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Sector risk assessment

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PANORAMA

December 2015

Barometer sector risks in the world

COFACE ECONOMIC PUBLICATIONS

By Coface Group Economists



In a context of low worldwide growth, sectoral dynamics are mixed. Amongst the 14 business sectors monitored in three main regions of the world (Western Europe, North America and emerging Asia), three were downgraded during the third quarter of 2015: metallurgy in Europe, retailing in North America and textiles-clothing in emerging Asia.

The latter suffers from overcapacity and is harmed by the increase in labour costs in China. More generally in this region,

the level of risk remains high in the industrial sectors where many players have over-invested and become over-indebted over the last decade (metallurgy, chemicals, construction, energy and mechanical engineering in particular). On the other hand, services, pharmaceuticals and retailing continue to benefit from the rise in the middle classes.

This Chinese overcapacity is contaminating Europe and particularly its metals sector, which must also cope with falling prices. Steel production has been declining in Europe since June 2015 in favour of imports mainly from Asia, which have

doubled since 2010 and are destabilising the European sector.

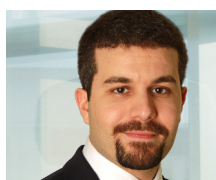
Lastly, the contrasts are less pronounced in North America, where the sectors taking advantage of the drop in oil prices (such as chemicals) or sustained household consumption (automobile, textile and transport) are relatively low-risk. Retailing is the exception that confirms the rule, with certain traditional players suffering from competition from Internet sales and declining consumer confidence (in the case of Canada).

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FOR SAFER TRADE

DECEMBER 2015

SECTORAL OUTLOOK



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SECTOR RISK ASSESSMENT			
Sectors	Emerging Asia	North America	Western Europe*
Agrofood	Medium risk	Medium risk	Medium risk
Automotive	Medium risk	Low risk	High risk
Chemicals	High risk	Low risk	Medium risk
Construction	High risk	Medium risk	High risk
Energy	High risk	High risk	High risk
Engineering	High risk	Medium risk	Medium risk
ICT**	Medium risk	Medium risk	Medium risk
Metals	Very high risk	High risk	↘ Very high risk
Paper-Wood	Medium risk	Medium risk	High risk
Pharmaceuticals	Low risk	Medium risk	High risk
Retail	Low risk	↘ Medium risk	Medium risk
Services	Low risk	Medium risk	Medium risk
Textile-clothing	↘ High risk	Low risk	Medium risk
Transportation	Medium risk	Low risk	Medium risk

Source: Coface

* European Union 15

** Information and communications technologies

Low risk

Medium risk

High risk

Very high risk

The risk has improved

The risk has deteriorated

Sectorial risk assessment methodology

Coface's assessments are based on the financial data published by over 6,000 listed companies in three major geographic regions: Emerging Asia, North America and the European Union 15.

Our statistical credit risk indicator simultaneously summarises changes in four financial indicators: turnover, profitability, net indebtedness, and cash flow, completed by the claims recorded through our network.

1 AGROFOOD

After having reached a minimum plateau in August 2015, the prices of all agricultural commodities picked up again in September and October. The FAO index of agricultural commodities recovered by 4% between August (the lowest level since February 2007) and October 2015. It is driven by the increase in the price indices of sugar (+21%), milk (+15%), and oils (+6%). In spite of this recent recovery, the price of these foodstuffs remains an average of 15% lower over one year. However, the increase in the price of sugar could last in 2016. According to the ISO ⁽¹⁾, the drop in production in mid-2015 combined with the growing increase in consumption should make demand greater than supply over the next quarter (for the first time in six years).

Given a stock level up by 6.2% over the last two years, the increase in the price of cereals (+2%) is more marginal. Lastly, the price of meat is not benefiting from the general recovery (-1%), also due to a level of production 2% higher on average than worldwide consumption in 2015. Although the FAO's forecasts anticipate annual average growth of 1.6% in worldwide meat consumption over the next ten years, the USDA predicts that the production of meat will be greater than consumption in 2016 (4% for cattle and 2% for poultry).

However, the drop in energy prices, particularly Brent crude (-47% between June 2014 and the end of October 2015) is continuing to generate downward pressure on the prices of all agricul-

tural commodities, even more so as the level of stock remains high and demand, particularly from emerging countries, is tending to slow. Stock levels could rapidly drop if the expected *El Niño* climatic phenomenon is of a historical magnitude. On 16 November 2015, the World Meteorological Organization predicted that the phenomenon should intensify by the end of 2015.

