



AFRICA

Botswana: ruling Botswana Democratic Party (BDP) wins elections

- > **Event:** In October, the 10th general elections were held since the country became independent in 1966. The ruling BDP won 45 of the 57 parliamentary seats on offer, surpassing the 44 seats won during the previous elections in 2004. The BDP's landslide victory has enabled President Ian Khama to prolong his presidency, with the president already having presented his new cabinet team. There has been a cabinet reshuffle but overall the elections have insured continuity.
- > **Impact on country risk:** President Ian Khama has successfully confirmed his leadership and now faces the more challenging task of kick-starting Botswana's economy. The drop in global demand for commodities and the accompanying fall in diamond prices have hit a diamond sector crucial for the economy. Foreign exchange as well as fiscal revenues have declined sharply and GDP is set to contract with 10% this year. The country has stepped up international lending to finance the budget deficit and a number of large-scale energy projects. There is obviously a need to diversify the economy and reduce reliance on the diamond sector. So, despite the democratic stability the country risk has increased due to economic setbacks. (**analyst:** Inge Lambrechts, i.lambrechts@ondd.be)

Sudan: US has confirmed sanctions against Sudan despite new US policy of engagement

- > **Event:** US president Obama favours a dual approach to persuade the government of Sudan to implement the 2005 peace deal between North and South Sudan. He has suggested a new US policy of engagement but recently also renewed sanctions because Sudanese policies still posed a threat to US national security and foreign policy.
- > **Impact on country risk:** Tensions between North and oil-rich South have been mounting in the run-up to a referendum after which South Sudan could claim independence. China is considering financing infrastructural projects which would allow exporting South Sudan's oil through Kenya. If the projects went ahead, the relations between Kenya and Sudan could be further strained. Sudan's oil reserves are appealing but the political and security situation remain an obstacle to the development of Sudan's potential. (**analyst:** Inge Lambrechts, i.lambrechts@ondd.be)

ASIA

China: economic expansion accelerates in Q3

- > **Event:** The third quarter has confirmed the acceleration of the Chinese economy as it grew by 8.9% year-on-year (+7.9% y/y in Q2). As a consequence, the government annual target of 8% growth should be within reach by the end of the year. While the rate of decline in exports continues to drop, having allowed millions of migrant workers to find new jobs over the past few months, rapid economic growth remains principally fuelled by massive public spending and bank lending. In an effort to limit the number of low-quality and useless projects, authorities have ordered state-owned banks to reduce lending to six important industries which face overcapacity.
- > **Impact on country risk:** China has had a quick recovery from the crisis. However, Chinese authorities will gradually have to put restraints on the huge stimulus package (USD 585bn), tighten

bank lending (over USD 1.250bn since January 2009) and monetary conditions, probably in the first quarter of 2010. A shift in policy is necessary to prevent further overcapacity issues, reduce the risk of asset price bubbles (real estate and equities) and limit the rise in banks' bad loans. Current over-reliance on investments in infrastructure and loose credit from state-owned banks are not sustainable. Sooner or later, expanding the share of domestic consumption in economic growth, together with progressive renminbi appreciation will be needed. (**analyst:** Raphaël Cecchi, r.cecchi@ondd.be)

Pakistan: new wave of violence as military seeks control of South Waziristan

- > **Event:** Coordinated militant attacks in, among others, Islamabad, Peshawar, Rawalpindi and the Swat valley are multiplying, demonstrating the strength of the Taliban's network. These attacks are likely to be aimed at destabilising the government. Pakistan has long supported the Taliban and other militant groups as a means to exert influence in Afghanistan and India. Throughout 2008 and 2009, Taliban influence spread from the remote mountains to the Swat region (near the capital of Islamabad). Initially, President Zardari, who took office in 2008, appeared reluctant to act. The campaign against militants in Swat, which eventually began in May 2009, has now been stepped up. By late October 2009, the Pakistani army stated it had made progress in its offensive in South Waziristan and was in control of Kotkai, the hometown of a key Taliban leader.
- > **Impact on country risk:** Political instability is likely to remain a key issue. Even if political leaders now appear to be united to fight militants, the opposition *Pakistan Muslim League-Nawaz* and its leader, Nawaz Sharif, are likely to capitalise on any opportunity to win the upcoming election. The economy also remains fragile. The IMF intervened in November 2008 to avoid a balance of payments crisis. Since then, the current account deficit has narrowed thanks to remittance inflows and a decrease in imports exceeding the drop in exports. GDP growth is expected to recover slowly from 2% in 2008/09 to 3% in 2009/10. However, huge challenges such as fiscal consolidation remain. (**analyst:** Pascaline della Faille, p.dellafaille@ondd.be)

