country, and to take a positive long-term view, based on Brazil's important position in world trade.

Brazil:

When the going got tough

To call Brazil's experience over the past few years "challenging" is to put it mildly. The unemployment rate has risen to an estimated 13%, up from 7% in 2015. Last year the economy contracted by 3.6%, and by 3.8% the year before, as the country faced its longest recession since records began back in 1901.

The roots of Brazil's woes lie in 2014. It was then that the global crash in commodity prices dragged down crucial export revenues and investment. Given primary goods such as metal ores, oil, meat and sugar account for nearly half (46%) of total exports – with soya products alone holding a 15% share of national produce – it is no surprise that dependence on raw materials cost Brazil dearly.

Weaker export revenues reduced the tax intake, straining the government budget. This brought the deficit to nearly 9% of GDP last year, and a record 10.2% the year before. Combined with unchecked government spending, this pushed public debt to an all-time high of almost 70% of GDP by the end of 2016.

Fragile revenues also took their toll on the Brazilian Real, which by last year had fallen to a two-decade low against the US Dollar. As well as making existing public debt, which is largely denominated in foreign currency, more expensive, this also pushed inflation rates over the 10% mark by 2016.

Drivers of a tentative recovery

The worst may be over, however. With GDP growth finally back in the black, Brazil is now entering into a moderate but consistent recovery. According to the IMF, the economy is set to grow by a modest 0.7% this year. The central bank has lowered interest rates to 7.0% – down from 14.25% last year – inflation has been tamed to 2.54%, and rounds of quantitative easing have provided some liquidity and cheaper funding.

The role of the government has been crucial to this recovery. The current administration has pursued orthodox macroeconomic policies generally regarded as more palatable to business. Above all, on taking office in May 2016, President Michel Temer promised to help address the fiscal indiscipline that in large part exacerbated Brazil's crisis.

Fiscal obstacles certainly remain, including the need for pension reform, for tax code amendments, and to address the deficit. But encouraging efforts have now been approved, including labour reform, measures to reduce bureaucracy and increase productivity, and an amendment to the Brazilian Constitution that essentially freezes the level of public spending for two decades.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Commerce, too, has helped Brazil to rebuild. A weaker currency has already had the effect of boosting exports, converting the country's trade deficit into a growing surplus. Back in January 2014, for instance, Brazil had posted its worst deficit of over $4 billion, but by May this year the balance was a positive $7.6 billion, the highest on record. The year's surplus, aided in no small part by a revival in commodity prices, is forecasted to be $60 billion.

Placing long-term trust in Brazilian trade
It is largely thanks to commerce, in fact, that investors now seem more confident of Brazil's future. Foreign direct investment is reaching new heights: last year, the country attracted a record $78.9 billion, and a total of $75 billion looks likely for 2017.

The country is enjoying renewed interest from global carmakers, for example, with Japanese and American firms having invested in plant expansions. The first quarter of 2017 alone saw both a 70% rebound in automobile exports and a 24% year-on-year rise in output. According to Anfavea, the national automotive industry body, Brazilian production is expected to rise by 11% this year – a promising sign for what has traditionally been a staple of manufacturing in the South American region.

Attracted by Brazil's large and diversified economy, investors are also looking forward to expectations of recovery in consumer demand for Brazilian imports across South America. Consider the country's trade with Argentina, Brazil's major commercial partner in the local Mercosur trading bloc and its third-largest export partner worldwide. Over the first three quarters of 2017, healthy demand for capital and consumer goods from Brazil's southern neighbour translated into some $13.4 billion worth of Brazilian exports, according to the United Nations' official trade estimates: this represents a 30% year-on-year rise.

On a broader scale, the country retains significant long-term potential as a crucial player in global trade flows. Brazil is, after all, the world's ninth-largest economy. Aside from its top two export partners, China and the United States – to which Brazil exported $35.1 billion and $23.3 billion worth of goods last year respectively – links with Europe offer major trading opportunities. For instance, as many as 1,300 German companies maintain subsidiaries and operations in Brazil, some 900 in the city of São Paulo alone.

It is for this reason that Commerzbank, reaffirming its trust in the country, opened a new subsidiary in São Paulo last year. Just the latest chapter in Commerzbank's 60-year history in Brazil, the new office is responsible for the bank's business across Latin America, dealing with trade finance and cash management, accounts, financing, risk and investment management, and offering insights on local and global markets.

Given Brazil's economic importance in South American markets, Commerzbank's subsidiary is intended to serve as a strategic door-opener "on the ground" for German and European clients seeking local opportunities, as well as a bridge for Brazil's internationalising companies aiming to do business in Europe and beyond. It is notable that, in only the twelve months since its launch, the branch has already recorded growing interest from its clients for cross-border business – thus reflecting the reassuring trends that are supporting Brazil's economic recovery.