WESTERN EUROPE

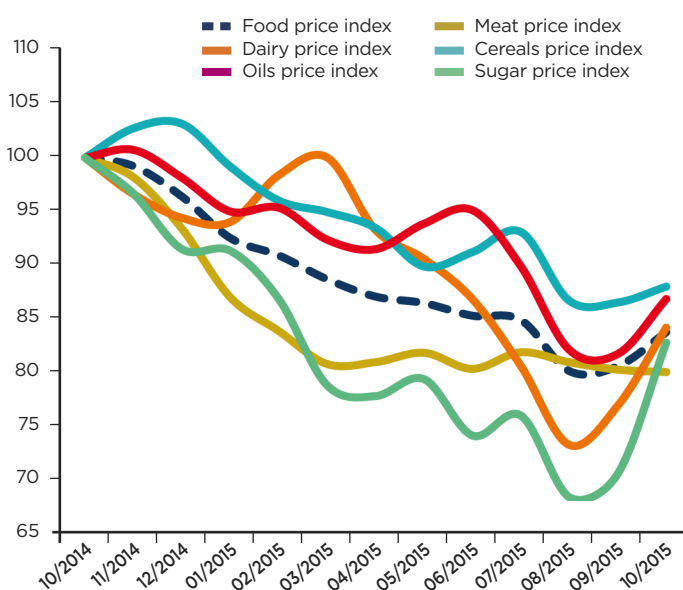
Just like the 8% reduction in turnover of the French group Tereos (the third-largest sugar group worldwide) in 2015 (tax year 2014/2015), European sugar producers are suffering from the drop in sugar prices, caused by overproduction by the big players in the market. But prices are recovering slightly at the end of 2015, which should help them. This is due to negative prospects related to the drop in production in emerging countries, which manufacture 91% of worldwide sugar consumed in 2015 ⁽²⁾. And although at the end of October, the Russian agriculture ministry predicted that sugar production in the Russian Federation (the second largest producer of beet sugar after the European Union) could increase by 9% over 2015, this has not intensified the pressure on prices. In November, FranceAgrimer reviewed French wheat production upwards (41 million metric tons -Mt-) and export prospects to the European Union downwards, leading to an increase in stocks by 5.1 million metric tons. This lack of outlets could again cause prices to fall in the first quarter of 2016. At the same time, the prices of maize and barley adjusted to those of wheat in order to remain attractive for animal feed. Concerning the processors, in July, Danone sold its DUMEX baby milk brand to the Chinese Yashili, in particular due to market share in China that was too low (8.1% in 2014 according to Euromonitor).

The risk remains medium

EMERGING ASIA

In South-East Asia, *El Niño* manifested itself through droughts, which caused the worst forest fires that Indonesia has known to date in 2015. These were originally lit to increase plantations of palm oil, for which the prices, which have increased by 6%, remain 13% below their prices of October 2014. According to the Australian agency "Green Pool Commodities", *El Niño* should also harm the cane sugar harvest in India (19% of worldwide production), in China (9%) and in Thailand (7%), the primary exporter of cane sugar. With Brazil, these four producers represented 83% of worldwide sugar production in 2014 and the level of their harvests plays a key role in fixing prices. Although the Indian food ministry predicts that the drought will cause a 9% drop in sugar production compared to the previous campaign,

Monthly indices of food prices (10/2014=100)



Source: FAO

(1) ISO: International Sugar Organization
(2) FAO

stocks reached 9.5 million metric tons in September 2015 and are up by 26.7% over a year. This was why India was able to export 4 Mt of sugar in 2015, which put downward pressure on world prices. Likewise, in spite of the drought in Thailand, the Office of the Cane and Sugar Board (OCSB) maintained its production forecast at 110 Mt in 2015 (111 Mt in 2014), the country having favoured production of sugar in 2015 to the detriment of its production of rice over 2015. Consequently, between October and November 2015, the FAO reduced by 2.2% (to 4.5 Mt) its production forecast for rice and secondary cereals (mainly maize) compared to 2014. Forecasts for rice production dropped by 1.6 Mt, leading to the 0.6% drop in total production compared to 2014. And the production of maize was lower than predicted in India (-1 Mt), given the heavy rains.

■ *The risk remains medium*

NORTH AMERICA

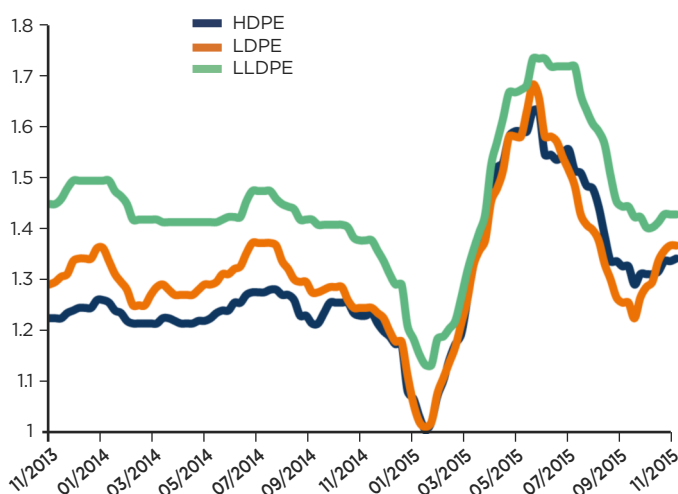
The United States should remain the primary worldwide producer of soybean and maize in 2015, with an increase in their respective production of 18% and 2.8% (provisional)⁽³⁾ over one year. This confirms the recent readjustment of forecasts⁽⁴⁾ for their harvests of soybean for 2015-2016, which intensified the pressure on the prices of oilseeds. We may imagine that they are anticipating a poor palm oil harvest in South-

East Asia, because soybean is a substitute for it. The demand for maize (the most-consumed cereal), for which consumption is 60% used for animal feed, 30% for industrial processing (ethanol-fuel and starch) and 10% directly as food, should increase by 3.2% over the period 2014/2015 (over one year). Demand for ethanol has been increasing much more slowly over the last year, with ethanol representing about 35% of the tonnage used and 10% of fuel in the United States. Although oil prices have a limited effect on most of the price reductions in agricultural commodities, this is not so for sugar, which is an energy competitor with ethanol (processing of cane and beet sugar). In a context of the drop in oil prices, and the drop in the Brazilian Real by 58% over one year, Brazilian producers have favoured their production of sugar since the beginning of 2015, to the detriment of ethanol production. If heavy rain (at the end of the year) is produced by the *El Niño* phenomenon in South America, the sugar harvest could be threatened in Brazil, the primary sugar producer (26% of worldwide production in 2014) and cause prices to rise. The production of ethanol in the United States has been maintained at high levels over the last three months of the August-September marketing campaign, with lower maize prices stimulating the industry's profit margins and leading to maximisation of harvests.

