

Country Risk Overview

July 2010



Industrialized countries

Recovery in the
United States and in
Japan, soft acceleration
in Europe

Japan – Unites States: Risk evolution

Japan

Upgraded from A2 ↗ to A1

reflecting the export rebound and the continuation of the programme implemented by the Government in order to support household consumption

Four straight quarters of positive GDP growth

Activity in the 1st quarter 2010 grew by 1.2%, quarter on quarter, mainly driven by exports, public investment and household consumption (+0.7%), itself supported by the governmental measures facilitating the purchase of low energy-consuming durable goods. Our growth forecast has been reconsidered, up to 2% and the rating upgraded from A2 (positive watch since January 2010) to A1 in June 2010.

Exports buoyed by intra-regional dynamism and the restocking process in developed countries

Household consumption has been fuelled by the continuation of the Eco-point programme until the end of September (car purchases) and until the end of the year (housing appliance purchases), and the programme implemented by the former Hatoyama administration (reduction or cancellation of the provision for petrol tax, child allowance in June, and so on). Nonetheless, the continued stagnation of wages and the weakness of the job market will weigh on private consumption. Despite profits increasing significantly, corporate investment has remained constrained, in the face of the high level of production overcapacity businesses has had to cope with.

Exports have underpinned growth, underpinned by demand from other Asian economies (54 per cent of Japanese exports), particularly China (16 per cent of Japanese sales abroad). Following a drop of 25% in 2009, they should not, however, return to their pre-crisis level (+20% expected in 2010) until household consumption in OECD countries (30% of export

sales) unequivocally picks up. Whilst exports can take advantage of the dynamic Asian markets, they are also dependent on the phase of reconstitution of stocks being observed in various OECD countries, which could well slow down in the 2nd half of 2010, particularly in the United States. The appreciation of the yen against the currencies of Japan's main trading partners will— if it persists — constitute a risk by making Japanese products less competitive and undermining the profits of companies operating abroad.

The new Naoto Kan government has not questioned the stimulus measures implemented by its predecessor. This spending, in conjunction with the sharp contraction of revenues, will deepen the public sector deficit (10% of GDP), and increase already colossal government debt (about 200% of GDP). But Japan should not face difficulties funding its financial needs, its public debt being quasi entirely detained (95%) by domestic investors. Should the government undertake public financial adjustments, that would probably be in a medium term with a fiscal policy targeting a surplus in primary budget. Besides, a hike in VAT could be decided in 2012.

Marked improvement in the bankruptcy trend

Intra-Asian demand has breathed new life into the export sector. The renewal of vehicle purchase support measures by the Chinese government until December should enable the automotive sector to achieve significant earnings. While intermediate goods should suffer from the softness of the consumption recovery in the United States and

Europe, electronics and home furnishings has continued benefiting from the prolongation of the Eco-point programme. The bankruptcy trend eased considerably with a 12% decrease in three months through

April. Some sectors are nonetheless still vulnerable: property, leisure-related activities, and independent shops.

United States

Rating unchanged: A2  since March 2010

Ending the 2010 first quarter with a 2% growth rate base

Economic growth inaugurated the year with a third consecutive quarterly rise (up 0.7% q/q in Q1), driven mainly by household consumption and corporate restocking. Corporate investment remained stable meanwhile, held back by a marked decline in spending on structures while purchases of light equipment and software trended down. Residential investment and net exports contributed negatively to growth. Compared to the sharp contraction in the 2009 first quarter, the economy has continued to recover (up 2.5%) with the growth expected for the year revised upwards to 2.9% in consequence.

A slowdown is expected in the second half of this year

Macroeconomic data for April and May do not suffice to conclude that domestic demand, particularly household consumption (70% of GDP), will be capable of picking up the slack for government support measures, which are expected to wind down in the second half of the year. Buying by households is thus expected to slump under the effect of the persistent, sharp devaluation of property assets, the volatility in financial markets, high unemployment (a slight improvement in April notwith-

standing), the growth of payment defaults, and the still difficult access to credit. Personal income rose in the first quarter (up 1.9%), but it is still early to determine how households will use the income should this trend continue: In particular they might give priority again this year to further paying down their debt, which fell from the 2008 high of 131% of disposable income to 122% in 2009. This context in conjunction with the deterioration of public sector finances, which raises the spectre of tax hikes, will likely prompt them to increase their savings rate again: After drawing on savings to finance first quarter spending (3.4% of disposable income), they turned around and replenished them in April (3.6% of disposable income).

Building starts continue to fall, due to of the high level of stocks (8 months in January 2010), difficulties encountered by developers in the financing of their projects and with the expiry of the tax credit for new owners. This does not augur well for a strong rebound of residential investment in 2010. Furthermore, the spiral of the seizures of property which feeds stocks continues to depress prices in the housing sector (13% beneath the pre-crisis prices). Commercial property will continue to suffer from the prudence of businesses that have still to cope with a low capacity utilisation level (75%).

The production cycle could come to an end as soon as the second quarter and remain below potential for the rest of the year. In this context industrial companies will make sure that demand is really coming back before making new spending commitments. Today, the contraction of credit (down 22% from the peak of October 2008) does not facilitate the financing by companies of heavy investments.

On the other hand, exports (12% of GDP) should continue to benefit from the recovery of activity in Mexico (11% of exports) and the dynamic Asian economies (20%). Nonetheless, this evolution will remain below the pre-crisis trend as sales abroad are recorded in industrialised countries where growth will be weak. Furthermore, the appreciation of the dollar against the euro is weighing on the price-competitiveness of American products, outside dollar areas. The \$700 billion Troubled Asset Relief Program (TARP) has had a considerable effect on public finances: the fiscal deficit will exceed 10% of GDP and the debt will swell (98% of GDP).

Non financial companies' profits soared in the first quarter

Large companies have limited the deceleration of the rate of profit last year —around 10% of GDP— and have significantly improved their cash flow-to-capital expenditures ratio, reflecting internal financing capacity, up from 99% to 120%. Large companies limited the deceleration of their profit rate (a positive 10%) and significantly improved their cash flow-to-capital expenditures ratios (reflecting internal financing capacity), up from 99% to 120%. The profits of non financial companies soared, up 16% q/q in the first quarter, a pace that could slow considerably as a result of the unfavourable exchange rates applicable to profit repatriation on transactions in Europe. Smaller companies have been more vulnerable as evidenced by the measures taken by the Obama Administration to encourage regional banks to support that business category. Bankruptcies increased 24% in the twelve months through March this year but the rate nonetheless eased in the last three months of the period (up 2%).

Western Europe

After a sharp acceleration mid 2009, economic growth was then largely flat in the fourth quarter and in the early months this year. Although the results of surveys focused on companies with good growth prospects stabilised at a slightly positive level, a soft acceleration appears likely in the second quarter and it is expected to continue, albeit sluggishly, into the second half.

Several factors have contributed to the sluggishness of the recovery:

- The deterioration of public sector finances (whether in deficit or debt terms or both) has been considerable in many regional countries, which had to prevent their economies and banking systems from collapsing in the

crisis. The deterioration has been particularly severe in several countries including Greece, Iceland, Ireland, Portugal, Spain, and the United Kingdom.

Under pressure from financial markets concerned about the deterioration, the fiscal stimulus measures have been disappearing, giving way to fiscal consolidation

plans whose impact on growth will hardly be neutral. Despite these plans, along with the wrapping up by the European Union, Eurogroup, and IMF of a rescue plan for Greece and a €750-billion European Financial Stability Facility, the markets remain unconvinced of the capacity of several countries to put their fiscal situations back on a sound footing and honour their debt obligations: a good proportion of the deficits are structural in nature, further complicating the consolidation process.

- Banks, many of which are convalescent, have been parsimonious in making loans to households and companies. In several countries, like Spain and Ireland, the governments remain concerned about the fate of many banking institutions with property assets far from completely sterilised. Elsewhere, like in France, Germany, the Netherlands, and Austria, exposure to Greek risk constitutes the main source of concern.
- The job market and wages continue to be affected by the need for companies to restore productivity and profitability levels depressed by the crisis. Wages have been in decline in Ireland and Italy in particular. Employment and wages in the public sector have not been spared.
- The debt of private economic actors has remained high not only in Spain, Ireland, Greece, Portugal, and the United Kingdom but also in Belgium and Scandinavia. The priority is thus often given to savings over consumption.
- Even if it is not the only deciding factor, the production capacity utilisation rate has remained at a historically low 75% that does not encourage companies to reinvest.
- The trends on prices and consumption vary widely by country with deflation in Ireland, Spain, and Iceland and a marked resurgence of inflation elsewhere, like in the United Kingdom. In the first case actors are prompted to postpone spending while in the second their disposable income is eroded.

All these factors have contributed to the sluggishness of European domestic demand (consumption and invest-

ment), which has undermined the economies of export-focused countries dependent on the European market, like Germany, Austria, and, severely, Benelux.

A few factors, however, have or tend to have a positive influence on the regional economy.

- Foreign trade has made a positive contribution to the regional economy insofar as the growth of its imports has not exceeded that of its exports, which have benefited from the strong growth of most emerging regions and the sharper recovery in North America. And the approximately 20% decline in regional exchange rates against the dollar so far this year has provided further support.
- Except in Greece, Portugal, Spain, and Ireland austerity plans will not begin to have an effect until 2011.
- Public sector investment has continued to support economic growth via infrastructure spending. But this support will disappear by 2011 as a result of the cutbacks in public spending.
- The slowdown in destocking has contributed to the recovery of industrial production. The continuation of destocking also means that industrial production has not recovered enough to stabilise stocks. This provides a substantial boost to growth.

In light of the above factors, European economies fall into very distinct categories.

First there are the economies where pre-crisis growth was strong — attributable to the fact that they lagged far behind the leading European countries — but imbalanced since it rested excessively on easy credit, consumption, and construction. The concentration of problems they face has drawn the attention of the markets: public sector financial deterioration, households and often companies still deep in debt, and banks often mired in difficulties. This category includes Greece, Spain, Portugal, Ireland, and Iceland. Their future will depend on their capacity to develop additional sources of growth.

The category at the other extreme includes advanced economies – Germany, the Netherlands, Sweden, Denmark, and Finland — heavily dependent on exports and thus hit hard by the decline in foreign demand, especially from within Europe. Although Norway, Luxembourg, Austria, and Switzerland also experienced declines in exports, the downturns were offset by relatively strong demand from households. These four countries have already begun to benefit from the recovery of foreign trade, albeit only with trading partners outside the region at this juncture. Public sector finances in export countries have, overall, suffered relatively little deterioration, even if they may have experienced difficulties in dealing with risky foreign assets held in their portfolios.

Other regional economies have been largely underpinned by household consumption. In this category, the crisis impact was more severe where households were deep in debt, as in the United Kingdom, or milder where they were relatively debt free as in France or Belgium. But in these three countries, public finances either deteriorated (UK and France) or were already deteriorated (Belgium).

Italy constitutes a special case: consumption has been sluggish there since 2007. With the deep recession in 2009 attributable to the sharp fall of exports, the economy is expected to benefit from the recovery of world trade provided recurrent competitiveness problems are resolved. In a deteriorated state before the crisis, public sector finances are still in poor shape today.

There is thus a marked heterogeneity in the region that a lack of both fiscal federalism and mobility of factors of production does nothing to mitigate.

Two crucial questions

- What is the relationship between fiscal policy and economic growth? None has been clearly established as yet. But it is noteworthy that the fiscal overhauls undertaken in the past in Europe (Finland, Denmark, Sweden, Ireland, United Kingdom, and so on) were not associated with a loss of growth.

On the contrary, economic activity accelerated. It is, however, necessary to point out that the fiscal belt tightening was coupled with a loosening of monetary policy. But on that score there has been virtually no leeway. Preference has moreover been given to cutting costs over increasing revenues as well as to substantial exchange rate reductions — and in that regard the trend has been good.

The capacity of households and companies to remain aloof from the financial difficulties of governments is thus a pivotal factor. Will consumers consider their own finances healthy enough for them to resume buying, particularly durable goods? Will corporate managers consider the outlook sufficiently clear and their profitability sufficiently restored to embark on some catch-up investment spending?

- Benefiting from favourable exchange rates and the marked recovery of non-European regions, will the dynamism of exports not be likely to largely offset the sluggishness of domestic demand?

Steady bankruptcy rate

The many uncertainties notwithstanding, corporate bankruptcies are, overall, no longer increasing in the region. The trend has even eased substantially in Scandinavia (except Denmark), the United Kingdom, and the Netherlands. Conversely, they are still trending up in Spain, Italy, and Ireland.