Brazil is finding light at the end of its tunnel. Despite the challenges it faces in the short term, with trade and the close support of partners abroad, its economy can look forward to brighter prospects ahead.

Source: Thomas Krieger, Commerzbank AG, Financial Institutions Latin America, December 2017

Eye on the industry:
Keeping global trade safe and sound from the risks of financial crime

Regulatory compliance is part and parcel of secure international trade business. For good reason: all banks must stay on the right side of sanctions regimes, and be well prepared in the fight against financial crime. But the industry is coming together to enable best practice.

Checking trade

The most pressing issues for compliance are trade-related. In order to comply with CFT, AML, KYC and KYCC regulation, Commerzbank regularly performs due-diligence checks on partners involved in a transaction: from its correspondent banking partners, to their own correspondent partners, from the first ordering party to the ultimate beneficiary – and everything in between. Where necessary from a risk perspective, Commerzbank will perform real "deep-dive" checks, which include 16-page questionnaires, aside further mitigating measures.

Of course, compliance checks must deal with a vast amount of data: worldwide, there are more than 1.3 million bilateral correspondent relationships. Checking all this information takes time, and as the old saying goes: time is money. This is why SWIFT's KYC Registry is so important – the collaborative online platform that allows standardised data on counterparties to be uploaded, stored, and validated for future reference – saving time, resources and costs. Encouragingly, over 3,500 banking entities have now signed up.

Maintaining the integrity of the Registry is crucial, of course. Success depends on banks keeping the information updated and authenticated. As part of the original group of banks that established the Registry, therefore, Commerzbank also helped to set up guidelines for SWIFT for checking its data – relying on the industry-made validation process to deliver.

Clarity and preparation

Yet industry players need to collaborate to increase transparency. On the one hand, if parties in trade can agree clear definitions for key terms in the regulatory jargon, companies and financial institutions can better abide by the rules. On the other hand, an in-depth knowledge and understanding of so-called "red flags" helps to identify potentially suspicious trade-related transactions. Together with the Bankers Association for Finance and Trade (BAFT), Commerzbank has produced a 24-page document identifying 16 red flags typical to trade transactions, in addition to offering suggested guidance to mitigate the associated risks. Doubtless, staying ahead of the regulatory game is essential. But Commerzbank is well prepared for new regulation.

For instance, the bank implemented most of the requirements of the EU's new Fourth Anti-Money Laundering Directive (4MLD) at least a year before it came into effect. Given banks face many of the same challenges, they can work together in order to tackle those challenges well in advance.