■ *The risk remains medium*

2 CHEMICALS

Price of main polyolefins in Western Europe⁽⁹⁾



Source: ICIS

NORTH AMERICA

According to the *American Chemistry Council*⁽⁵⁾ (ACC), at the end of October 2015, chemical production in the United States increased by 2.4% compared to October 2014 (+0.2% over one month). The sector is driven by the healthy automobile sector, for which sales of light vehicles are up, over the first ten months of 2015, by 5.8% over a year. Also, building permits, according to the Census Bureau, are up by 11.9% over the first ten months of 2015 over one year.

The "oil to gas" ratio⁽⁶⁾ dropped by 28%, largely caused by the sharp drop in prices of WTI by 62% between mid-June 2014 and 17 November 2015. Yet, at the same time, prices of natural gas also collapsed by 48%, enabling American producers⁽⁷⁾ to keep their major competitive advantage over their European competitors⁽⁸⁾ by having an abundant and inexpensive raw material.

■ *The risk remains medium*

(3) EIU: Economist Intelligence Unit

(4) EIU: Economist Intelligence Unit

(5) ACC is an industry trade association for American chemical companies

(6) Ratio of the price of WTI futures and the price of natural gas in the United States

(7) Output produced from ethane, a gas derivative

(8) Output produced from naphtha, a derivative of crude oil

(9) Polyolefins are polymers coming from ethylene. They are used as inputs for plastics processing and packaging. We distinguish several kinds of them, but the most common are HDPE (High-Density Polyethylene), LDPE (Low-Density Polyethylene), and LLDPE (Linear Low-Density Polyethylene)

WESTERN EUROPE

Western European chemical production remains low with regard to the growth in the industrial production index calculated by the European Central Bank (ECB), 0.9% over the first eight months of 2015. According to data from the CEFIC⁽¹⁰⁾ over the first eight months of 2015, production increased by only 0.3% over one year. Chemical products intended for consumers represent the most dynamic segment, with 5.1% growth over the same period. However, the petrochemicals sub-sector is significantly down by 4.9% over the same period, still in competition with American and Middle Eastern production.

The players in the plastics-processing sector are undergoing supply difficulties due to announcements of cases of “force majeure” by their petrochemical suppliers⁽¹¹⁾. Thus, according to the EuPC⁽¹²⁾, over the first six months of 2015, there were as many cases of “force majeure” (nearly 40 cases) as in 2012, a year with a particularly high number. These difficulties have resulted in supply restrictions and have therefore kept prices

of polyethylene⁽¹³⁾ artificially high by 28% compared to the low point at the end of December 2014 (see graph page 4).

The risk remains high

EMERGING ASIA

The drop in crude prices has dropped naphtha down with it⁽¹⁴⁾ (-50% since June 2014). A question remains with the implementation of the 13th five-year plan in China (2016-2020), which aims to accelerate the development of the production of olefins⁽¹⁵⁾ from coal. China has an advantage in producing alkenes from coal, which is abundant, particularly in the Shanxi province, and cheaper to produce. Thus, production will increase by 12 million of tons. Chinese authorities are expecting to maintain jobs in Central and Western China by developing chemical plants. Will demand meet supply?

The risk remains low

3 CONSTRUCTION

WESTERN EUROPE

Although the number of building permits is still not increasing (-3.9% at the end of July 2015), the improvement in the employment market, combined with the drop in lending rates, is reviving the sector. Furthermore, prices have corrected since 2007, which is increasing household purchasing power. Even though they remain slightly overvalued (by about 7% according to the OECD), prices have dropped since 2007 by 7.4%. The countries

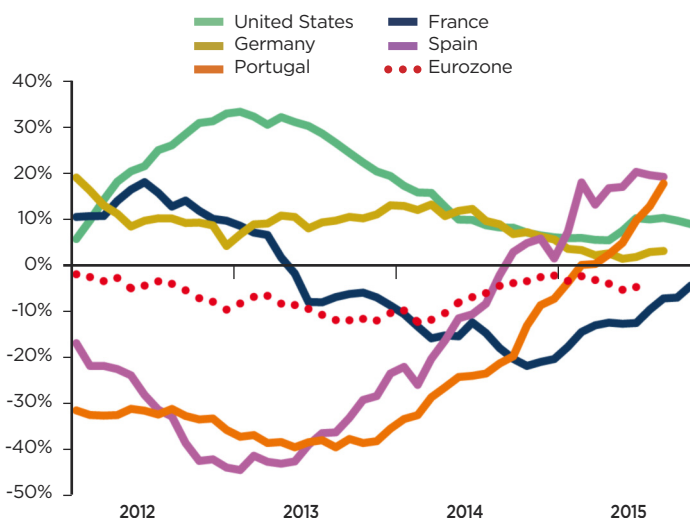
of the South are showing strong growth in their activity after a long period of contraction. The attrition is even substantial in Spain, where the number of companies in construction has gone from 21 to 16% of the total between 2008 and 2014. Also, the German market has again been showing signs of strength since June 2015. The number of new building permits there increased by 4.2% at the end of September 2015 over one year. In Austria, the dynamism of its migratory balance is compensating for the stagnation of its demography, which is supporting the development of the sector: building permits increased by 3.9% in the first quarter of 2015 over one year. Conversely, the unemployment rate is still not falling in France (10.7% of the active population at the end of September 2015). However, sales of existing property have been increasing since the beginning of the year, driven by the drop in lending rates. Lastly, in the longer term, demand from first-time buyers remains constrained by the unemployment of the active young, which remains worrying in the euro zone, at 22.9% at the end of October 2015.

The risk remains high

EMERGING ASIA

In this zone, the sector remains closely related to the orientation of real estate in China. After a prosperous period of development, the sector has had to cope with significant overcapacity.