Rating changes

Switzerland

Withdrawal of the negative watch on the rating A1

reflecting the good trend observed in household consumption and in exports despite the appreciation of the Swiss franc; the soft deterioration of the public finances will enable the government to wait until the recovery is solidly on track before envisaging reductions in government spending

Strong performance of household consumption and exports in the 2010 first quarter

Switzerland emerged from recession in the third quarter last year, which facilitated limiting the contraction of growth for the full year with down 1.5% expected. In the first quarter this year, the economy grew 0.4% underpinned by household consumption and exports. Economic growth was consequently revised upwards to a positive 1.3% and the A1 Country@rating was removed from the negative watchlist status it held since March 2009.

The federal government has room for manoeuvre

With Swiss households generally in a healthy financial position, their consumption has continued to hold up well despite unemployment that is a relatively high 4.2% compared to the rates - between 2.5% and 2.8% - recorded before the crisis in the past. Spending is thus expected to increase at substantially the same rate in 2010 as it did last year - about 1.3% - despite the hardly favourable trend of disposable income and the loss of the benefit from the decline in the prices recorded in 2009 (down 0.5%). The dynamism shown by exports early this year will likely continue thanks to strong demand for precious metals conducive to recovery in the watchmaking and jewellery sectors, but at a somewhat less exuberant pace due to the Swiss franc appreciation. The euro depreciation could, however, by enhancing the price competitiveness of the products

of Switzerland's main trading partners (particularly Germany, market for 20% of Swiss exports) spur the volume of orders flowing to Helvetian companies from those countries. The current account surplus is thus expected to remain stable at around 6% of GDP. After postponing their investments in 2009 to a less drastic extent than companies elsewhere, Swiss companies will doubtless remain prudent again this year, a good level of capitalisation notwithstanding.

Despite vigorous interventions by the federal government in support of the financial sector since 2008, the public sector deficit did not widen much and the public debt has remained at sustainable levels (40% of GDP). That will doubtless enable the government to wait until the recovery is solidly on track before envisaging reductions in government spending and continuation, if necessary, of measures in support of the economy.

Good export trend by sector

The highly export-oriented sectors, pharmaceuticals, food, and technologies, should be hardly affected by the slowdown of demand from the European Union in the 2010 second half. The tourism sector continues, however, to suffer from the wait-and-see stance of European households and the appreciation of the Swiss currency. The financial sector has steadied, but if the pressures from abroad to lift bank secrecy meet with success that could affect it and reduce its weight in the Swiss economy.

United Kingdom

Upgraded from A3 to A3⁺

reflecting the marked improvement of Coface payment incident experience, the sharp decrease in corporate bankruptcies (-14% in the first quarter), the fiscal tightening which should have a limited impact on growth in 2010, currency control and a public debt largely held by local banks.

Recovery late in coming after a sharp economic downturn

Developing in the 2009 last quarter after six quarters of recession the recovery was thus slow to develop. Domestic demand particularly suffered from the difficulties in the financial and property sectors in a context of high household and corporate debt. The accommodating character of economic policy and the government's massive bail-out of the financial sector, which went as far as nationalisations, only sufficed to slow the fall.

A timid export-based recovery

The recovery is very slim indeed resting at this juncture essentially on a destocking slowdown and exports. Despite the sharp fall of the pound sterling - down 30% and 20% respectively against the dollar and the euro since the latest peak - exports have managed just a moderate take-off with exporters apparently preferring to shore up profitability rather than attempting to increase market share. Sales of services (40% of exports including 30% for financial services alone) have been struggling.

Household consumption - already squeezed by the VAT increase implemented early in the year, the raising of income taxes, the upsurge of inflation, and a still sluggish job market - could come under even greater pressure: The new coalition government formed by the conservative and liberal-democratic parties has intensified cost-savings measures in the framework of the emergency budget released on 22 June. Disposable income and employment should be in for some more suffering. In this context residential property prices, still historically high, could be accompanied by a new increase in savings.

With economic activity still low corporate investment has stagnated and will be unlikely to initiate a catch-up process until late in the year. Non-residential

construction will nonetheless benefit from the continuation of projects in preparation for the Olympic Games and spending on housing will likely grow slightly albeit from a low level.

The net effect of the budgetary treatment the new coalition in power will accord to the public sector deficit - immediate increase in capital gains taxes for higher rate tax payers, new rise in VAT in 2011, reductions in social benefits, two-year freeze on civil service payrolls but also income tax exemptions for one million low-income households - could choke off the recovery especially with interest rates unable to come down any further. Although the recovery in manufacturing is expected to continue thanks to exports and stock replenishment, services and construction have already begun to run out of steam. The sentiment of households and companies - their expectations on income and business - will be crucial.

Payment behaviour beginning to improve

Corporate payment behaviour deteriorated sharply in the 2008 second half, except in Northern Ireland. The sectors affected most include construction, property and financial services, metallurgy, paper processing, printing, road transport, catering, and non-food retail. The deterioration came to an end in the 2009 first half and a trend toward improvement emerged at that juncture. Companies continue meanwhile to adjust their production capacity to the reduced level of activity. To improve their performance, export companies refrained in all likelihood from passing on the entire pound sterling depreciation in their sales prices. In Scotland, meanwhile, where the original deterioration was relatively limited, the improvement process seems accordingly to be faster paced. It will take time, however, for payment behaviour to return to pre-crisis levels.

Greece

Downgraded from A3 to A4

reflecting the sharp decline in household consumption, corporate and public investment, and the deep recession that will result of it (-4%)

Collapse of domestic demand in the 2010 first quarter

In May 2010, Greece made commitments to the European Commission and the IMF to implement a €30-billion savings plan by 2012. In the first quarter of the year, even before the government implemented the main part of its austerity programme, economic activity contracted for the fifth consecutive quarter (down 1% quarter-on-quarter), in phase with the initial measures taken early in the year. Intended to reduce the public deficit from 14% of GDP to below 3% by 2012 and make the primary balance positive again by 2011, the savings plan will deepen the recession now expected to reach a negative 4%. The existing A3 rating for Greece, negative watchlisted since January 2010, is downgraded to A4.

Households and companies severely affected by the drastic savings plan

The sacrifices imposed on Greek households will profoundly affect their consumption, which is expected to contract by 4% this year. The public sector is facing a three-year wage freeze, elimination of 13th and 14th-month wage payments above a specified income ceiling, and reduction of various bonuses. Pension payments for a 13th and 14th month have also been eliminated. Already increased by two points in March this year, VAT is again being raised by that margin at this juncture - from 21% to 23% -, and a third two-point hike is expected in the second half. Special consumption taxes - fuel, alcohol, tobacco - are up 10%. Property taxes are also higher. And with the institution of a new exceptional income tax the most profitable companies are being asked to make an even greater contribution. Structural reforms have been initiated targeting the pension system, the labour market (to raise the

competitiveness of Greek companies), and a tax system overhaul (to improve tax collection effectiveness, reduce the weight of the grey market in the official economy, and combat tax evasion). The government is moreover making reductions in total public sector investment and liberalising the transport and energy markets. Exports will doubtless benefit from the wage cuts expected in the private sector in coming months and from the euro depreciation. The current account deficit will narrow with imports declining in the wake of the collapse of domestic demand. The services surplus (tourism, maritime freight) will remain intact. In this context, household disposable income is expected to decline by over 3% and investment by companies to fall nearly 14% and by the government some 10%. Unemployment could affect nearly 14% of the population this year fuelling risks of public unrest that could destabilise the country.

Companies faced with financing difficulties

Holding a high proportion of Greek bonds, Greek banks may find it increasingly costly to borrow in financial markets. They could thus experience a new shock and have to further restrict lending to households and companies, which represents 75% of GDP. Corporate borrowing grew at a 2% annual rate in the first quarter, down sharply from the 25% growth rate recorded last autumn. And companies themselves may also have a tough time borrowing in international markets with foreign banks limiting their exposure to Greek counterparties.

Emerging Europe

A soft recovery
in 2010

Emerging Europe

After suffering a severe recession in 2009 (down 3.9%), emerging Europe is likely to experience a modest recovery this year (up 2.8%), but relatively weaker than the upturns expected in the other emerging regions. Turkey and Poland, expected to rebound 5.4% and 3.0% respectively, will essentially drive the recovery with real GDP likely to be virtually stagnant in most of the region. Growth rates were still negative year-on-year in the first quarter this year in the Baltic States, Bulgaria, and Romania.

Many countries came into the crisis with difficult-to-sustain imbalances: excessive external deficits attributable to the boom in domestic demand, rapid growth of private debt. **Deterioration of the international financial environment has made major adjustments in terms of growth inescapable.**

Countries with fixed exchange rate regimes (Baltic States, Bulgaria) were all the more affected not having been able to make use of monetary depreciation to bolster their competitiveness.

Emergence from the recession has been facilitated at this juncture by stock replenishment, low interest rates, revival of world trade, and support provided by multilateral institutions to weaker regional economies (including Latvia, Hungary, and Romania). **Several factors will, however, have a dampening effect on the recovery this year:** private-sector deleveraging, greater selectivity exercised by banks in granting loans, deteriorated state of the job market, fiscal austerity, and weak external financial conditions particularly in the context of tensions over the sovereign debt of countries in the south of the euro zone.

Contagion effects are to be feared in that regard. And they have already begun to materialise on the financial level as evidenced by the upsurge of volatility, noticeable since early May, in exchange rates,

stock markets, and risk premiums on regional sovereign bonds. The growth of spreads has, however, remained limited in comparison to that observed early last year, even if some countries, like Hungary, where public sector debt levels and fiscal management can give cause for concern, have been more heavily penalised. As regards trade performance, the **euro depreciation against the dollar will likely benefit regional countries** (directly where the local currency is pegged to the euro, indirectly for countries with floating exchange rate regimes and that are subcontractors to the European manufacturing industry). **But implementation of austerity plans in the euro zone**, particularly in Southern Europe, **is at the same time expected to reduce demand for goods imported from Emerging Europe**, particularly Romania and Bulgaria. The Balkan states remain the countries most directly exposed to the repercussions of the crisis in Greece in view of the ties that bind them to that country (not only merchandise trade but also expatriate worker remittances, direct investment, and banking flows).

The recovery in the region would be in great jeopardy in case of lasting difficulties in refinancing foreign debt and a generalised credit shortage.

Rating changes

Estonia

Withdrawal of the negative watch on the rating A4

The country should post a soft recovery in 2010 (+0.3 % growth forecast). Joining the euro zone, at the beginning of 2011, proves the quality of its macroeconomic management and represents an exit from the currency board

Slight recovery likely in 2010

Domestic demand began to weaken from 2007 because of the bursting of the property bubble. The financial crisis and the contraction of world trade only worsened the slump. The contraction of exports and of consumption as well as destocking and the collapse of investment plunged the country into deep recession in 2009. Estonian GDP continued to contract in early 2010 partly due to tax rises. Growth should however recover slightly by the end of the year thanks to restocking, a limited recovery in exports and improving business and household confidence. On the other hand, the upturn in private consumption will be hampered by falling wages and the need for households to free themselves from debt. Weak domestic demand and foreign capital inflows will weigh on investment. Finally, fiscal policy is likely to remain tight.

Sound macroeconomic policies hailed by the European Union

The contraction of domestic demand made it possible to rebalance the external accounts after several years of huge current account deficits and, at the same time, to bring inflation below the Maastricht level. The fiscal reserves built up during the good years, the negligible level of public sector debt (7.2% of GDP in 2009) and far-reaching budgetary measures have enabled the government to avoid financing difficulties.

In May 2010, the European Commission, welcoming this policy, allowed Estonia to join the eurozone in January next year. Moreover, despite the increase in non-performing loans, linked in particular to the collapse of the property market, banks have weathered the crisis successfully thanks to good supervision of the sector, adequate levels of capitalisation and liquidity, and the support of their Scandinavian parent companies. The country's extremely rigid exchange-rate regime (currency board) has, until now, been resilient. Businesses and households, most of whose bank loans are denominated in foreign currency, have not therefore been subject to the devastating effects of a sharp fall in the exchange rate. Euro membership will greatly reduce risks associated with the high levels of external debt and foreign currency lending.

Limited political risk

The government has been a minority one since the Social Democrats left the three-party coalition in May 2009. Early elections could be held before the end of the term of office (2011), leading to the creation of a new alliance bringing the opposition parties together. However, Estonia's credit is unlikely to suffer because this change would not call into question the broadly liberal orientation of the economic policy. The austerity measures are, however, of such nature as to feed public discontent.

Lithuania

Withdrawal of the negative watch on the rating A4

The adjustment of the country should help to resume growth into 2010 (+2.1 % growth forecast)

Recovery likely in 2010 after a severe contraction

After strong growth in past years spurred by buoyant domestic demand and the property boom, Lithuania - like its Baltic neighbours - was caught up in a severe recession in 2009. There as elsewhere, the bursting of the property bubble compounded the effects of the international financial crisis (drying up of financing and contraction of world trade), resulting in a sharp drop in investment, consumption, and exports. However, economic activity is likely to resume in 2010, supported by export growth, a rebuilding of inventories and higher absorption of EU funds, although domestic demand will remain subdued due to high unemployment, contracting incomes and weak supply of credit. Sales abroad gave the initial impetus to the recovery with sectors like capital and transport goods, pharmaceutical and oil products rebounding strongly. Disinflation and wage adjustments have helped restore some of the competitiveness lost in past years.