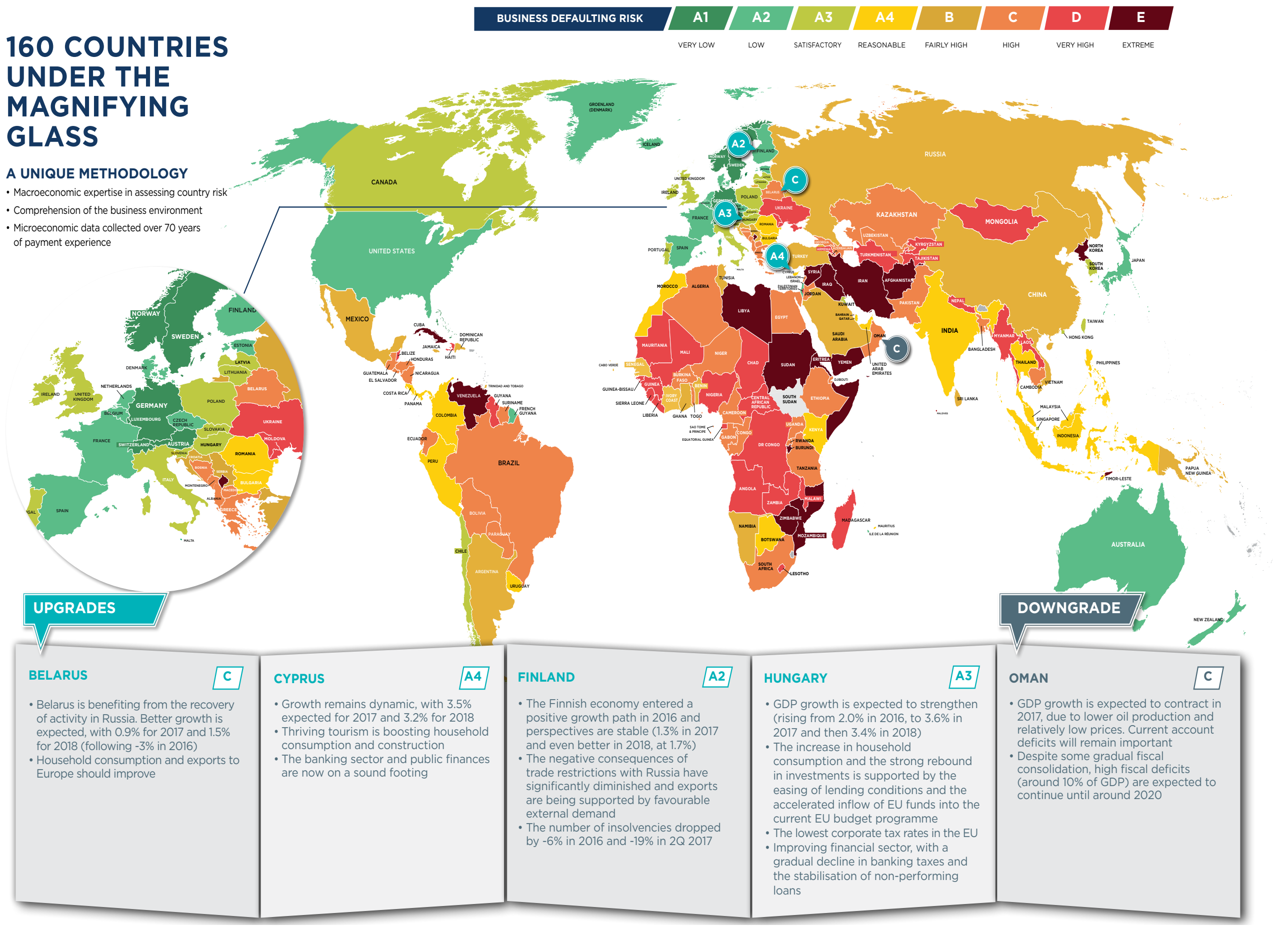
One particularly welcome regulatory development has been the revised "Guidance on Correspondent Banking" issued by the Financial Action Task Force (FATF) in October 2016. This document made a significant contribution to the debate on de-risking – the trend of banks to retrench operations and lending from markets and jurisdictions perceived to be too high risk. This is because, ultimately, banks need the standards need to be clear before they can modify their approach to dealing with risk.

Now it remains for national regulators to implement these standards and send a clear message to their supervised institutions. After all, it is the work of the regulators to communicate expectations clearly and to be consistent with their published guidance, in order that market players might create compliance procedures both robust enough to manage risk and also conducive to growth. Commerzbank looks forward to further discussion with regulators across the globe as this process unfolds.

Source: Thomas Piontek, Commerzbank AG, Financial Institutions, October 2017; Tassilo Amtage, Commerzbank AG, Corporate Clients, October 2017

Country risks at a glance:
Coface Germany's country ratings

Coface Germany produces international country risk analyses and up-to-date country ratings based on economic, financial and political developments. Read their latest assessments **here**.



Source: Coface, 3rd quarter 2017

Euler Hermes Country Risk Map

Consult additional current country assessments in the media centre of Euler Hermes.

Source: Euler Hermes, Q3/2017

Interesting links

Commerzbank international business
Internationalisation can serve as an important stimulus for your business's continued growth. If you want to make the most of the opportunities offered by foreign business and reduce the risks associated with it, you need a partner who can assist you in foreign markets. You will find more information **here**.

Trading worldwide
"Trading worldwide" is an exclusive reference work that gives you a comprehensive introduction to issues associated with cross-border business. This must-have for your international business is available as a down-load. For more information, please talk to your Relationship Manager.

Commerzbank industry information
Our industry experts' publications regularly give you all the important information relating to an economic sector, individual industries and the manufacturing sector. You will find more information **here**.

Commerzbank Commodities Radar
The Commodities Radar newsletter is a quarterly publication which provides updates on the developments of the key commodities in the areas of industrial metals, precious metals, energy and agricultural products. You will find more information **here**.

Commerzbank
"Ratschläge für die Ausfuhr"
Comprehensive information regarding your foreign business: this reference work for German exporters and export industry service providers has been published exclusively by Commerzbank for over 40 years and comprises comprehensive information on more than 200 countries around the world in areas such as currency and collection regulations, and tips relating to licence systems. You will find more information **here**.

Any questions or suggestions relating to the Country Risk Radar?

If you have any questions or would like more information on this topic, feel free to contact our Cash Management & International Business specialists. And for more information on all the aspects of Commerzbank's foreign business, go to **www.commerzbank.com/corporatebanking**

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