Building permits, annual variations



Sources: OCDE, US census bureau

(10) European Chemical Industry Council is an industry trade association for European chemical companies

(11) Suppliers cannot deliver due to production outages. This results in supply limitation

(12) European plastics converters

(13) A major input for plastics processing

(14) Naphtha is a derivative of crude oil, which is used for petrochemical production

(15) Also known as alkenes : class of hydrocarbons including ethylene and propylene, used in plastics processing and packaging

Property developers have been obliged to lower their prices to sell their stock. Investment in property has therefore considerably slowed, going from a growth rate of greater than 20% over the last decade, to 2% in October 2015. At the same time, measures to loosen monetary policy have been adopted by the Chinese government. The minimum rate of mandatory bank reserves has been dropped four times since February 2015, going from 20% to 17.5%. Encouraged to lend more, the banking sector is supporting household demand for property. Sales of residential housing units (in square metres sold) have thus been increasing again since August, to reach +3.5% at the end of October 2015 over one year. In the 70 largest towns, property prices thus increased by 0.1% for new property and 1.4% for existing property at the end of October 2015 over one year, according to the Chinese authorities. This recovery should be confirmed over the forthcoming months. Nevertheless, the total vacancy rate still remains high, since it reached the record level of 21 million square metres at the end of October 2015 in Beijing (*China Index Academy*).

The risk remains high

NORTH AMERICA

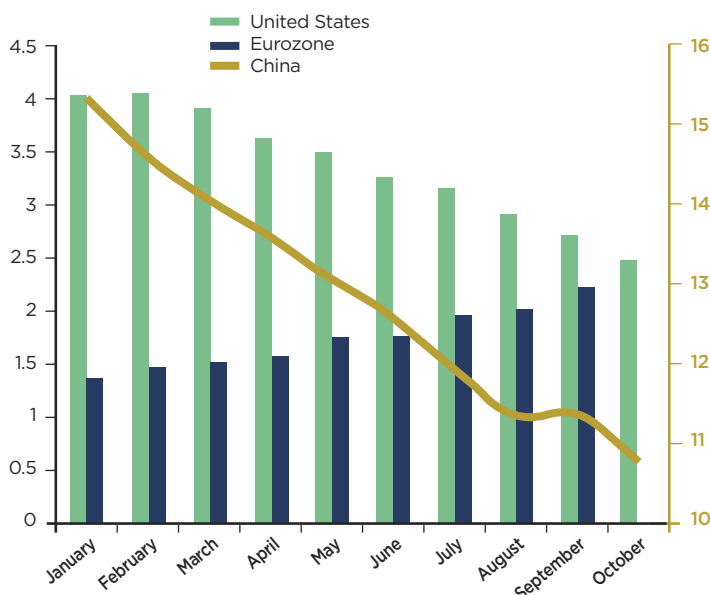
Building permits are continuing to increase at an annual rate of 9.0% at the end of October 2015. The sector remains supported by the financial sector, for which property loans increased by 4.4% at the end of July 2015. However, the tightening of US monetary policy will bid up the cost of property financing, which could constrain the entire sector. The increase in wages related to the drop in unemployment (5% of the active population in October 2015) and the drop in petrol prices (-35% since the beginning of 2014) and, more generally inflation, are the cause of the increased purchasing power of American consumers. In Canada, the employment market situation is worsening, with an increase in the unemployment rate since the beginning of the year, to reach 7% of the active population at the end of October 2015. Even though the level appears low, Canada is the fourth country of the OECD where property prices are the most overvalued (around 30%). In other words, extended weak demand could affect the construction sector in Canada.

The risk remains medium

4 RETAIL

The driver of retailing, household consumption, is in a mixed situation from one region to another. Its behaviour is slowing but remains favourable in Asia and the United States, while it is recovering in Europe. The only cloud on the horizon: Canada, whose dependency on the oil sector and the high rates of household debt are affecting consumer confidence.

Variation in retail sales in 2015 (average annual %)



Sources: Eurostat, United census bureau, National Bureau Of Statistics Of China

Electronic commerce covering volume retailing products is growing strongly (+28% in 2014⁽¹⁶⁾) throughout the world, and should reach 1,700 billion dollars (\$bn) in 2015 (50% of which made in the United States, China and the United Kingdom). Like Leclerc, which plans to invest €1 billion in e-commerce over the next three years, the investments of volume retailing players are increasing on this segment. In 2015, 11% of French funds raised for the *CapHorn Invest* fund (specialised in retailing) relate to the digital transformation. Although the giants of e-commerce (Amazon, Alibaba and Ebay) had about 800 million customers in 2015⁽¹⁷⁾, online purchasing represents only one buyer in four. Although the potential of the market is high, the retailers' battle to acquire market share has become even tougher.

WESTERN EUROPE

In Western Europe, the purchasing power of households tends to increase in line with the weakness of inflation (0% at the end of October over one year) and with the reduction in fuel consumption expenses. The drop in unemployment rates, which affected 10.9% of the active population of the European Union at the end of September 2015 (11.5% at the end of 2014) is not unrelated to it. Thus, although the level of growth in retail sales remains low in Europe (2.2% in July 2015