Adjustment in external accounts but deterioration of public sector finances

The collapse of domestic demand contributed to a sharp reduction in imports and the emergence of a current account surplus. Even if energy imports increase as a result of the shutdown of the Ignalina nuclear

power plant late 2009, external accounts should continue to show a slight surplus in 2010. Draconian fiscal adjustments have been made since late 2008 to stem the deterioration of public sector finances associated with the expansionary policy pursued before the October 2008 legislative elections and the deterioration of economic conditions. These measures were instrumental in strengthening the credibility of Lithuania's rigid exchange rate regime (currency board) and enabled the government to borrow in the markets with no major difficulty. In this context, recourse to aid from the IMF proved unnecessary. Nevertheless, as a result of the rise of the deficit and contraction of economic activity, the government debt burden - very limited until 2008 (15.6% of GDP) - more than doubled. Further measures are required to bring the deficit below 3% of GDP in 2012, meeting that criterion for joining the euro zone.

Moderate political risk

The ruling coalition lost its majority in the parliament with the departure of some of its MPs. Nevertheless, it should be able to rely on support from some deputies of the opposition. Even a rebuilt coalition should continue to be dominated by the centre right and thus be likely to maintain policy continuity. However, some measures could be difficult to implement, particularly on social issues.

Turkey

Upgraded from B to B⁺

The country has showed good resilience capacity during the crisis and is experiencing a strong rebound this year (+5.3% growth forecast)

A sustained recovery after a severe recession

There was a pronounced recession in the first half of 2009, activity rebounding, however, in the final quarter, limiting the decline in GDP over the year as a whole. The unprecedented fall in domestic interest rates, the replenishment of stocks, and the strengthening of capital flows and foreign demand are reflected by a strong recovery in 2010. Growth has been accompanied by rising inflation and a widening current account deficit but is likely to gradually slow during the year reflecting the end of base effects, a limited rise in household income, excess capacity and the fallout of the European crisis. Economic activity currently rests on sound foundations (entrepreneurial dynamism, improvement in the business climate, specialisation quality, banking sector solidity) which augur well, in the medium and long term, for a relatively sustained growth.

Payment incidents returned to satisfactory levels

Corporate payment behaviour deteriorated sharply in autumn 2008. The deterioration was caused mainly by the economic downturn, the fall in exports, and the depreciation of the exchange rate, which affected automotives, construction and related activities (plastics, cement, electrical equipment), retail, paper, chemicals, and textiles-clothing. The financial health of Turkish companies has nonetheless gradually strengthened during the past year with the payment index improving in consequence and returning to more satisfactory levels from summer 2009.

Good capacity to cope with the international financial crisis

The lack of an agreement with the IMF notwithstanding, the financial tensions that had intensified in

autumn 2008 began to ease in the second quarter last year. Concerns over the extent of foreign financing needs eased considerably as a result of the sharp contraction in the current account deficit, the repatriation of assets held abroad by residents, and the resumption of foreign capital inflows. Financial stabilisation, the signs of recovery and the desire to conduct an independent budgetary policy explain the decision of the authorities not to negotiate a new stand-by agreement with the IMF. Strong pressures on the exchange rate, that would primarily affect companies with heavy foreign currency debt, could, however, return in the event of budgetary difficulties (the government, however, has committed itself to strengthening fiscal discipline via the implementation of a fiscal rule) or political unrest. Meanwhile, a banking sector that benefited from a profound clean-up since the national financial crisis in 2001 has held up well in the global crisis. It is in a position to finance both the credit recovery and the purchase of treasury bills thus easing the pressure on public finances, which deteriorated as a result of the economic downturn and the loosening of fiscal policy.

A tense political climate

The victory in the municipal elections won by the ruling party (AKP) in March 2009, even if the results were mixed, tends to ensure political continuity. However, tensions have increased between the government and Kemalist forces, which control the courts and the army, and there are uncertainties as to the continuation of the present economic policy after the legislative elections planned, in principle, for July 2011. The constitution debate launched end of May 2010 by the AKP opened a lengthy electoral campaign.

CIS

The pace of growth
reflects the weakness
of the recovery

CIS

After having been hit by the world's worst regional recession in 2009 (with a 6.6% fall in GDP), CIS economy has rebounded since the beginning of 2010 thanks to the recovery of the global economic environment. Full-year growth for the region is expected to reach 4%-5%. This pace remains lower than the rate prevailing before the crisis (7.5% on average between 2000 and 2007) despite very favourable base effects, reflecting the weakness of a recovery which is also marked by great disparities between countries.

Regional growth is mainly driven by energy exporting countries, and especially by Russia which generates 77% of regional GDP. Azerbaijan, Kazakhstan, Uzbekistan and Turkmenistan also benefit from oil price's upswing and from major oil and gas infrastructure projects and thus post high growth rates. On the other hand, small economies like Armenia, Georgia and Moldavia, which are net importers of oil and gas, show a modest recovery with growth rates around 2%. They will continue to depend on IMF assistance. Such is also the case of Ukraine, whose renewed political stability has convinced the Fund to provide the country with a new 14.9 billion dollar loan over the next two-and-a-half years (this new stand-by arrangement is still to be approved by IMF's executive board at the end of July).

Besides oil prices, rebound in global demand and inventory rebuilding have spurred industrial production and emergence from recession. Remittances of earnings from expatriate workers in Russia are increasing and spurring consumption.

Many risk factors still weigh on the region, though, and tend to weaken the recovery process. Private foreign debt is very high. Government anti-crisis plans have certainly been instrumental in stabilising banking sectors, particularly in Ukraine, Russia and Kazakhstan. Yet, credit supply is still being choked off by high levels of non-performing loans. Moreover, banking systems remain handicapped by structural weaknesses: a limited and dollarized deposit base, heavy dependence on external funding and deficient supervision.

On the geopolitical front, a civil war has threatened to break out in Kyrgyzstan in the wake of anti-Uzbek violence in mid-June, which could have dragged neighbouring Central Asian countries into open conflict. To a lesser degree, tensions continue to run high between Armenia and Azerbaijan over the Nagorno Karabakh region.



Rating change

Ukraine

Upgraded from D to D⁺

The activity rebound is on its way and the political situation has stabilized since Viktor Yanukovich has been elected as President

Rebound after a severe recession

Financial aid from the IMF saved Ukraine from financial disaster but did not avoid a harsh contraction of the Ukrainian economy in 2009. The country emerged from recession in the first quarter of 2010, thanks to the recovery of foreign demand and some very favourable base effects. The terms of trade also improved. The strength of the recovery is at risk because it is heavily reliant on external factors (demand from Russia and Europe, steel and, gas prices, for example). The euro depreciation coupled with higher inflation in Ukraine caused the real hryvnia exchange rate to appreciate since the beginning of the year and erased part of the competitiveness gains obtained by the devaluation of the Ukrainian currency end 2008. Growth could in the second half, as the favourable base effects fade.

Heavy dependence on multilateral assistance

Following the 30% price reduction obtained by the government on gas imported from Russia, the 2010 budget voted in April inspired hopes for the release of an IMF loan, frozen since autumn 2009. The budget met indeed the IMF's required 6% deficit objective. A new 14.9 billion dollar loan provided by the Fund over the next two-and-a-half years was finally approved in July. This deal took some time to be

achieved as public budget initially did not include certain quasi-public spending as the recapitalization of the banking sector. As a matter of urgency, the government was forced to turn to Russia at the beginning of June to obtain a short-term \$2 billion loan from the state-controlled bank VTB. This shows at what extent official aid is crucial for Ukraine. The country's short-term economic and financial outlook are certainly improved by IMF's new stand-by arrangement.

Political stabilization tilted eastward

The political situation has appreciably improved since the election of Viktor Yanukovich to the presidency last February. The new president succeeded in quickly establishing a parliamentary coalition, and in giving the country its first fully-fledged government in over a year. Close to the Kremlin, the new executive has been realigning Ukrainian diplomacy eastward. The improved relations with Russia, very tense under the previous government, will likely benefit a Ukrainian economy heavily dependent on its neighbour. However, the rise in unemployment, wage arrears and the political situation exacerbate social tensions. Moreover, poor governance and endemic corruption place the country at a high level of risk.

Main regional economies

Kazakhstan (B)

Rating unchanged

A strong recovery

The Kazakh economy has begun to recover its dynamism after two years marked by a severe banking crisis. Increases in raw materials prices, investment in the petroleum industry, and the government's economic stimulus plan spurred an acceleration of growth in the 2010 first quarter, facilitated moreover by favourable base effects. Private consumption, depressed by tight credit, will be buoyed by welfare benefits distributed by the government throughout the year. The construction and real estate sectors, - major engines of pre-crisis growth - will, however, remain for the most part in great difficulty. Growth is expected to accelerate further in the coming years.

A banking sector that remains risky despite debt restructuring

The Kazakh government provided massive support to the banking sector by injecting over \$4 billion in the form of fresh capital and cash, and the sector is largely stable today largely thanks to approval of the debt restructuring of three banks that defaulted in 2009: BTA, Alliance Bank, and Temir Bank. The Kazakh banking sector remains nonetheless very risky because of the explosion of non-performing

loans, which exceed 20% of total loans outstanding. The sector also continues to suffer from structural weaknesses: a limited and dollarized deposit base, dependence on foreign financing, the excessive concentration of loan portfolios, and inadequate supervision.

Political progress

Perceived as the architect of the strong economic growth these past years and guarantor of enviable political stability, President Nazarbaev enjoys great popularity, albeit weakened by the current economic difficulties. Although his ultimate succession remains an element of uncertainty, the open policy to foreign investments seems unlikely to be in jeopardy especially in the absence of a reasonable alternative. The increase in the government's role in the economy could nonetheless deteriorate the business environment. Externally, while maintaining good relations with the West and China, Kazakhstan seems to be strengthening its partnership with Russia as evidenced by implementation of a tripartite free trade area. In 2010, Kazakhstan is the first CIS country to preside over the Organisation of Security and Co-operation in Europe (OSCE).

Russia (C⁺)

Rating unchanged

A moderate recovery

Hit in 2009 by the deepest recession since the 1998 crisis, Russia has experienced a recovery since the beginning of the year thanks to an upturn in oil prices, the return of foreign demand and favourable base effects. The improvement in labour market conditions and an increase in government welfare spending have fuelled consumption, benefiting mainly imports though. The unemployment rate remains high and investment sluggish. The stricken construction sector is still in the doldrums. The outlook for the second half-year is uncertain. The favourable base effects will fade and slow the pace of growth. The rouble appreciation has undermined the competitiveness of Russian exports already suffering from lacklustre demand from the euro zone. The persistence of certain structural factors — lack of an efficient banking system, lag in technology, insufficient investment in the oil sector, and problems associated with the business climate — also affects the recovery.

Substantial room for manoeuvre on fiscal policy

During the crisis the government adopted an anti-cyclical fiscal policy with costly, emergency measures intended to prevent the collapse of the financial system and the failure of the private sector. In conjunction with these measures, the decline of oil revenues and the economic recession put Russia's fiscal balance into deficit for the first time in ten years. And the budget deficit is expected to remain high through end 2010 with the government conti-

nuing to pursue its economic stimulus policy focused on the automotive, farm, and defence industries and supporting household consumption. The deterioration in public finances in no way affects government solvency with Russia carrying little debt and benefiting from a substantial safety margin through its Reserve funds.

Large state-controlled banks strengthened

The banking sector remains risky. Despite many cases of recapitalisation, the deterioration of loan portfolios has affected all banks. Large state-controlled banks, strongly supported by the authorities, have seen their role expand and they now represent a very high proportion of banking sector assets and deposits. The many small private banks have suffered more from solvency problems and struggled to obtain refinancing. After the sharp contraction last year lending has resumed. Corporate payment behaviour, which deteriorated during the crisis, appears to be improving.

Preponderance of the government

External events (war in Georgia, financial crisis) have served to consolidate the predominant domestic roles of the government and its Prime Minister, Vladimir Putin, particularly in the economy. But considerable social tensions have developed. And Russia still suffers from a business environment that is not very reassuring.

Kirghizstan (D)

Rating unchanged

A narrow deteriorating economic situation

In 2009, Kyrgyzstan's economy slowed. Exports of gold and remittance inflows from migrant workers (30% of GDP) diminished greatly because of the economic and financial difficulties faced by Russia and Kazakhstan. The economic shock was amplified by recurrent energy supply problems. Formerly very dynamic, construction sector suffered from the drying up of credit due to the difficulties in the banking sector, dominated by the Kazakh banks. Thanks to international financial support (IMF, World Bank and Russia), the increase in public expenditure partially took over from diminished private consumption.

