



Trade Credit & Political Risk Insurance

Major Country Developments May 2012

Overview

Global growth prospects have weakened in recent weeks. This is reflected in lower demand for crude from Asian countries which has weighed on oil prices in recent weeks. Reports that imports of Iranian crude by major Asian importers would decline in the coming months also played a role in keeping oil prices down. Saudi Arabia is reportedly pumping close to its historic highest daily levels of crude (10 million barrels), while storing 80 million barrels in case of any disruption in supplies.

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In the US, slow employment growth and lackluster manufacturing activity reaffirmed that the economic recovery remains weak. There were also reports of a slowdown in the all-important services sector of the US economy in April. It's been stressed that the path to a sustainable recovery cannot lie in restoring irresponsible and unaffordable pre-crisis spending, which previously had the side effect of creating unsustainable jobs in finance, construction and elsewhere. Sensible policy choices will emphasize improving the capabilities of the workforce across the country so that they can get sustainable jobs with steady incomes. On a positive note, there has been progress over several months on the US trade front. U.S. exports increased by 11% in 2010 and 6.5% in 2011 and this trend continued into

2012. Also, household debt in the US is coming down via a combination of repayments and debt write-offs.

The euro-zone remains in recession and faces significant political changes, which will challenge many of the assumptions used in recent debt negotiations and agreements. Renewed concerns over the health and direction of the euro-zone coincide with weaker growth elsewhere.

Meanwhile, China's growth is cooling rapidly. China's factory activity was down for the sixth consecutive month in April. This trend is beginning to drag noticeably on employment as companies are shedding jobs at the fastest pace in 37 months. Manufacturers are also reporting weakness in underlying demand.

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In India, a spate of recent weak economic data has caused the Indian currency, the rupee, to weaken to 5-month lows. Fitch reported that the country's private sector banks will need recapitalization to the tune of \$56 billion if they are to become compliant with Basel III rules.

The triple whammy of slowing growth in emerging markets, low-to-negative growth in developed markets, and growing political uncertainty in the euro-zone, has damaged investor confidence and points towards slower global growth ahead.



China

In China, the slowdown in economic growth will continue. While demand for items used in infrastructure upgrades, manufacturing autos and rail development are still growing, they are doing so more slowly. That's because China is transitioning to both lower growth and a different path to continued growth. China is coming to the end of what is called "extensive growth" driven by rising inputs of labor and capital. It must now move to "intensive growth" driven by improving skills and technology. Among other consequences, China's rate of growth will slow sharply from its average annual rate of close to 10% during the past three decades.

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The era of cheap labor in China has come to an end. Labor costs have risen steadily at double digits rates over the past decade in the major manufacturing centers located on China's coasts. More recently, workers in the interior have demanded and are receiving huge pay increases. China is no longer a place where manufacturers have access to ultra cheap workers. Labor in other countries such as Cambodia, Vietnam and Bangladesh is much cheaper.

However, contrary to conventional wisdom, it will not mean that companies suddenly close their Chinese factories and rush to these cheaper locations. China still has advantages even if labor isn't cheap. Unlike lower-paying rival countries, China has reasonable infrastructure, sophisticated

supply chains and the advantage of scale. When demand surges for a particular product, the biggest firms in China can add thousands of extra workers to a production line in matter of hours.

While China will not "hollow out", if it is to keep growing fast, it must become more innovative. Its leaders are referring to this as "indigenous innovation", which the government thinks it can foster by subsidizing strategic industries and by strong-arming foreign firms to transfer intellectual property to budding state companies. However, while the system of state capitalism worked when the aim was to copy western ideas in the cheapest ways possible, the state is not a good innovator and gets in the way of those who are. China needs a less top-down approach that gives its citizens more space to experiment. It must let private investors risk money on ideas they think might work, and let them bear the consequences of failure.

Vietnam

Consumer confidence in Vietnam dipped to its lowest level since the third quarter of 2010, as concerns over the economic situation continue. The consumer confidence index has fallen five points since the first quarter 2012. 75% of Vietnamese consumers believe that the next 12 months will not be a good time to make purchases and 69% consider saving spare cash as the top priority for their households over the next 12 months. Only 49% of consumers are confident that their personal finances will be good by this time next year.

Vietnam's inflation slowed for the eighth consecutive month in April, after hitting a three-year high in August, 2011. Consumer prices climbed by 10.4% year on year, with the rise of food and foodstuff prices decreasing to 11.5% year on year vs. an



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increase of 17.6% a month earlier. Growth in transport prices slowed to 8.1% from 11.7% previously.

Vietnam's meager foreign exchange reserves mean that the State Bank Vietnam will not be able to counteract downward pressure on the dong by intervening in the currency markets. The dong is expected to drift lower over the course of the year as persistent inflation saps confidence in the currency. As inflation slows and exports expand in the medium term, the dong should perform better against the US dollar in future years.

It is not expected that the authorities will make much progress in reducing Vietnam's large fiscal deficit over the next few years. The deficit shrank to an estimated 4.8% of GDP in 2011, partly reflecting the government's success in reducing public spending. However, the budget deficit will likely widen in 2012 and stay high for several years due to the expectation of increases in spending to support economic growth.

Australia

The economy is forecast to grow by 2.6% in 2012-13 and 2.5% in 2013-14, outperforming most of the developed world. Demand from Asia is expected to continue to support historically high commodity prices while driving record levels of investment in resource-related projects in Australia. This should allow the country's solid export volumes to continue and allow for the continued recovery from the devastating floods of late 2010 and early 2011.

Nonetheless, the Australian economy is looking like it could gradually fall from superstar status. Recent housing data point to a long-awaited burst in the "bubble", and the sitting government is unpopular

and is expected to lose the parliamentary elections due in 2013. The Australian dollar has appreciated by 70% since 2008, choking manufactured exports and stifling tourism. With ongoing consumer caution and changes expected in expenditure patterns, which could weigh heavily on the non-mining sectors of the economy, the outlook has become uncertain. Against this background, the central bank has cut interest rates and sharply revised its outlook for the economy.

Still, the country's global ranking for doing business improved to fourth place from sixth a year ago. Further, the forecast is for Australia's business environment to improve over the coming three years due to infrastructure enhancements.

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FCIA's Deals Of The Month

Multibuyer Policy: \$14,000,000 Limit of Liability on Named Buyer Policy supporting sales to retailers, USA

Facultative Reinsurance Policy: \$5,000,000 Limit of Liability on reinsurance of another insurer - electronics sector, Netherlands