(16) Kantar WorldPanel

(17) Forbes

over one year), it has been accelerating since September 2014. The months of September and October have seen sales of volume retailing products driven by the beginning of the school year and e-commerce. In France, although expenditure for VRP⁽¹⁸⁾ in the generalist circuit is up by 1.5% over one month by value, the Internet Channel (64% of the growth in purchases of VRP) is accelerating its growth in market share by 0.9 of a point. In France, the prices of consumer products in volume retailing have been increasing since March 2015. Volume retailing has demonstrated resilience, as shown by Carrefour, which had a 3.4% increase in turnover (in organic growth⁽¹⁹⁾) over the first 9 months of the year. In the United Kingdom, the rate of growth of sales in e-commerce is three times greater than that in the euro zone. In July, the Anglo-Dutch group Unilever (third-largest player in the food processing industry) formed a partnership with Alibaba (n° 2 in e-commerce) in order to penetrate the Chinese market. Lastly, the discounters have a bright future: the brands Aldi and Lidl have increased their market share by 10% in three years⁽²⁰⁾ in the United Kingdom.

| The risk remains medium

EMERGING ASIA

The boom in the digital, social and mobile-technologies economy, combined with the growing adoption of these technologies by users, is continuing to accelerate the change in modes of consumption throughout the world. And it is in the developing countries that the growth in electronic commerce is the most dynamic⁽²¹⁾. China is the champion of e-commerce growth amongst the BRIC countries (Brazil, Russia, India and China). Between 2009 and 2014, it is the only BRIC country to have had a growth in e-commerce by value (>4,000%) higher than the growth in mobile Internet subscriptions (3,000%)⁽²²⁾. The rate of penetration of the Chinese market could reach 15% by 2025⁽²³⁾. The growth in retail sales in China has stabilised since January, but remains greater than 9% over one year in real terms. The dynamics of internal consumption therefore remain rather favourable, even more so as Chinese statistics do not include purchases made over the Internet. Nevertheless, the slowdown in the Chinese economy (+6.9% on a sliding annual basis in the third quarter of 2015) shows signs of weakness: consumer confidence and the growth in their income have clearly

slowed. In this context, the financial situation of retailers is mixed. While Alibaba (the second-largest e-commerce site in the world) saw its turnover grow by 32% over a year in the third quarter, notably with a gross volume of goods purchased which leapt by 28% over a year, Carrefour has seen a drop in its organic sales of 10.6% over a year in the third quarter of 2015 in China. The financial situation of certain Chinese suppliers could tighten, given this drop. Lastly, high rates of growth of retail sales (greater than 10%) have also been seen in Vietnam and Indonesia.

| The risk remains low

NORTH AMERICA

US growth is driven by household consumption (+3.2% at an annualised rate in the third quarter of 2015) and the continuous drop in unemployment over the last two years (5.2% in the third quarter of 2015). Nevertheless, the growth rate of retail sales over a year has been showing signs of running out of steam since March 2015. The turnover of the number one retailer worldwide, Walmart, stagnated (-0.5%) over the first 9 months of 2015. In particular, the strong dollar has negatively affected the income of retailers, which make a third of their turnover outside the United States. Concerning e-commerce, in July 2015, Walmart launched its programme of free and unlimited deliveries on US soil for \$50 a year (against 90 for Amazon's "prime" programme). Growth is not benefiting all retailers, as shown by the chapter 11 bankruptcy protection filed by the Quick Silver group in September 2015 and American Apparel group (textiles) in October. The risk is also increasing in this sector in Canada. The country officially went into recession in the second quarter of 2015 and household consumption slowed by 2.4% over a year in the second quarter of 2015, against 2.8% in the fourth quarter of 2014. Increases in retail sales dropped to almost half their rate in September 2015 (+2.6%) compared to November 2014 (4.6%). This change of trend is not without consequence for companies, as shown by the closure of all the shops of the Canadian subsidiary of Target (fifth-largest American retailer) at the beginning of the year (133 shops and 17,600 jobs concerned).

| The risk is evolving from low to medium

(18) VRP: Volume retail products

(19) Organic growth: growth in comparable shops plus net openings over the last twelve months, temporary closures included. It is understood at constant exchange rates

(20) Kantar WorldPanel

(21) UNCTAD, March 2015

(22) Euromonitor

(23) Kantar WorldPanel

5 METALS

The sector is still suffering from significant overcapacity, creating a distortion between supply and demand. The prices of the main base metals have therefore been falling since the beginning of 2014. This is particularly the case of iron ore (-65% at the end of November 2015), copper ore and nickel ore (-40%). Numerous investment projects have been initiated since the 2000s to meet the demand from emerging countries. China has thus gradually become the number one worldwide consumer of iron ore (60% in 2014), aluminium ore (48%), copper ore (50%) and nickel ore (45%). However, its economy is showing signs of a slowdown, which has become more pronounced since 2014, thus creating risks for its consumption of base metals. Thus, worldwide consumption of steel was down by 1.7% in 2015 (*World Steel Association*). In order to sell its excess production, China is now exporting massively to the rest of the world, thus worsening the risk to companies in the sector in other countries. In June 2015, eight metal producers' associations around the world made a joint statement to accuse China of increasing its production capacities and subsidising its exports of metals. But it will take time to return to balance between supply and demand in this sector. The current overcapacity is being absorbed slowly: the capacity usage rates for worldwide production seem to have stabilised in September at 69.3% (*World Steel Association*) after a historical low in August at 68%.