In 2010, the economic rebound of the region's larger countries has triggered a resumption of exports and remittances from expatriate workers, and growth is expected to be stronger by year end. Electricity shortages and droughts in agricultural regions will, however, limit the scale of the recovery. In particular, the new government was forced to cut energy prices and cancel the privatization of the state-owned electricity company, Severelektro, thereby reducing the flow of revenues to the government. New international financial support (IMF, World Bank and Russia) will consequently be needed soon.

From political upheaval to interethnic crisis

The country has been mired in a period of instability since the removal of President Kourmanbek Bakiev last April, with a sudden outbreak of violence against the Uzbek minority in the Och region in June. Hundreds were left dead and over 400,000 Uzbeks were temporarily displaced, of which some 100,000 took refuge in Uzbekistan. Tensions always existed between the two communities but the sequence of events - the massive presence of firearms and the simultaneous triggering of several attacks - smacks of deliberate ethnic cleansing. The situation will remain very tense in the coming months with a risk of regional contagion.



Emerging Asia

Emerging Asia:
stronger position
coming out of
the crisis

Emerging Asia

→ **Economic growth in emerging Asia rebounded from the second quarter of 2009. Several factors explain the sustained economic improvement:**

- **After bottoming out in the first quarter last year, world trade began a gradual upturn.** Electronics exports (which represent over a third of Asian exports) rose steadily from the second quarter. And increasingly dynamic domestic demand in China has resulted in higher raw material imports, beneficial to Indonesia and Malaysia, and of capital goods (with China's stimulus plan calling for major infrastructure investments) beneficial to Korea and Taiwan.
- **Financial conditions have normalised compared with the situation at the end of 2008.** Portfolio investment flows towards emerging Asia have recovered, reflecting good growth prospects and prudent macro-economic policies. The rise in risk aversion at the start of 2010 in the wake of the Greek crisis had only a limited impact on capital flows. From March 2010, there were renewed capital flows especially on Asian domestic bond markets, which proved very dynamic in a context of narrower spreads on corporates. Moreover, in the majority of emerging Asia countries, conditions for access to liquidity have eased with the general relaxing of monetary policies and the end to sterilisation in the 1st half of 2009. In China, it was more specifically the lifting of loan quotas, which led to very strong credit growth (up 33%).
- **Stimulus plans were implemented across the region last year offsetting the decline in private investment and production by export industries.** The most significant is the stimulus plan in China, which represented 14% of GDP in 2009, followed the plans in Korea (4.7% of GDP), Singapore (3.4%), and Malaysia (3%). Fiscal stimulus policies in Asia represented an average of 2.8% of GDP (compared with 2% in the industrialised countries) and generated 1.8 points of GDP.

→ **For the rest of 2010 and in 2011, growth in emerging Asia is expected to continue to trend up (8.3% expected) spurred by firm domestic and external demand, despite tightening economic policies.**

Against a background of renewed activity, rising inflation (especially in India) and the risk of a property and stock market bubbles, several countries moved to tighten monetary policy at the end of 2009 (interest rate hikes in India and Malaysia, increase in legal reserves in China). Furthermore, the fiscal stimulus for 2010 has been cut by a third on average compared with 2009.

- **China** and India will continue as the two engines of growth. Despite the monetary policy tightening, India posted strong economic momentum in Q1 2010 (8.6% year-on-year) and this trend looks set to continue for the rest of 2010 (8.5% expected). Economic growth rests on good fundamentals: large domestic market, high savings and investment rates, diversified and high-performance production along with balanced growth. Furthermore, the Congress Party's significant victory in the May 2009 elections is expected to allow the reform process necessary for the dismantling of infrastructure bottlenecks to be implemented. As for China, growth reached 11.9% year-on-year in Q1 2010 and will remain buoyant for the rest of the year (10% expected), despite the increase in bank reserve requirements, administrative measures particularly in the property sector, and the renewed appreciation of the yuan against the dollar. Growth will still be driven by investment, notably in construction. Thanks too to the continuation of steps to support consumption, the home appliances and automobile sectors can be expected to continue their rapid growth. Moreover, there will be ongoing momentum in retail sales as a result of the "consumption cheques" distributed to low-earning households.
- In **Korea**, the economy just managed to avoid recession in 2009 (0.1%) thanks to the weakness of the won, which benefited exports, and to expansionary monetary

and fiscal policies. In Q1 2010, growth reached 7.8% year-on-year. The annual figure is expected to reach 6%, resulting from a recovery in investment (essentially in infrastructure) and exports destined mainly for China, the country's main trading partner.

- **Hong Kong, Taiwan and Singapore** - small open economies very dependent on exports - achieved record growth in Q1 2010, in part due to a base effect: 8.2% in Hong Kong, 15.5% in Singapore and 13.3% in Taiwan. During the remainder of 2010, these economies will benefit from the rebound in China, better growth prospects in Japan and the United States and from major stimulus policies being implemented. Accordingly, growth in Singapore is expected to reach 8.9% while in Hong Kong and Taiwan it could come to 5.2% and 6.5% respectively.

- For the **ASEAN** economies, prospects diverged in 2009. While the open economies — **Malaysia** and **Thailand** — were in recession in 2009 (down 1.7% and down 2.2% respectively), the **Philippines, Indonesia** and to a lesser extent **Vietnam** held up well (0.9%, 4.5% and 5.3% respectively). In the 1st quarter of 2010, all the ASEAN countries posted positive growth: 12% in Thailand, 10.1% in Malaysia, 7.3% in the Philippines and 5.7% in Indonesia. Over the remainder of the year, this trend should firm up particularly with sustained domestic demand, improved exports especially of electronics and higher raw material prices (benefiting Indonesia and Malaysia). Growth is expected to reach 3.8% in the Philippines, 6% in Indonesia and Malaysia. In Thailand, despite the political uncertainties and violent demonstrations affecting tourism, the economic outlook remains good, with growth expected to reach 3.5% in 2010. Strong growth (6.5%) is expected in Vietnam, although the country's financial situation remains shaky as a result of persistent external account imbalances, ongoing pressure on the dong, and low currency reserves.

A more pessimistic scenario in which sluggish European demand depresses the region's growth prospects cannot, however, be totally ruled out.

According to Patrick Artus, if exports to the EU stagnate in 2010, Asian exports growth (excluding China) could

slowdown by 1.2% and GDP growth by 0.7 point. China would be more seriously affected (down 6% for exports growth and down 2.8% for GDP growth). Nevertheless, the Greek crisis is expected to have only a limited effect on the region in terms of financing growth, since according to an estimate by the RBC, European bank loans to emerging Asia represented only 7% of Asian GDP in 2009, against 28% in eastern Europe and 16% in Latin America. So, even if a systemic banking crisis develops in Europe, access to credit in emerging Asia is likely to remain close to normal and the Asian financial situation is expected to remain stable.

→ **In 2010-2011, the ASEAN countries will face two principal challenges.**

Consolidation of the economic recovery against a background of reduced momentum in industrialised countries:

In this respect, the establishment of the China-ASEAN free-trade area on 1 January 2010 could constitute an advantage. With a population of 1.9bn, 6,000bn dollars of GDP and nearly 4,500bn dollars in trade flows, CAFTA (the China-ASEAN Free Trade Area) represents the largest emerging country free-trade area, within which customs duties have been abolished on 7,000 groups of goods (which represents almost 90% of tariffs). This does not apply, though, to Cambodia, Laos, Myanmar or Vietnam, which will benefit from a transition clause until 2015 allowing them to bring their customs duties on Chinese goods down to zero. This free-trade agreement is expected to correct an integration deficit between ASEAN and China. The intensity of trade between ASEAN and China is hardly greater than that which results naturally from China's economic weight (without even taking factors of proximity into account): China represents 9% of ASEAN's exports and 12% of its imports compared with 7% and 10% respectively worldwide. Inversely, China's weight in trade with Japan, Korea and Taiwan is much greater than its weight in trade with the rest of the world, around 15-20% for both imports and exports, which is explained by geographical proximity. CAFTA will doubtless allow trade between China and ASEAN to grow and compensate for the integration deficit. However, it should be

noted that some economists fear that this free-trade agreement will lead to loss of market share for ASEAN where the share of capital goods has been in steady decline to the benefit of China. Sales to the United States have fallen from 15% to 10% over the past 8 years, while those from China jumped from 11% to 24%. Similarly on the European market, ASEAN's share has declined from 5% to 4% while China's has climbed from 3% to 8%.

Control of the effects associated with the instability of external capital movements:

Faced with huge inflows of capital from the second quarter, the authorities in Asian countries stepped up their interventions in foreign exchange markets (via the accumulation of reserves) to prevent the appreciation in the face value of their currencies. Some countries are also considering strengthening capital controls, following the example of Taiwan, which decided in November 2009 to ban non-residents from making sight deposits, or Korea, which in June 2010 introduced limits on

foreign currency hedging and other derivatives that banks can use in Korea (Under the new rule, Korean local banks are required to have no more than 50% of total FX derivatives positions over their capital and foreign banks are required to bring down this ratio to below 250%). Moreover, the probability of new episodes of financial instability (huge outflows of portfolio investments) cannot be ruled out in a still shaky economic and financial context. The establishment of a foreign-currency reserve pool in Asia in December 2009 (multilateralisation of the Chiang Mai initiative) is expected to allow the region to reduce liquidity risk and limit the effects of financial contagion. The 120-billion dollar fund became operational on 24 March 2010 and allows countries to obtain financing needed to deal with difficulties encountered regarding international settlements and short-term liquidity problems. Nevertheless, strict conditions (IMF arrangement for utilisation of more than 20% of drawing rights) risks limiting the scope of the initiative.

Rating changes

Singapore

Rating upgrade from A2↗ to A1

Rating upgrade from A2↗ to A1 reflecting the significant recovery of the economy and the good payment record

Recession in 2009 but a substantial rebound in 2010

The Singaporean economy has been significantly affected by the crisis due to the contraction of exports (which represent 210% of GDP) with sales abroad of manufactured products (electronics, engineering, pharmaceuticals, petrochemicals) and services (financial services, tourism, transport) affected by the economic downturns suffered by the main trading partners (Malaysia, United States, China, Japan). In response to the economy's entry into recession, the Central Bank cut interest rates several times and

a stimulus plan representing 8% of GDP was implemented in January 2009. Thanks to increased public infrastructure spending in the transport, health, and education sectors, the authorities were able to limit the contraction in total investment but without, however, offsetting the collapse of private investment. The government moreover provided guarantees covering up to 80% of the default risk on new loans. And it adopted measures in support of household consumption including an income tax reduction and employment support measures.

Economic growth rebounded strongly in the 2010 first quarter, up 15.5% year-on-year. Although this performance needs to be put into perspective — notably because of the rebound effect — the growth of the economy is expected to remain on track for the rest of the year with 8.9% growth forecast for all of 2010. Private consumption will be the main growth drive spurred by an improved job picture and a rebound in investment. Exports have moreover been trending up with Singapore selling an increasing proportion of its merchandise to Asian neighbours, particularly China and ASEAN countries. On the supply side, the construction industry benefited again in 2010 from the increases in public spending while electronics, pharmaceuticals, petrochemicals, financial services, and tourism are gradually getting back up to speed. According to Coface records the trend on payments has thus been good. Singapore boasts the best governance record in Asia thanks to an effective legal system that facilitates claim collection and a high degree of financial transparency.

Strong financial position

Despite the implementation of a far-reaching stimulus plan, the fiscal deficit has remained under control in 2010. Public financial accounts have thus remained in good shape.

External accounts, meanwhile, continued to show a substantial surplus in 2010, despite the decline in exports. This year, the still high current account has narrowed slightly with imports recovering more rapidly than exports reflecting the rise of raw material prices and the rebound of domestic demand. And the volatility of portfolio investment flows observed after the Lehman Brothers bankruptcy eased in 2009 and early 2010. Thanks to its high foreign exchange reserves, the country continues to enjoy good capacity to withstand a sudden flight of capital.

Despite the international financial turmoil and the exposure of some banks to subprimes and Lehman Brothers, the banking system remains solid thanks to satisfactory management of risks, effective oversight, and high solvency and liquidity ratios.

Hong Kong

Rating upgrade from A2 to A2⁺

Rating upgrade from A2 to A2⁺ reflecting the rebound of exports and the improving payment record

Recession in 2009 but a significant rebound expected in 2010

Hong Kong was particularly affected by the global economic and financial crisis as a result of its economic openness with exports and imports representing 350% of GDP. Machinery, electronics sales abroad and tourism contracted for the full year. Domestic demand, however, showed signs of recovery by the 2009 second quarter. Private consumption is again trending up buoyed by the improvement in the job market attributable in particular to the recovery in the tourism sector, the increase in nominal wages, and the positive wealth effect resulting from the rise of the Hong Kong stock market's Hang Seng index

and the property market. Corporate investment gradually recovered after the easing of credit conditions. On the supply side, the financial services and retail sectors achieved rapid growth while trade-related services continued to suffer from the slowdown of foreign demand.