EUROPE

Estonia : IMF raises prospects for euro adoption in 2011

- > **Event:** In its latest assessment of Estonia's economic situation, the IMF lauded the government for the fiscal efforts and the implementation of structural reforms, though calling for a further limitation of budgetary procyclicality. The Fund even holds the opinion that euro adoption in 2011 is within reach. Eventually, it is still up to the EU to decide on Estonia's entry. With low public debt and a deflationary price evolution, the major hurdle for entering the zone will be the fiscal deficit, as the Maastricht criteria only allow for a deficit of 3% of GDP.
- > **Impact on country risk:** Owing to low public debt and some fiscal reserve, Estonia was better equipped to weather the crisis than its troubled neighbour Latvia. The positive euro adoption prospect underlines this distinction. Though euro adoption would be highly welcome for Estonia – even if only to fix euro-denominated debts – it is no cure-all for its problems. The IMF expects the Estonian economy to shrink by a shocking 14% this year. Tallinn should be cautious not to sacrifice what will already be a slow recovery to the prospect of joining the euro zone as soon as possible. Euro conversion could imply a devaluation as the kroon is still overvalued. (**analyst:** Ben Deboeck, b.deboeck@ondd.be)

Romania : political bickering results in government collapse ahead of presidential elections

- > **Event:** PM Emil Boc's government did not live to celebrate its first year in power. Boc triggered the collapse of his own coalition by ousting a coalition-partner minister. The parliament subsequently passed a vote of no confidence. Opposition parties hold a 2/3 majority and will most probably vote down any proposed cabinet line-up, instead calling for an administration of technocrats.
- > **Impact on country risk:** The political strife is a result of the build-up to the presidential elections later this month, in which Boc ally Traian Basescu hopes to secure a second term. Nevertheless the political turmoil distracts attention from Romania's troubled economic situation. The country is relying on a €20bn IMF/EU bail-out of which only half has been disbursed so far. Despite public

protests, the outgoing government has taken measures to strengthen a fiscal stance weakened after years of populist spending. Further structural adjustments are required to retain access to the IMF lifeline though opposition parties want to renegotiate the IMF agreement. The authorities are already struggling to pay salaries and pensions and in case external assistance is frozen, the authorities risk running out of money. (**analyst:** Ben Deboeck, b.deboeck@ondd.be)

LATIN AMERICA

Brazil: government installs financial operations tax

- > **Event:** Brazilian authorities have imposed a tax on financial inflows. The tax applies to short and long-term inflows but excluding foreign direct investment flows. In recent months, the Brazilian real has appreciated against the US dollar, thereby weakening Brazil's external competitiveness.
- > **Impact on country risk:** In 2008 Q4, the real depreciated against the US dollar, but this trend was reversed in 2009 as Brazil outperformed many other emerging countries during the economic crisis. Even though the new tax may raise some policy concerns, political risks are unlikely to deteriorate significantly in the near future. (**analyst:** Pascaline della Faille, p.dellafaille@ondd.be)

Bolivia: government announced that all lithium-related patents are to belong to the state

- > **Event:** Back in 2006, the government began to nationalize the hydrocarbon sector, which was followed by nationalization in the energy and telecoms sectors. Mid-October 2009, president Evo Morales stated that the nationalization of the electricity sector would be completed in the near future. The government also announced that all lithium-related patents are to belong to the state. In the run-up to the December presidential election, these declarations come as no surprise but are likely to deter potential investors. The discovery in September 2008 of lithium resources, a metal widely used in batteries, has attracted foreign investors to Bolivia. In the meantime, a new major deposit was discovered in Mexico, which if confirmed may divert potential investment from Bolivia to Mexico because the latter provides a more investor-friendly environment.
- > **Impact on country risk:** If Morales is re-elected in December 2009, which is highly expected, he is likely to consolidate his socialist agenda, making investments expensive due to profit sharing with the government and expropriation risk. On the positive side, Bolivia offers a more stable macroeconomic environment than before. The country has proved to be resilient to external shock thanks to its sustainable level of external debt, its current account surplus. The GDP-growth rate is likely to reach 2.8% in 2009. (**analyst:** Pascaline della Faille, p.dellafaille@ondd.be)

MIDDLE EAST

United Arab Emirates (UAE): Dubai assesses various options to meet its payment obligations