WESTERN EUROPE

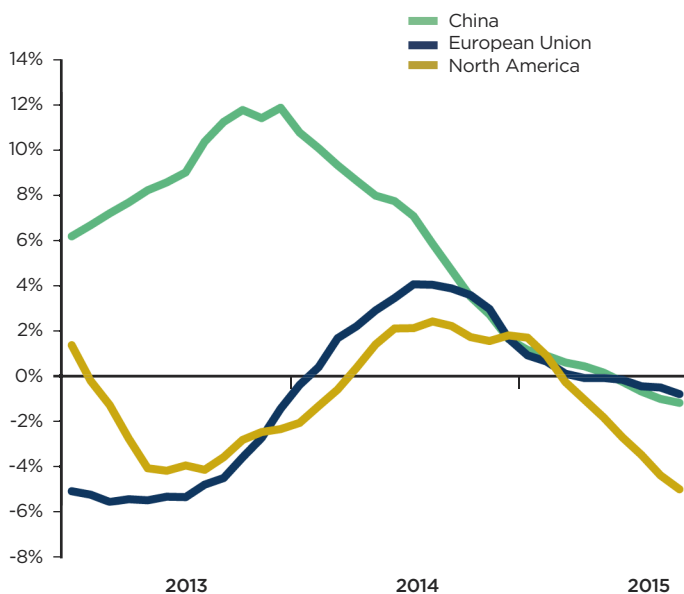
The zone is taking advantage of a loose monetary policy by the European Central Bank, which took a new turn in March 2015, with its quantitative easing program. The drop in the euro against the dollar is thus benefiting companies. Growth is slow but sure, going from 0.9% in 2014 to 1.5% in 2015, while households are benefiting from the improvement in the employment market (10.8% of the active population at the end of September). In this context, registrations of new vehicles in the euro zone grew at 7.2% annually at the end of October 2015 (ACEA). Furthermore, the property market is showing encouraging signs of recovery in several countries (Spain, Germany, Austria and the United Kingdom) even though, at the scale of the euro zone, the number of building permits dropped by 3.9% at the end of July 2015 over a year. This context is supporting demand for metals, particularly zinc, steel and aluminium. However, production of steel has been declining in Europe since June 2015 (-0.7% at the end of September 2015 over one year, *World Steel Association*). Production has dropped off in favour of imports, mainly from Asia, which have doubled since 2010, thus destabilising the European sector. Adopted in April 2015, and put in place at the end of August for 6 months, the European Commission has instituted an anti-dumping tax on stainless steel coming from China and Taiwan. In spite of this tax, over the first 7 months of 2015, Europe imported, from China, twice as much as it imported in 2013 (Eurofer).

▮ *The risk moves from high to very high*

EMERGING ASIA

Chinese consumption of steel should drop again by 3.5% in 2015 (*World Steel Association*), which has a direct impact on demand for nickel and zinc, which are used for stainless steel. Given the large stocks, exports of steel increased by 33% by volume at the end of October 2015. But, after Europe, India also imposed anti-dumping taxes on steel coming from China in June 2015. This protectionism will therefore further negatively affect the Chinese sector. Concerning internal drivers of growth, while the increase in automobile sales is slowing, the government has decided to halve the taxation on small cars (less than 1.6 L), which has revitalised sales, which are up by 11.8% in one year in October (all vehicles). However this recovery might not be sustainable and be more related to opportunistic behaviour of households concerning delayed re-equipment. The consumption of lead, used in manufacturing electric batteries, again slowed in 2015 by -3.5% (Lead and Zinc Study Group). The sector is coping with large stocks after having supported the development of electric bikes, which is 90% controlled by China (Electric Bikes World-Wide Report) but which is currently close to saturation. Furthermore, in order to encourage the most advanced and envi-

Annual growth in steel production



Source: World Steel Association

ronmentally-friendly technologies, such as lithium ion, a tax of 4% on lead batteries will be effective from January 2016. In this context, the consumption of aluminium is growing strongly thanks to its properties (recyclable almost to infinity, moderate cost, competitive weight/strength ratio). Lastly, in August 2015, China announced more than \$160 billion of bond issues over the forthcoming years to support spending on infrastructure, which heavily uses base metals.

| The risk remains very high

NORTH AMERICA

The sector is coping with contrary winds in North America. On the one hand, it is benefiting from the dynamism of automobile sales, which were up by 10.1% at the end of October 2015 over one year (BEA, all vehicles), which is also driving the con-

sumption of aluminium. At the same time, building permits increased by 9.0% in the United States at the end of October 2015 (US Census Bureau). On the other hand, steel production declined significantly in 2015, to reach -4.9% at the end of September 2015 over one year. Production of aluminium also dropped by 2.9% over the same period. The dynamism of internal consumption stands in opposition to the reduction of investments in oil energy, down by 20% in the third quarter over one year and which absorbs 10% of the local steel production. But the American sector must, above all, cope with more competitive imports, mainly from China. After investigation, the US government also imposed taxes, in November 2015, on imports of stainless steel from China, India, Italy and South Korea. Imports of stainless steel grew by 29% in May 2015 over one year.

| The risk remains high

6 PHARMACEUTICALS

NORTH AMERICA

The ongoing reconfiguration of the health sector in the United States is imposing new rules upon those involved. Thus, the payers⁽²⁴⁾ (in a private-health-insurance system) are merging in order to reach a sufficient critical mass.

This is particularly the case for health insurance policies, but also for the PBM⁽²⁵⁾. Thus the market

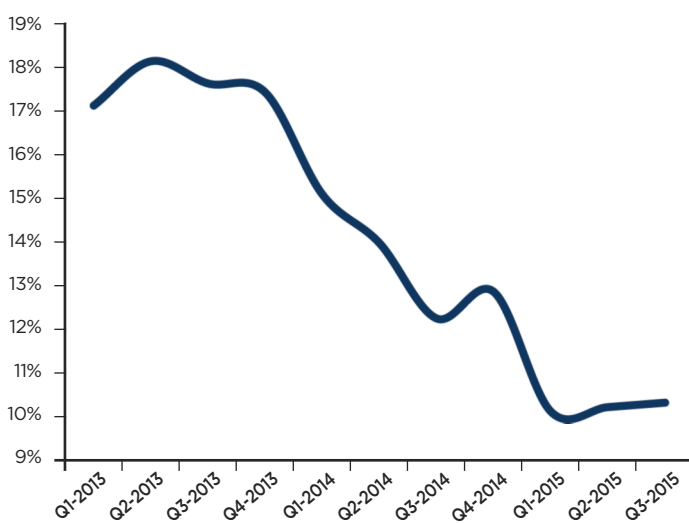
is becoming more and more concentrated, and the pharmaceutical companies must agree price reductions which may affect their profitability. Since the beginning of 2015, the mergers between OptumRx and Catamaran, as well as those of CVS and Omnicare, have confirmed this trend. Express Scripts, helped by its large size, has benefited from a 30% drop in the price of Vievira Pak (against hepatitis C) from AbbVie, after having refused to pay for Sovaldi from Gilead Sciences because of its cost (\$84,000). With the ongoing consolidation, these price drops could be commonplace in therapeutic areas where there is strong competition. The balance of power may benefit to these managers, who will take advantage of their size during negotiations.