In Q1 2010, GDP growth reached 8.2% y/y and the recovery will likely stay on track in 2010 thanks to the economic rebound in Continental China, low interest rates, and expansionary fiscal policy. The fiscal stimulus measures implemented (equivalent to 5% of GDP) are expected to result in a gain of two points of GDP by supporting household consumption and smaller companies via property and income tax

exemptions and reductions, transfer payments to low-income households, and a system of public guarantees for smaller companies. In this context, Coface monitoring records are expected to reflect improvement in payment behaviour.

A still healthy financial position

In the financial sphere, the more rapid contraction of exports of goods and services compared to imports contributed in 2009 to the decline in the current account surplus as a result of the fall of demand from OECD countries for electronics, telecommunications equipment, machinery and manufactured goods. Although the Lehman Brothers bankruptcy gave rise to massive withdrawals of portfolio investments, they were offset by the repatriation of funds by companies based in Hong Kong and by the unwinding of carry trade transactions. Foreign exchange reserves

thus increased again in 2009. The current account surplus is expected to grow slightly in 2010 as a result of the recovery of exports of services (tourism, financial services, merchandising, and logistics). The reserves will thus remain at a satisfactory level.

The peg of the Hong Kong dollar to the US dollar is expected to be maintained in 2010 even if the chief executive officer, Donald Tsang, has raised the long-term possibility of establishing a link between the Hong Kong dollar and the renminbi.

The banking system held up well in the crisis thanks to effective oversight and regulation and prudent risk management. The exposure of Hong Kong banks to toxic assets has been limited with the proportion of non-performing loans in their portfolios remaining low and their solvency and liquidity ratios high

Taiwan

Rating upgrade from A2 to A2⁺

Rating upgrade from A2 to A2⁺ reflecting the rebound of exports and the improving payment record

Recession in 2009 but gradual recovery in 2010

Taiwan was significantly affected by the crisis. The recession is mainly attributable to the weakening of foreign demand, particularly from the United States, the island's main trading partner considering that it is the ultimate re-export destination for about 70 per cent of Taiwan's exports to Mainland China. The contribution of net exports and investment to GDP growth was negative in 2009. Conversely, consumption, spurred by the stimulus plan proved relatively resilient to the crisis. On the supply side, the drop in foreign demand affected the machinery and electronics sectors, which represent over 50% of exports. Particularly laptops and LCD monitors — products where Taiwan is the leader — were the first branches to suffer. The services sector (particularly tourism, wholesale commerce, and financial services) also contracted.

In Q1 2010, thanks to the expansionary fiscal and monetary policies adopted and the gradual revival of growth in China and the United States, the Taiwanese

economy recovered gradually (13.3% y/y). For the entire year, GDP growth should reach 6.5%. Indeed, exports have rebounded and contributed positively to growth while household consumption has increased in a context of growing confidence and improvement in the labour market. But investment has remained sluggish with public investments planned in the stimulus package not sufficing to offset the lack of dynamism in the private sector. In this context, corporate payment behaviour has improved. However, the contraction of margins associated with the overcapacity in some sectors will bear watching

Solid financial position

The fiscal deficit widened considerably in 2009 as a result of the fiscal stimulus implemented by the authorities to revive growth: tax reductions, infrastructure investments, income subsidies for the neediest households, and loans to first-time home buyers. Although the deficit should remain large in 2010, the public debt is expected to remain sustainable.

The current account surplus increased in 2009 due to the more rapid contraction of imports in relation to exports, and it will remain large this year as a result of the expected recovery of machinery and electronics exports and tourism.

Meanwhile, 2009 was marked by massive inflows of capital, three-quarters of which, according to the Central Bank, are speculative in nature representing bets on the appreciation of the new Taiwanese dollar. In this context, the Financial Oversight Commission decided to bar non-residents from making sight deposits from November 2009. This control on capital flows is expected to remain in effect in 2010.

And foreign exchange reserves will likely remain very high in 2010, providing the island with protection against a foreign currency liquidity crisis.

Strengthened economic and financial cooperation with Continental China

In the political arena, the January 2008 legislative elections and March 2008 presidential election were marked by the coming into power of the Kuomintang. Under the Ma Ying-Jeou presidency, the tensions with Beijing have tended to ease and economic and financial relations to develop. Several agreements have thus been concluded restoring air transport, maritime, and postal links between the two countries. Progress was also made on financial cooperation as attested by the opening of the Taiwan Stock Exchange to investors from Mainland China, the possibility for banks from either territory to set up subsidiaries on the territory of the other, and the possibility for Continental China to open renminbi accounts in Taiwan. This trend is expected to continue in 2010 with the conclusion of the Economic Cooperation Framework Agreement in June 2010.

China (A3)

Rating unchanged

A3 rating maintained, strong growth in prospect but with readjustment of the growth model necessary

Good capacity to cope demonstrated in 2009 thanks to the stimulus plan and economic rebound in 2010

The strong economic growth continued in China in 2009 (8.7%) thanks mainly to the lifting of loan quotas and the resulting strong credit expansion (up 33% in 2009 compared to up 16% in 2008). In addition to the elimination of quantitative limits on lending, the expansionary monetary policy (four reductions in the bank reserve requirements and five interest rate cuts), the stabilisation of the yuan, and the far-reaching 586-billion-dollar stimulus plan (14% of GDP) focused on strengthening the country's infrastructure and increasing social spending also provided support for the economy. In the first quarter this year, GDP growth reached 11.9% year-on-year. But the strong growth is nonetheless not devoid of risk. With the massive influx of capital attributable to the internatio-

nal context, the economy has been awash with cash that has spurred the rise of asset prices. And the contribution of investment to the growth has steadily increased, exacerbating the problems with overcapacity in some sectors (automotive, construction, steel).

In view of these problems, the overriding economic-policy objective in 2010 is to consolidate the growth while making it more balanced. In the fiscal policy framework, 2010 is the second year the stimulus plan has been in force. Key components of the plan have been maintained and strengthened: investment in infrastructure, measures to spur household demand, support for sectors considered emerging and strategic in relation to the objectives of promoting innovation and moving the economy upmarket. Spending on sectors saddled with overcapacity will, on the contrary, be limited. As regards monetary policy,

China's exit strategy calls for gradual measures. Late 2009 and early 2010, several measures were taken to limit the expansion of credit and liquidity: limits on lending in sectors with overcapacity and increases in bank reserve requirements. The overall thrust of monetary policy is nonetheless expected to remain accommodating. The credit growth, albeit remaining a high +18%, has thus been substantially revised downward compared to 2009. Inflation risk has been kept under control despite the current rise of the price index linked to the rise of wages. And finally, adoption of a strategy of gradual adjustments in foreign exchange policy has been announced by the Central Bank in June 2010. The gradual appreciation of the yuan could, however, be delayed as a result of the euro's sudden weakness in the wake of the Greek debt crisis: the 14.5% yuan appreciation against the euro in the first four months this year has penalised Chinese export companies with 15% of their products now flowing to the euro zone.

Persistent weaknesses: overcapacity risk and default risk will bear watching in 2010

Default risk will bear close watching in certain sectors, particularly those dealing in value-added products (textiles, shoes, toys) and those hampered by overcapacity (automotives, construction, steel) with the government working to move the economy upmarket. And with the stimulus plan spurring investment, overcapacity risk remains a critical weakness of China's growth regime in the medium term.

The property market is another sector that will bear watching and in this case as regards the formation of speculative bubbles mainly in large cities. On the stock market — despite the strong recovery of the Shanghai composite index — the 32% ratio of market capitalisation to GDP in China remains far below the ratios in Japan (67%) and the United States (87%), which would tend to ease the macroeconomic consequences of a stock market crash.

Strong financial position

Financially, China remains very strong. The current account surplus is still high in 2010 despite the faster recovery of imports compared to exports (associated with the rebound of imports of intermediate goods assembled in China). Foreign exchange reserves thus remain extremely high.

Banking risk, on the contrary, has been rising. As a result of the successive interest rate cuts and the lifting of lending quotas, the expansion of credit accelerated considerably in 2009. In a context of essentially lax risk management, asset quality has deteriorated (increased volume of non-performing loans). In view of the government's commitment on recapitalisation in case of difficulties systemic risk will remain limited.



Latin America

A fairly strong
recovery

Latin America

The relatively strong recovery rests on dynamic domestic and foreign demand and a resumption of capital flows. With elections scheduled in several regional countries this year, public spending remained a significant component of domestic demand in the first half, notwithstanding the gradual winding down of the fiscal stimulus measures.

Demand for raw materials produced in the region has been boosted by the economic expansion in Asia and singularly in China. But exports also derive support from the recovery, albeit more modest, in developed countries.

And interest rate differentials with those developed economies have spurred capital flows to the region, whose improved growth outlook has moreover boosted investor confidence.

Besides the particular characteristics of the various regional countries, their respective economic trajectories reflect, to some extent, disparate performance in foreign trade.

The recovery has been stronger in South America, which benefits from more geographically diversified foreign trade and attractive natural wealth. The rebound in world raw material prices has contributed to the improved outlook enjoyed by that part of the region, with growth in **Brazil** notably expected to exceed 7% in 2010.

Highly dependent on the North American economy for export sales, remittances, foreign direct investment and tourism revenues, **Mexico**, Central America, and the Caribbean area have been somewhat slower to initiate a recovery.

Overall, Latin America has become more resilient to exogenous economic and financial shocks as exemplified by the sovereign debt crisis gripping a few peripheral countries in the euro zone notwithstanding the possibility of some countries being exposed if Spain were to be affected, considering the scale of bilateral trade with the region's historic partner. Some sovereign and private-corporate Latin American borrowers, acting out of prudence or foresight, nonetheless accelerated their financing programmes early this year.

The primary factor in the new resilience has been the improvement in the fundamentals of most regional countries in the past few years. After years of reforms and improved management, they have consolidated public finances, improved solvency ratios, and brought their financing needs down to manageable levels. Even a "maverick" like **Argentina** hopes to restore relations with world capital markets after the success of the exchange of securities on a residual fraction of its foreign debt, at the end of June 2010.

The economic recovery expected in 2010 will pave the way for envisaging easier loan conditions — not only for large Latin American multinationals, but also for small and medium sized enterprises — as well as improved payment behaviour by companies in general.

Rating changes

Costa Rica

Withdrawal of the negative watch on the rating A4

reflecting the economic recovery

A recovery, with persistent inflation

GDP growth will resume in 2010, in phase with the global economic recovery, especially in the United States (market for almost half of sales abroad). The main growth drivers include sectors dependent on foreign demand - manufacturing in customs free areas, agriculture and tourism - as well as private consumption and investment, which have benefited from fiscal stimulus measures.

With the central bank notably lacking a targeting regime, inflation is expected to remain at higher levels than in most regional countries, despite a decline that brought it to its lowest point in 30 years, between 6% and 7%.

Necessary reform of public finances

The large fiscal deficit that developed in 2009, after implementation of the Escudo economic stimulus programme, is expected to remain this year with the government still pursuing expansionary fiscal policy. Efforts to reduce a public debt burden expected to represent 50% of GDP this year - half in foreign currency - and clean up public finances will notably require improvement in both the tax base and collection efficiency. The urgent but repeatedly postponed fiscal reform should still be hard to be implemented because of the lack of a parliamentary majority.

Shaky external accounts

Costa Rica's external accounts will benefit from the American economic recovery and its positive impact on exports of goods and services, tourism, and ex-

triate remittances. While enjoying preferential access to the American market under the CAFTA-DR free trade agreement, Costa Rica has nonetheless sought to diversify its markets abroad, particularly in China, its second largest client country, with which a free-trade agreement was signed in February 2010. At the same time, the external accounts will be affected by the higher cost of oil imports, increased demand for intermediate goods in manufacturing, and profit repatriation by multinationals. The resulting large trade and current account deficits are nonetheless expected to be mainly covered by foreign direct investment, two-thirds of which from the United States. The liberalisation of the electricity, telecommunications, and insurance sectors provided for under the CAFTA-DR trade agreement is moreover expected to attract foreign investors in those areas.

The Costa Rican colon should remain relatively stable, with the Central bank managing an intervention band since late 2006. Good solvency and liquidity indicators notwithstanding, the banking sector has remained weakened by the extent of the dollarization and the offshore sector.

Political continuity

Laura Chinchilla has succeeded to the president Oscar Arias in May 2010, coming from the same centre-right party, Partido Liberación Nacional. Economic policy continuity is thus expected, although the lack of a majority in the unicameral Congress is likely to complicate its implementation.