- > **Event:** Dubai's troubled government-related entities Dubai World and Dubai Holding have restructured their real estate operations. There are indications that Dubai World, which controls the heavily indebted real estate developer Nakheel, is considering to sell some of its assets. The government of Dubai has announced it will take up the second 10bn tranche of the 20bn bond before the end of this year, but so far the second tranche has not been issued. The UAE's central bank, backed by Abu Dhabi, bought the first tranche in February this year and is expected to do same for the second tranche. The central government of Dubai also wishes to raise funds beyond the UAE. Media reports say Dubai aims to obtain 6.5bn USD.
- > **Impact on country risk:** Dubai's economy and the real estate sector in particular have suffered since late 2008. For 2009, Dubai's economic growth is estimated at -3.0% on an annual basis. Next year, positive growth could resume to 2.3%. Although market confidence appears to be improving, there is also growing uncertainty whether there will be sufficient funds available to bail out all public companies in Dubai. Short-term financing needs are after all enormous. Analysts estimate that Dubai is to pay off approximately 50bn USD over the next years. In short, corporate risks remain high in Dubai and contrast sharply with the still favourable political risk for the UAE, which is largely due to the abundant foreign assets of Abu Dhabi. (**analyst:** Inge Lambrechts, i.lambrechts@ondd.be)

COUNTRY IN THE SPOTLIGHT: RUSSIA

Ever more reliant on cheap foreign credit and high commodity prices, Russia has been confronted with the inherent flaws of its economic model through the economic and financial crisis. The global credit crunch has provoked a massive and abrupt capital flight, reversing the high capital inflows of previous years which fuelled a consumption and investment boom. The price collapse of oil and other commodities have inflicted a second severe external shock. External shocks have been amplified by structural weaknesses, plunging Russia into a widespread and deep recession.

Over the first nine months, Russia's GDP has contracted by 10% compared to last year. Though still contracting by 9.4% over the third quarter compared to the same period last year, the economy grew slightly when compared to this year's second quarter, indicating that Russia is crawling out of recession as its terms of trade have improved significantly. For the whole of 2009 a contraction in the vicinity of 8% is expected, compared to an average growth of 7% over the past decade.

Outdated capital goods require investment push, reveals dependency on foreign capital

Despite a number of promising reforms at the start of his tenure, economic policy during the Putin years focussed on the commodities sector and the reversal of the chaotic privatisations of the nineties. State enterprises are dominant in the major sectors in the Russian economy. Ever-rising energy export revenues have been used to create national champions in the commodities sector and the heavy industry, while little attention has been paid to diversifying the economy or improving the investment climate. Anti-crisis measures have further increased the share of the Russian State in the economy to more than 50%.

Struggling with an often outdated and inefficient stock of capital goods, Russia is in dire need of large investments. Industries which excelled in Soviet times are falling out of step with technologically more advanced competitors abroad. As the country lacks deep domestic capital markets for providing long-term financing, Russia depends heavily on foreign investments. These are at a rather low level, however, when compared to regional peers or other emerging markets. The large capital inflows in previous years were mostly composed of loans, not of more direct investments which tend to be more stable. This explains the sudden and enormous capital reversal Russia had to endure when international markets became highly averse towards emerging markets and called in loans. Investment needs are particularly high in the vital energy sector. Although the country has vast oil and gas resources, new capital-intensive reclamations are necessary to make up for exhausting fields. The growth in oil and gas output has been slowing down and recently turned negative. Red tape barriers, the overall investment climate and the taxation system are to blame for lacking investment.

Ailing banking sector could prolong crisis

Fiscal revenues, along with the rouble rate, export numbers, economic growth and stock markets are all subject to the whims of international oil prices. Diversification of the economic structure should therefore be a primary objective for Russian politicians. President Medvedev recently described Russia's raw-material dependency as 'humiliating' and 'primitive'. It is doubtful, however, that politicians will take action towards diversification given the intertwinement of politics and the commodities sector.

The most pressing issue at the moment is the banking sector. Russia has some 1,100 banks, many of which are undercapitalised and are highly exposed to one sector or even a single large company. Massive government interventions have allowed the sector to survive without major casualties. Asset quality has been deteriorating, however, and could trigger a second round of crisis in the banking sector. This would mean that lenders would further freeze credit granting, resulting in slower recovery. Anti-crisis measures taken by the government entail the risk of budgetary deterioration, meaning a ballooning non-oil deficit and the failure to replenish fiscal reserves needed to safeguard the economy from future commodity price fluctuations. Existing reserves are being depleted at present as the government scrambles to finance the deficit. The international crisis has uncovered the profound flaws of Russia's growth model and has confronted the country's leaders with several structural problems. The sense of urgency seems to fade, however, with the oil price picking up and Russia slowly moving out of recession. This threatens to once more postpone radical but vital reforms, which could in the long run result in economic stagnation.