Also, the merger between the giant *Pfizer* and its Irish counterpart *Allergan* is partly due to these problems, but also allows the American laboratory access to its competitor's "pipe"⁽²⁶⁾.

The surge of the ACA⁽²⁷⁾ is still in the news: the percentage of non-insured adults dropped to 10.4% in the third quarter of 2015⁽²⁸⁾, against 12.5% in 2014 (see graph). Nevertheless, faced with the increase in expenditure on medicines, insurance premiums could increase by 10% in 2016⁽²⁹⁾, and revive the debate on fixing the prices of medicines, a cause which has been taken up by certain candidates for the 2016 presidential election.

| The risk remains medium

Proportion of uninsured Americans



Source: Urban Institute

(24) Mainly the programmes Medicare and Medicaid, health insurance policies and employers

(25) The PBM or Pharmacy Benefit Managers manage treatment forms, but negotiate prices and volumes of medicines with the drug companies, on behalf of the insurers

(26) The "pipe" is all of the molecules and therapies under development

(27) ACA or Affordable Care Act, more commonly known under the name of Obamacare, aims to guarantee affordable health insurance for the least well-off Americans

(28) According to the Urban Institute, a non-partisan think tank

(29) Ibid.

WESTERN EUROPE

Expenditure on prescription medicines in the five largest countries of the zone (Germany, Italy, United Kingdom, France and Spain) increased by 2.4% in 2014, after having dropped by 0.8% in 2013, according to Evaluate Pharma. This increase is the result of the increasing take-up of certain speciality medicines, in oncology, for example, as well as in therapeutic areas such as hepatitis or cardiovascular diseases. The increase appears more contained than that seen in the United States, but will require more restrictive actions on the balancing of health-insurance budgets.

Thus, the exercise of price limitations and rationing of medicines continues in Western Europe. In the United Kingdom, NICE⁽³⁰⁾ has recently prevented payment by the NHS for Kadcykla from Roche (advanced/metastatic breast cancer). The NHS has just announced a record deficit of £1.6 billion for the first six months of 2015. In France, the Social Security Accounts Commission is predicting an increased deficit for 2015 of €7.2 billion, against 6.5 in 2014, largely driven by payments for innovative medicines against hepatitis C. These budgetary

restrictions risk further increasing the pressure on the prices of medicines, and reducing the margins of drug companies operating in Western Europe.

The risk remains high

EMERGING ASIA

With 11% of sales of medicines on prescription in 2014, China is a flagship market for locating laboratories. As its health expenditure represented "only" 5.4% of GDP in 2014 (against 17.4% in the United States, and respectively 10.9% and 11% in France and Germany), China remains a market with strong potential. The share of the population covered by a form of public health-insurance (national or via a rural cooperative) went from 45% in 2006 to 96% in 2014. Nevertheless, the contributions are still low and therefore so is coverage, leaving a large share of expenses to be paid by patients. As salary increases are slowing down, this situation risks imposing choices upon households.

The risk remains low

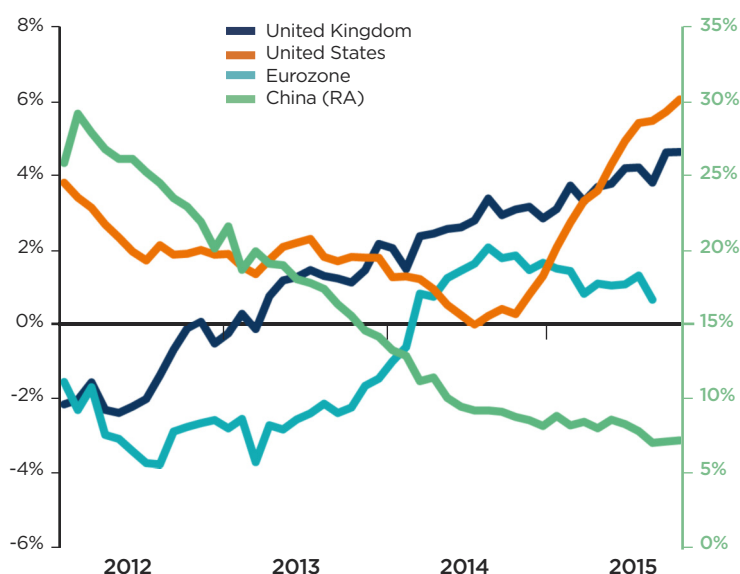
7 TEXTILE-CLOTHING

Since October 2015, prices of cotton have remained stuck at below \$70 per pound (Cotlook A, average world price). Worldwide production of cotton in 2016⁽³¹⁾ will continue to drop for the

fourth consecutive year. But stocks remain very high, which will continue to weigh on prices. However, for the first time in five years, worldwide production will not cover demand, which will enable stocks to be slightly reduced. But demand is not yet strong enough for the drop in production to have an impact on cotton prices. Production of cotton is now driven by India, the primary worldwide producer since the 2015 campaign. During the monsoon, between June and September 2015, the rains were 14% below their long-term average. However, production dropped by only 4% thanks to the use of new seeds which require less water. In spite of low prices, cotton fibre must still compete with synthetic fibres (polyester, acrylic and viscose) which benefit from the drop in the price of the oil from which they are made. On the worldwide scale, cotton represents only a third of textile consumption. In Europe, synthetic fibres still represented 54% of textile consumption in 2013, according to Eurostat.