Panama

Withdrawal of the negative watch on the rating A4

reflecting the acceleration of the economic growth

Importance of Canal and its extension to the economy

Growth is forecast to accelerate in 2010, after experiencing the slowest rate for eight years in 2009, caused by the negative impact of the US recession and the decline in international shipping. The enlargement of the Panama Canal programmed through to 2014 at an estimated cost of \$5.25 billion (fully financed, notably by the EIB and the JBIC) will continue to underpin economic activity. The recovery will also be driven by household consumption, buoyed by declining unemployment, as well as by private investment in the free trade zones and public investment in infrastructure.

On the other hand, public spending will be restricted by the policy of holding the budget deficit to 2% of GDP (and 1.5% in 2011), in conformity with an amendment to the 2008 Fiscal Responsibility Law. Fiscal revenues will benefit from the continuing stream of toll revenues from the Canal, as well as from tax reform introduced at the end of 2009 and beginning of 2010. Public finances should therefore continue to improve, with a further gradual decline of public debt, forecast to be about 42% of GDP in 2010.

Because of the importance of the Canal to the local economy, the recovery of world trade and the expansion in China, second-largest user of the Canal, will boost services linked to this sector. The external accounts deficit will, however, deteriorate substantially, handicapped by the high cost of oil imports, and even more so by the cost of equipment required for the

Canal enlargement, allied to repatriation of profits by foreign-owned companies. The resulting financing need will, nevertheless, be easily covered, for half by foreign direct investment attracted notably by the proposed construction of a gas pipeline from Colombia and a new oil refinery, and for the balance via international finance and official loans.

Again delayed, probably until 2011, ratification by the US Congress of the Free Trade Agreement signed in 2007 with the US, Panama's principal trading partner, will give hope of an increase, in due course, in exports and a consequent reduction of the current deficit. Besides, the banking sector is well capitalised and benefiting from reinforced supervision since a new law promulgated in August 2008. This sector remains, however, exposed to potential exogenous shocks, due to the preponderance of foreign banks (60% of total) and the country's position as a regional financial centre. Lastly, Panama still figures on the 'grey list' of tax havens published by the OECD, notably because of information exchange difficulties.

Challenges for the new president

Since taking up office as president in July 2009 for a five year term, the conservative Ricardo Martinelli is tributary of a fragile parliamentary coalition, his party Cambio Democrático having only 13 seats out of 41 in Congress. Combined with the interventionist tendencies of the president, this dependence may not be propitious to social progress or improvement in the general business environment.

Brazil

Upgraded from A4 to A4⁺

reflecting the very strong economic growth

Brisk growth rebound and inflationary pressures

After a slight contraction in 2009, the Brazilian economy is resuming relatively strong growth this year amid the run-up to the presidential election in October and the recovery expected in the global economy. GDP growth is driven by increased public spending, strong household consumption fuelled by the rise of wages, as well as by a strong expansion of corporate investment.

Due to the strong recovery in activity, coupled with inflationary pressures and overheating fears, the Central Bank is gradually tightening its monetary policy during the course of 2010, after cutting its key rate (Selic interest rate) to a historical low in 2009.

Putting the deterioration of public accounts into perspective

As a result of the international crisis, which required implementation of counter-cyclical measures, the public finances situation was weakened with public spending remaining too rigid, the structure of domestic debt deteriorating, and already high public debt growing further and consequently impeding investment in infrastructure. Sovereign risk will nonetheless remain manageable in view of the relatively moderate cost of the economic stimulus programme and the net creditor external position maintained by the public sector since 2008.

Deterioration of external accounts due to domestic demand expansion

Foreign trade has been following the trend in world trade and will thus be likely to benefit from the upturn expected this year. In 2009, however, for the first time since 1978, exports of staple commodities exceeded those of manufactured products, a trend likely to continue with Brazil's export performance driven by sales to China, consisting mainly of commodities.

Furthermore, domestic demand expansion is sustaining an upsurge in imports, which will significantly drive down the trade surplus. Therefore, with the services deficit likely to grow, the current account deficit will widen, but foreign direct investment is expected to cover almost half of large external financing needs.

Foreign debt amount will grow substantially in 2010, with an increase in the proportion of private debt, and the burden of serving that debt remaining high in relation to exports. But Brazil's external vulnerability will likely remain manageable. As a result of the relatively bright outlook overall, the real is expected to remain at fair levels with foreign exchange reserves increasing to record levels. Although the banking sector is solid, the sharp rise in loans granted by state-run banks in the framework of the stimulus programme constitutes a potential risk.

Race for the presidential election next October, but a lagging pace on reforms

In the presidential race, the fight should be tight between the centrist opposition candidate José Serra (PSDB) and Dilma Rousseff, designated by President Lula (who is barred by the constitution from seeking a third term) to represent the government party PT. Whatever the outcome of the election, however, economic policy is expected to remain essentially unchanged. But the political system makes government-by-coalition inevitable, which tends to complicate adoption of structural reforms in a country still marked by severe inequality.

Improvement in payment behaviour

In this generally favourable context, all sectors have performed well: the industry continues to lead the expansion, agriculture rebounds after poor results in 2009 (due to drought) and services show significant improvement. Moreover, large firms have been renewing their credit lines on favourable terms and credit

is readily available for small and medium sized enterprises. For companies penalized by the the exchange rate trend, they focus on the vast domestic market at

the expense of exports. The improvement of corporate payment behaviour should therefore continue.

El Salvador

Withdrawal of the negative watch on the rating B

reflecting the economic recovery, albeit fairly moderate, and an agreement with the IMF

Lacklustre economic recovery

Economic activity will get off to a very soft start in 2010, owing to the recovery in the United States on which the country remains extremely dependent for exports, investments and expatriate remittances. Growth will be weakly supported by household consumption following a slight improvement in jobs and transfers as well as company investments, thanks to a more favourable economic environment and an easing of financing conditions. Further, inflation should remain limited (under 2%), mainly because of subdued domestic demand.

Worsening public finances

With the recovery, even modest, a renewed deepening of the trade deficit will appear. This is explained by an upturn in private consumption and investment resulting in increased imports, in turn dependent on purchases of oil at higher cost. The growth in imports will be higher than that of exports, which derive mainly from light industry and assembly units (maquiladoras). Furthermore, slightly increasing expatriate remittances and tourism revenue will not offset the rise in repatriations of dividends by foreign companies. The result will be a worsening current account deficit, only very partially covered by foreign direct investment, although external debt ratios are expected to remain stable.

In addition, the banking sector, reinforced since the acquisition of the major local banks by Bancolombiano, HSBC and Scotiabank, remains well capitalised and liquid, but banking supervision needs to be tightened.

External exchange still unbalanced

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A government with no real room for manoeuvre

President Mauricio Funes' task, taking a pragmatic left-of-centre line, and his government's, in power since June 2009, is complicated by the absence of a parliamentary majority (his party, the FMLN, having only 35 seats out of 84). Strong opposition from the party of the right, Arena, in power for 17 years, and the need to form alliances makes politics difficult and hinders progress with social programmes, especially in the area of education, aimed at alleviating poverty and, as a knock-on effect, reducing insecurity and violence.

Guatemala

Withdrawal of the negative watch on the rating B

reflecting a moderate economic recovery and the IMF support, as a preventive measure

Moderate recovery

Activity will get off to a soft start in 2010, along with the recovery in the United States, the country's N° 1 trading partner (about half of all exports) and financier. This is because household consumption will suffer from high level of unemployment and only a slight rise in expatriate remittances from the United States, as well as still restrictive and costly credit conditions, which will in turn affect private investment. Nonetheless, inflationary tensions, exacerbated by the weakness of the currency and the prices of certain commodities, will be more than offset by moderate domestic demand.

IMF support

On account of the prolonged impact of the recession on income, the government has no choice but to review its initial social and investment spending plans downwards for 2010. In addition, the government's economic programme is backed by an 18-month Stand-By Arrangement of \$935m, approved by the IMF in April 2009 and expected to remain precautionary. However, public finances remain fragile even though the authorities' main objective remains that of increasing tax revenues, which represented only 11% of GDP in 2009, based on a reduction in tax evasion and the part played by the informal economy (estimated at half of GDP).

Persistent external account imbalance

Economic recovery for the country's four main trading partners (United States, El Salvador, Honduras, Mexico) will be conducive to a surge in exports, currently supported by various free-trade agreements (CAFTA/DR, with Chile, Panama). However, the rise in imports will be higher than that of exports, owing to the higher cost of oil and an increase in input for assembly units (maquiladoras). Combined with the modest recovery in remittances and tourism income, it is likely to result in an increase in the trade and current account deficits in 2010. Discounted foreign direct investment flows should enable about half of external financing needs to be covered, with the remainder covered by official aid and foreign reserves establishing themselves at correct levels. As for the banking system, it stood up well against the shock and banking supervision was strengthened further in 2009.

Some legislative advances despite reduced room for manoeuvre

The centre-left president Avaro Colom, in power until 2011, has seen his political room for manoeuvre reduced as his Unidad Nacional de la Esperanza party is in the minority in Congress. This will hamper progress with indispensable reforms. Nonetheless, during 2009, agreements were made with other parties aimed at improving legislation regarding security and the judicial and banking systems.

Peru

Upgraded from B to B⁺

reflecting the dynamic recovery of the activity

Very strong return to growth

Growth will rebound quite strongly in 2010, in line with the expansion in Asia and Brazil and with the recovery in the U.S., after a deceleration in 2009 due to the international crisis. Economic activity will also be driven by the rebound in household consumption, linked to the reduction of unemployment, by business investment, mainly in mining, as well as by public spending in social programmes, public works and water sanitation.

Robust public finances

Measures to boost the economy via a counter-cyclical fiscal policy, led to a deficit in 2009, which should, however, decline in 2010, despite new fiscal stimulus measures ahead of the regional elections in October 2010 and the presidential and legislative elections in April 2011. The government remains committed to a programme of reforms in relation with the IMF and the public debt ratio represents only a quarter of GDP, although the part denominated in foreign currencies remains substantial. In general, public finances are healthy; Peru has accumulated a fiscal stabilisation fund of \$3 billion.

Small current account deficit but external position satisfactory

After the dip in 2009, exports should benefit in 2010 from stronger demand from Asia, especially sales of ores and also fish to China, now the country's second trading partner behind the US. After the signing of a free trade agreement with the US in 2007, a new commercial agreement with China has come into force at the beginning of 2010. Other agreements were concluded with the EU, Canada and Singapore, and negotiations are under way with Mexico, Japan and South Korea. The recovery will nevertheless cause

imports to rise even faster, especially of heavy equipment. A slow increase in remittances from expatriates and in tourist revenues, combined with a rise in transport costs and in profits repatriation by foreign-owned companies, should spell a slight decline of the current account deficit, entirely covered, however, by foreign direct investment flows.

Moreover, repayments ahead of schedule of debt due to the "Paris Club" public creditors have contributed to reducing external debt and related service costs, so that debt ratios equal the best of the region. Also, a high level of foreign exchange reserves reduces the risk of a liquidity crunch and should contribute to the stability of the nuevo sol in 2010. Besides, the banking system remains sound, despite a significant dollarisation.

Socio-political tensions persist

President Alan Garcia can not constitutionally stand in April 2011 and could seek to promote a moderate candidate. In the meantime, the President still faces serious socio-political problems, as popular discontent continues to be fuelled by problems related to implementing public programmes, by corruption and by opposition from the indigenous groups to government investment projects in regions with mining and energy resources.

Satisfactory payments experience

The mining and gas sector is the most successful one along with fishing, whereas the textile and garment industry is suffering from competition from Asia. Accordingly, Coface's experience of payments from the private sector should remain satisfactory, despite the poor quality of the country's institutions and the business environment.

Dominican Republic

Withdrawal of the negative watch on the rating B

reflecting the acceleration of the economic growth

Accelerating GDP growth

The pace of growth has been accelerating, after remaining fairly sustained in 2009 despite the recession in the United States, the country's first trading partner (two thirds of exports and main source of expatriate remittances). The main drivers of economic activity are the public expenditure, private consumption - supported by transfers-and tourism. GDP growth will continue, however, to be hampered by an inefficient public sector, due to excessive red tape and corruption problems. This is reflected particularly by electricity shortages, which are a major obstacle to investment.

Crucial IMF support

Owing to the 28-month stand-by arrangement concluded with the IMF in October 2009, for a loan of \$1.7 bn, the State is unlikely to experience too many difficulties in covering its financing needs in 2010 and in 2011, even if the position of the public finances is improving only gradually. Moreover, the challenge of fiscal consolidation can only be tackled with improved efficiency of tax collection and once the problems in the electricity sector have been resolved.

Purchases of oil at a higher cost, still weigh heavily on external accounts and the increase in imports must be greater than exports, coming mainly from mining and agricultural sectors, as well as assembly units. In addition, tourism receipts and expatriate remittances,

slightly increasing, will not offset the rising cost of freight and insurance. As a result, the current account deficit should worsen in 2010. Support from the IMF should, however, facilitate access to international markets to cover a portion of external financing needs, with the remaining needs covered by foreign investment flows directed mainly towards the mining, tourism and communications sectors. IMF intervention, supplemented by assistance from the World Bank and the Inter American Development Bank, is also likely to limit the external debt overhang and reduce the risk of a liquidity crisis, which is rather high on account of insufficient foreign exchange reserves and the vulnerability of the peso;

Slow socio-economic progress

The Partido de la Liberacion Dominicana (center) of President Leonel Fernández won largely the mid-term elections in May 2010, with 31 of the 32 Senate seats and 105 of the 178 seats in the Chamber of Deputies. In this context, a constitutional amendment could be introduced to enable the President Fernandez to represent a fourth time in 2012. In any event, the process of economic and social reform may remain slow, while a significant fraction of the population remains affected by poverty, which maintains social tensions and insecurity.

Uruguay

Upgraded from B to B⁺

reflecting the sharp rebound of the economic growth

A growth rebound with inflation still high

GDP growth is expected to gain strength in 2010, after remaining quite robust in 2009, owing notably to the construction of a new wood pulp factory, amid the global economic crisis. The economy will be underpinned by household consumption, thanks to wage increases, and private investment, notably foreign. The economy will also benefit from improved productivity and a more buoyant international environment.

Despite a less relaxed monetary policy, inflation will persist (around 7%) due to the pressure exerted by domestic demand, the rise of world raw material prices and the likely slight depreciation of the exchange rate.

Return to prudent fiscal policy

After the fiscal stimulus measures adopted in 2009, justified by the need to cushion the effects of the crisis, the government led by the new president, Jose Mujica, will have to return to prudent fiscal policy intended to reduce the public debt burden (60% of GDP, mainly in US dollar). A mandatory balanced-budget rule could thus be adopted in the future. Meanwhile, the economic recovery is expected to make it easier to keep electoral promises as regards social spending (education, health) and support for small and medium sized enterprises, via tax incentives and micro credit.

Slight deterioration of external accounts

After the decline in foreign demand that marked 2009, exacerbated by the drought that affected agriculture and livestock breeding, exports will benefit from the rise in world prices for farm products and the growing needs of the main trading partners - Brazil, United States, and Argentina - and from the growth of cellulose and wood pulp sales. But imports will surge even

more, due mainly to the rise of oil prices with the country remaining dependent on hydrocarbon purchases (a quarter of total imports). The services balance will likely benefit from increased tourism, but the income balance will be affected by dividend repatriation by foreign companies. These trends will only partially offset the deterioration of the trade balance and, overall, a current account deficit is expected.

Foreign direct investment inflows should, however, cover a large proportion of that deficit, notably with a new project of pulp and paper mill by a consortium of Swedish and Chilean firms, and allow foreign exchange reserves to remain at a very comfortable level. Moreover, the banking system is relatively strong, with adequate capitalization and liquidity, but its continued de-dollarization is necessary.

Political continuity characterised by moderation

The new president, José Mujica, in office since March 2010, belongs to the same centre-left party, the Frente Amplio, as the outgoing president, Tabare Vazquez. Backed by a small parliamentary majority resulting from the elections held late 2009 and faced with the task of reconciling the pragmatic and radical wings of the government coalition, Jose Mujica is expected to follow essentially the same moderate economic and social policy as his predecessor.

Ecuador

Withdrawal of the negative watch on the rating C

reflecting the soft economic recovery

Modest economic recovery in 2010

After a contraction of activity in 2009, due to weak private consumption and investment, as well as a decline in oil production, the economy will get off to a soft start in 2010. Public spending and a slight rebound in oil exports will support growth. In contrast, household consumption will be held in check by high levels of unemployment and low increase in expatriate remittances. Company investments will continue to be affected by the mistrust of government policy.

Worsening public accounts, although limited external accounts surpluses

A still significant budget deficit is forecast in 2010, with social spending and investment in public infrastructures largely exceeding revenue, hit by the drop in oil production since 2008.

In a more favourable international environment, oil exports should benefit from higher prices but sales of other goods abroad will suffer, in particular, from a lack of investment. However, the Andean Trade Promotion and Drug-Eradication Act (ATPDEA), which allows preferential access to the US market, the country's N° 1 trading partner (destination of over half of its exports), has been extended until the end of 2010, and there

should be a slight trade balance surplus. It should offset the low increase in remittances from emigrants living in the United States and Spain, as well as the repatriation of dividends by foreign companies, and will result in a modest current account surplus. Given the fall in foreign direct investment, part of the external financing needs should be covered by loans from multilateral regional institutions (IADB, CAF) and "friendly" countries (China, Venezuela).

President's dwindling popularity

The new Constitution of September 2008 set out increased presidential powers and permitted state intervention in "strategic" sectors (energy, mining, telecommunications, banking). However, after the April 2009 early general election, the (anti-liberal left) Alianza Pais movement led by President Rafael Correa has only a relative parliamentary majority. The necessity of finding an accommodation with the other parties does not make for easy governability. On top of this, the president's popularity has been dented by rising popular discontent, including the left as well as indigenous groups, caused by unemployment, insecurity and unfulfilled promises.

Bolivia

Upgraded from D to D⁺

reflecting the continuation of a sustained economic recovery

Accelerating GDP growth

Economic growth is expected to accelerate in 2010, after holding up well in the global economic slump in 2009, thanks largely to public spending and a robust informal economy. GDP growth is driven by household consumption, underpinned by welfare programmes, and an increase, albeit modest, of workers remittances. The economy is benefitting also from continuation of expansionary fiscal policy, financed by hydrocarbon revenues. Except from a buoyant construction sector, private investment will recover only gradually, as it remains affected by state interventionism and an unsatisfactory business environment. Inflation, meanwhile, is not expected to exceed 2%, owing to low food products prices and a strong exchange rate.

Continuing state interventionism

The development model providing for increased state intervention in the economy is stipulated in the new constitution. After the nationalisation of the gas sector end 2006 and the main telecommunications operator in May 2008, a mining company, a subsidiary of a Swiss firm Glencore, as well as four electricity companies, including Corani controlled by France's GDF Suez, have been nationalised in May 2010. The Morales administration also wishes to create state-run companies in the cement, paper, dairy, and pharmaceuticals sectors. It also wants to see development in the iron and lithium areas, to be in a position to export additional enhanced products. Applying that policy is nonetheless remaining complicated by the lack of local skilled labour and, without help from abroad, the government is likely to meet with difficulties in managing the state-owned enterprises.

A still significant current account surplus

The recovery of the global economy will spur an upturn in exports, particularly natural gas to Brazil (the main market for this product) and ores to Asia. This upturn is limited, however, by the loss of preferential access to the United States market under the Andean Trade Promotion and Drug Eradication Act. Suspended end 2008 for "non-cooperation in combating narcotics trafficking", the preferential access was then cancelled in June 2009 by the Obama administration. Imports will rebound due mainly to the rise of world energy prices. The recovery of emigrant remittances (mainly from Spain) will be gradual, however, with services and invisibles remaining slightly in deficit. Finally, there will be a still significant current account surplus.

Although a part of external debt has been cancelled and foreign exchange reserves are expected to remain at very high levels, the poorest South American country's relations with international creditors and international financial institutions will continue to be strained, due to the radicalism of Bolivian authorities.

President Morales' position consolidated

The new Constitution ratified in February 2009 - providing in particular for a second presidential term and autonomy for both indigenous Bolivians and the rich Eastern regions still under opposition leadership - paved the way for President Evo Morales' easy re-election in December 2009. And his position has been consolidated by the victory of his party, the Movimiento al Socialismo, in Congress, facilitated by the divisions in the ranks of the conservative opposition. Reforms intended to increase welfare assistance and strengthen the government's role in the economy are thus expected to go forward. President Morales' second term in office could nonetheless be tempered by some degree of pragmatism.

Middle East & North Africa

A soft recovery

Middle East & North Africa

A modest recovery underpinned by a foreign demand rebound and expansionary policies.

The region's growth forecasts for 2010 have been revised slightly upwards from 3.8% to 4% compared to 1.6% in 2009. The recovery has been gradual in regional countries, driven by both an acceleration of exports attributable to more buoyant foreign demand and by the recovery of hydrocarbon prices, up an estimated 25% from 2009 levels. Emigrant worker remittances and tourism have also been improving. Most governments have moreover been pursuing expansionary policies to support growth. At the onset of the crisis the region's economies were in a position of strength having benefited directly or indirectly from the boom in oil prices in past years. While hydrocarbon exporting countries are in general financially strong, the expansionary policies have undermined public finances in other regional countries, burdened by fiscal deficits and high public debt.

The oil-producing economies are gradually emerging from the crisis, which directly affected them in 2009 through the tightening of financing conditions abroad, the decline in world demand for hydrocarbons, and the fall of barrel prices. Despite the anxieties coming from the euro zone, the resurgence of foreign demand for hydrocarbons, boosted in particular by the Chinese market, in conjunction with the rise of barrel prices have spurred the economic recovery benefiting companies in 2010. **Qatar** will doubtless show the best performance with 18.5% growth expected as a result of an increase in liquid gas production. In **Saudi Arabia** the largest regional eco-

nomically, growth has increased from 3.2% to 3.6% compared to 0.1% in 2009. An improved trend on oil revenues has provided support for largely expansionary policy that benefits the non-oil sector through large infrastructure projects. After the increase in public sector wages in 2009, retailing has benefited from the improvement in the confidence of households, which have been saving less and spending more. In the **United Arab Emirates** growth has also been revised upwards: 1.3% instead of 0.6% compared to a 0.7% decline in 2009. Abu Dhabi, with its economy driven by public infrastructure spending and the recovery of oil production, remains the growth driver. Dubai will still be in recession this year (down 0.5%), however, with growth undermined by excessive debt and a prolonged decline in the property and construction sectors.

The banking systems in the Gulf States, well capitalised and profitable, were largely supported in 2009 by their governments. But in the **United Arab Emirates, Kuwait** and **Bahrain** in particular, they were affected by the decline in property, slowdown in the economy, debt crisis in Dubai, and bankruptcies of two large Saudi groups, Saad and Gosabi, and payment defaults by Kuwaiti investment companies. And uncertainties over the quasi sovereign buyers after the moratorium requested by Dubai World have prompted banks to exercise greater caution. In this context, with banks remaining skittish, lending has been slow to recover, penalising private investment and household consumption.

In **Iran**, growth of around 3% is expected. Fiscal expansionism has been impeded by the stagnation of hydrocarbon production attributable to a lack of investment. And household consumption has suffered amid high inflation exceeding 8%. With new UN sanctions just imposed on the Islamic Republic, its isolation continues to undermine investments and the development of its oil and gas production capacity. **Algeria** continues its policy of supporting growth through public spending with a new \$280 billion public investment programme for the 2010/2014 period. Although 4.6% growth is still expected, it could be affected, however, by weaker-than-expected European demand for gas. Restrictive policies on imports have moreover had a depressing effect on business activity and household consumption.

Oil-importing countries, in general less directly affected by the crisis, are also benefiting from a recovery in foreign demand and foreign direct investment.

In these countries there has in general been a recovery in tourism, remittances from emigrant workers (especially in the Gulf countries), and direct foreign investment

since the second half of 2009. Moreover, in **Egypt**, **Morocco** and **Tunisia** fiscal stimulus and public investment policies continue to spur domestic demand. Growth is expected to remain around 5% in Egypt. Construction has been in the throes of a strong expansion. Manufacturing and services (shops, financial services, and services linked to tourism) have also maintained strong growth. Growth in Morocco and Tunisia is estimated at 3.3% and 4.0% respectively. **Jordan's** growth, estimated at 3.5%, will be largely below the rates maintained in- pre-crisis years. The collapse of the construction boom and the pursuit of tight fiscal policy have affected economic activity. **Israel**, one of the largest economies to take off again in 2009, could achieve growth estimated at 3.8%. The country has benefited from an improved foreign demand trend but with its heavy dependence on export revenues it could be affected by the crisis in the euro zone.

Rating changes

United Arab Emirates (country rating A3)

Business climate: Downgraded from A3 to A3↓

reflecting the lack of corporate transparency and the uncertainties concerning their status.

As a reminder, the country @ rating has been downgraded from A2 to A3 because of the request for a moratorium of Dubai World in November 2009 on debt of over \$ 20bn.

Upturn in oil prices helping steady recovery in 2010

The global crisis has gripped the Emirates since July 2008 causing capital to take flight, financial markets to dry up, global demand for hydrocarbons to slump and oil prices to fall. Investor confidence collapsed and the speculative property bubble burst, mainly in Dubai.

In 2009, the drop in oil production in conjunction with a sharp downturn in the non-oil sector, given significant number of projects placed on hold or cancelled in Dubai, plunged the economy into recession. However, measures taken by the authorities including a fiscal stimulus and support for credit limited the deceleration in non-oil activity. Abu Dhabi achieved a positive growth in contrast to Dubai given the collapse of real estate prices and the slump in construction. A slight recovery is likely in 2010. A gradual emergence from the crisis at the global level is expected to spur a moderate increase in oil production, an upturn in barrel prices and improvement in consumer and investor confidence. But Dubai battered construction and property sectors remain a drag on growth.

But Dubai construction and property sectors in turmoil.

With high debt, public companies in Dubai were severely affected by the financial crisis and bursting of the speculative property bubble. Payment defaults have accelerated. Many projects have been put on hold. As there is no sovereign guarantee on the debt of Dubai World, a failure of the debt restructuring that is required could lead

to bankruptcies. The difficulties of real estate could spread to other sectors whose expansion was linked to its development. The request for a moratorium of Dubai World in November 2009 on debt of over \$ 20bn has highlighted the uncertain nature of the quality of quasi-sovereign debt buyers. The outcome of the rescheduling of Dubai World will reassure the markets, but further restructuring of debt can not be excluded. The lack of transparency of public companies regarding their status and their accounts undermines the business environment.

The banking system has extensive exposure in property, which has resulted in deterioration of its asset quality and profitability. Systemic risk will likely remain limited with the support pledged by the federal authorities. Banks will nonetheless remain cautious.

A strong system given Abu Dhabi's sponsorship.

On a consolidated basis, including Abu Dhabi and Dubai, the public sector surplus shrank and the current account balance posted a deficit. An upturn in oil prices is expected to boost twin surplus in 2010. Foreign debt has increased sharply in recent years mainly as a result of borrowing by public institutions in Dubai. At the UAE level, default risk on the sovereign debt is limited as they are in a net creditor position thanks to the Abu Dhabi sovereign fund. But given Dubai overindebtedness, Abu Dhabi financial support is necessary but it will be selective and subject to conditions. This could lead to greater concentration of power in Abu Dhabi.

Algeria (country rating A4)

Business climate : Downgraded from B to B ↘

reflecting the restrictive measures concerning imports and foreign direct investments.

Growth underpinned by public spending

The global crisis has affected the Algerian economy via the trade channel resulting in a contraction of demand of hydrocarbons and the fall of barrel prices starting in the 2008 second half.

Economic growth was thus limited in 2009 by the decline in oil production, which had to be adjusted to foreign demand and OPEC quotas. Activity in the non-oil sector was dynamic, however, particularly in construction and public works, spurred by counter-cyclical policy. Despite the drop in oil production, oil revenues put into reserves in past years in the Revenue Regulation Fund (RRF) have enabled the government to pursue a vast public investment programme in infrastructure and housing. After the poor farm season in 2008, excellent harvests also contributed to the growth. But measures taken to limit imports have affected activity in the private sector and employment. And the banning of consumer credit has dampened household consumption.

The recovery in 2010 is driven by the rebound in hydrocarbon production which adjusts to a gradual increase in external demand. It could however suffer from a weaker than expected European demand. Activity in the non-oil sector is expected to grow at a respectable pace underpinned by public spending.

Capacity to withstand a decline in oil revenues

With falling oil revenues and expansionary policy, the public sector posted a deficit in 2009. With public spending continuing to support growth in 2010, the public finance will remain in deficit, despite an upturn in oil prices. But, barring lasting collapse of prices, the RRF reserves are expected to suffice to cover financing needs. Algeria moreover has very limited public sector debt, which provides it with some room for manoeuvre. Despite the fall of exports, the external financial position remains solid. An active policy to reduce foreign debt with a prohibition on companies borrowing abroad and early repayment of the rescheduled debt has brought the corresponding ratios to very low levels.

Political stability but increased protectionism prejudicial to the business environment

The political context is characterised by continuity since President Bouteflika's re-election in April last year. The security situation has improved. Sporadic attacks by the Al Qaeda radical Islamist group remain nonetheless possible and could have a destabilising effect, albeit limited, on economic activity and investment. In the economic policy arena, the adoption since 2009 of stronger protectionist measures on foreign direct investment and imports is prejudicial to the business environment in the near term and economic development in the longer term. The measures involving import restrictions could result in higher costs and longer supplies delay for companies.



Sub-Saharan Africa

Activity
should rebound

Sub-Saharan Africa

After managing just 1% growth in 2009, the regional economy is expected to rebound to 4.9% in 2010, a level nonetheless below the pre-crisis growth rate of 6% recorded for the 2003-2007 period. Growth will likely be spurred by the rebound of raw material prices, the continuation of counter-cyclical policies, as well as by the recovery of private financing flows, which actually held up well during the crisis. But the recovery is jeopardised by risks associated with the volatility of raw material prices and the political developments in some regional countries [Côte d'Ivoire, Nigeria, South Africa].

After recording no growth in 2009, **Angola (rated C)**, the continent's second ranking oil producer, will likely achieve stronger growth, up 8%, albeit below the 19% average registered in the catch-up years from 2005 to 2008. The increase in oil production made possible by the easing of OPEC guidelines, the rise of hydrocarbon prices, and the ongoing flow of public investment spending are expected to spur growth. Although **Nigeria (rated D)**, the continent's leading oil producer, is also expected to benefit from the rebound of prices, the Niger delta insurrection will continue to constrain the level of production. Farm sector dynamism and continued public spending will drive growth above 5%. In the political arena, interim President Jonathan Godluck, a southerner born in the Delta region, appointed after the death of President Umar Yar'Adua in May 2010, will likely be able to capitalise on progress achieved via the July 2009 amnesty, which paved the way for integrating many Delta rebels into the peace process. He will nonetheless have to consolidate his legitimacy within his own party, the People's Democratic Party, which is getting ready to choose its candidate for the 2011 presidential elections. According to an implicit rule, the candidate must be a native of the country's northern region, which is not the case for Jonathan Godluck. In this context, increased political instability cannot be ruled out.

Lacking diversification, the African economies that suffered from the last year's decline in world prices for **their main export products** [diamonds for **Botswana** (downgraded to **A4** in June 2009) and **Namibia (A3)** or coltan for the **DRC (D)**] are expected to resume growth at levels exceeding 4%. The mine prospecting and production sectors — profitable again thanks to the upturn of prices — will doubtless attract increasing foreign direct investment flows [DRC, **Zambia**, **Uganda (rated C)**]. These countries will also remain dynamic in both telecommunications [as will **Niger**, **Ethiopia (rated C)**] and agriculture [along with **Mozambique (B-)** and **Mali (C)**]. **Ghana (C-)** on the verge of becoming Africa's seventh-ranked oil producer by 2011 will record growth above 5%, buoyed by investment in oil, rising gold production, and farm sector dynamism. Currently trending up, **private transfers** have proven very resilient to the crisis and are expected to continue to underpin household consumption across Africa where they represent as much as 30% of goods and services exports [**Senegal (B-)** and **Togo (C-)**]. And **increased financial support from the IMF and World Bank** via the raising of drawing rights and the doubling of grant packages will likely continue to facilitate **covering financing needs** that have remained high due to the growth of spending on imports.

Governance deficiencies will continue to affect the business environment, as in **Senegal** where the government's payment arrears with the private sector — although discharged in 2009 with the help of financial backers — continue to undermine corporate financial health. The upsurge of political risk, significant since 2008, will be likely to continue in 2010. After several years of stability marked by the end of major conflicts [Angola, DRC, **Sierra Leone (D)**, **Liberia (D)**, **Rwanda (D)**] and the progress made on governance [Ghana, Namibia], the coups that hit **Mauritania (C)** in August 2008 (**business environment downgraded to D in June 2010**),

Guinea (D) in December 2008, **Madagascar (C)** in January 2009), and **Niger (C-)** underscored the weakness of the democratic processes initiated in Africa. And elections remain critical junctures that can destabilise socio-political equilibrium exemplified by the turmoil that marred the voting process in **Gabon (B)** in September 2009, the re-emergence of violence in **Uganda (C-)** in the run-up to elections in 2011 or the risk of resurgence of the civil war in **Sudan (D-)** associated with the elections schedules this year.

The negative outlook has been maintained on the A3 rating for South Africa (33% of sub-Saharan African GDP). After emerging from recession in the 2009 third quarter, the South African economy is expected to grow about 3%, a rate well below the 5% average for the 2003-2008 with household consumption (64% of GDP) likely to remain sluggish amid continuing high unemployment, up slightly from 23% to 24% in the crisis reflecting the elimination of 900,000 jobs. The increase in the price of electricity (up 25%) will doubtless also squeeze disposable income. And the Central Bank, which has already cut its key rate by 550 bps to 6,5% between December 2008 and March 2010, will have little leeway for further rate cuts amid persistent upward pressure

on prices. In this context, companies will only be likely to rebuild their stocks very gradually especially with production capacity largely underutilised. Export sectors (automotive vehicles) will suffer from strengthening of the rand. Despite the growth of platinum exports and the likely increase in tourist revenues spurred by the World Cup, and exports will moreover make a negative contribution to growth as a result of the rebound of imports. Government spending has increased by 5% and will likely remain the primary growth engine. The crisis has moreover exacerbated South Africa's structural weaknesses. The persistent energy shortage attributable to a lack of investment has impeded a stronger production recovery. The financing of the large current account deficit, widened by the recovery, continues to depend mainly on volatile flows, vulnerable to a crisis of investor confidence. And the risk of social unrest remains significant amid high unemployment, particularly among the black population, and with the provision of quality public services (transport, water, electricity) still deficient. Jacob Zuma's inability to respond to the great hopes inspired by his election has increased the risks of urban uprisings. These uncertainties could affect corporate payment behaviour.

Rating change

Mauritania (countryrating C)

Business climate : Downgraded from C to D

Reflecting the insufficient protection of the creditor rights, whereas the public power is interfering in the application of court decisions.

Fragile business climate despite return to constitutional order. Persistence of terrorist threat

The election in July 2009 of Mahomet Ould Abdel Aziz as head of state brought about a return of

constitutional order to Mauritania following the military coup of August 2008. This coup had marked the end of the first experience of democratic transition, which had been ongoing since March 2007.

The return to constitutional order was made possible by the pressure exercised by the main international financial backers (EU, United Nations) but by also the regional bodies (African Union, Islamic Conference Organisation). However, the Inter-Mauritian accord of June 2009, which enabled the return to constitutional order, is still fragile. There are significant social challenges, especially in the urban areas. In addition, business climate is all the more so fragile as the public power is interfering in the application of court decisions. The terrorist threat, which particularly affects foreign interests in Mauritius, is hampering the country's development.

Erratic oil production

In 2009, economic activity suffered from the downturn in world prices for minerals and hydrocarbons, as well as from the negative impact of the coup d'état and terrorist attacks on revenues from tourism, on FDI and the flow of international aid. In 2010 the rebound will be moderate. Delays in onshore oil explorations, particularly in the Taoudeni desert region, in the Northeast of the country will have an impact on the country's production capacity. Moreover, the only oil field in activity, the Chinguetti offshore oilfield will continue to face technical problems. In this context, the level of production will reach a ceiling of 18,000 barrels a day compared with an original objective of 75,000. The development of the tourism sector is expected to remain fairly dull in a context of persistent terrorist threats. Activity will however be supported by public sector investments in transport and water distribution infrastructures (the Nouakchott road, which links Tangiers to Dakar, the Nouakchott international airport, rehabilitation of the Nouadhibou mineral port), financed by international aid. Agriculture (13% of GDP) will continue to show rising productivity thanks to the increased use of fertilisers, even though the objective of ensuring self-sufficiency in food by 2012 seems somewhat unrealistic. Similarly, fishing (15% of GDP) is expected to prove dynamic. Mining will benefit, for its part, from the revival of exploration for base

metals (copper) and precious metals. The National Industrial and Mining Company of Mauritania, the SNIM, is naturally counting on the exploitation of new deposits in the Zouderat region, to increase iron production by 10% (33% of exports in 2010).

Resumption of international aid

The holding of the elections in July 2009 following the October 2008 coup d'état made possible the resumption of international aid flows. The Mauritanian state benefited in 2009 from financial aid of \$83m from the IMF. The IMF's PRGF programme, begun in 2006 and interrupted in October 2008, but started again in March 2010 and was prolonged until 2013. Similarly, in 2009 the World Bank released \$14m for infrastructure expenditure. Mauritania, which had benefited from substantial write-offs of its external debt in 2006 in the framework of the HIPC and MDRI debt relief programmes, remains very dependent on international aid. All in all, Mauritania secured aid pledges totalling more than 3 bn \$ at a late June meeting with donors, notably from Middle East countries. This amounts to 20% of GDP and to 90% of public sector investment in a context where the attractiveness of the country for FDI remains slight. However, China, the country's main commercial partner, intends to increase its investment efforts, in particular in mining and oil.



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