Demand in emerging Asia still remains strong but the rate of growth is significantly decreasing. Furthermore, tensions in the Chinese market (drop in cost competitiveness and clearance of cotton stocks) are causing a resurgence in company risk in the sector. In the developed economies, the Europeans are slowly resuming consumption of clothing, while in North America, the sector is growing significantly.

Growth in sales of clothing (% volume, annual average)



Sources: Eurostat, BEA, Statistics of China

(30) National Institute for health Care Excellence: organisation responsible for defining the policy on the payment for medicines by the National Health Service (NHS), the healthcare system in England

(31) Season from June to July

WESTERN EUROPE

Demand for textiles remains low in Western Europe. The clothing budget of households remains under pressure and although unemployment is continuing to decrease in the euro zone, it remains high. Moreover, younger consumers are allocating more resources to textiles/clothing. Yet the level of unemployment of those aged 15 to 24 reached 22.1% over the same period. However, in this zone, 2014 was the year of recovery after two years of contraction: industrialists in textiles and clothing saw a 2.4% increase in their activity (*Euratex*). The large European economies have therefore half-heartedly resumed the consumption of clothing. The growth in the turnover of the giant H&M slowed slightly to +13.1% over the first nine months of its tax year, against +16.5% the previous year over the same period, due to an unusually warm season, according to the group.

| The risk remains medium

Also, the Chinese sector is suffering from loss of cost competitiveness. Over the last ten years, the average salary has been multiplied by six in urban zones. Bangladesh, where the production of clothing remains very dynamic, has a minimum salary 3.5 times less than that seen in China⁽³²⁾. Although Indian and Chinese relocations are continuing to support the sector in the zone, industrialists should accelerate their development outside Asia. H&M, which sources 80% from Asia, has been developing its orders with suppliers in Ethiopia since August 2013.

| The risk moves from medium to high

NORTH AMERICA

US production of cotton, the third-largest in the world, is suffering from the slowdown in Chinese demand related to import restrictions. The United States was one of the main suppliers of China. So, after a very good harvest in 2015, planted areas dropped by nearly 20% according to the EIU, which is predicting a 15% drop in cotton production in 2015-16. Also, demand remains very dynamic in the United States thanks to the improvement in the employment market. In Canada, the sectoral risk should be monitored. The slowdown in energy investments is weighing on the economy. The recent increase in unemployment could cause tensions in household income and therefore their expenditure on clothing.

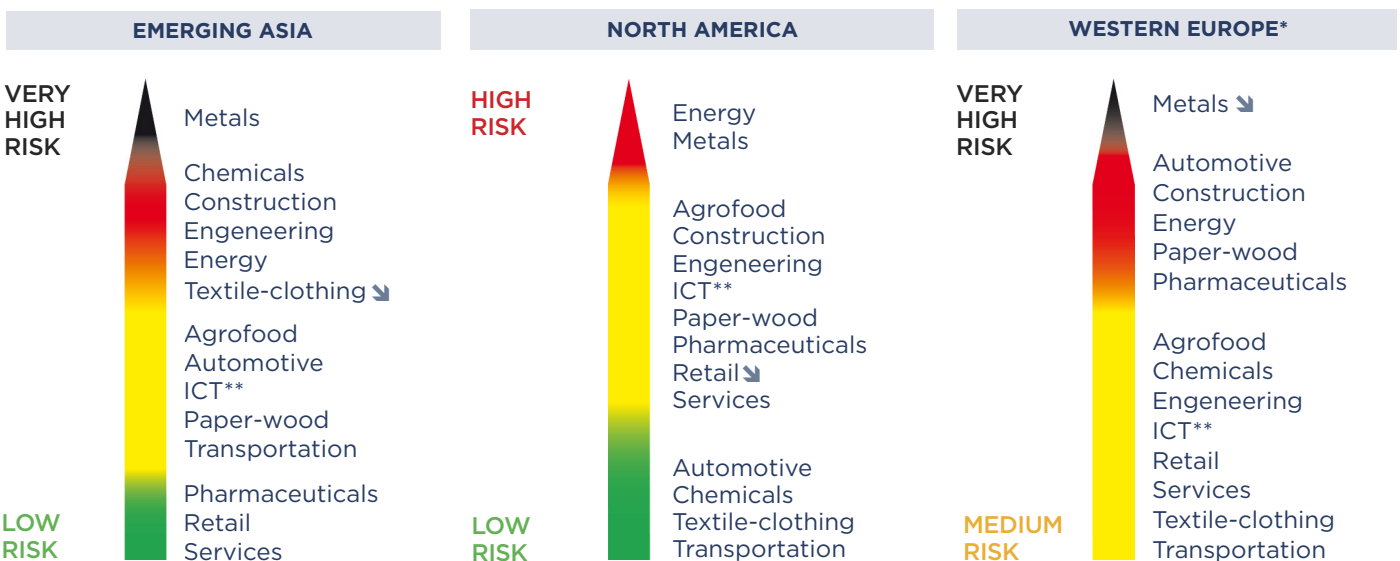
| The risk remains low

EMERGING ASIA

Although demand remains dynamic in the zone, companies are coping with disruptions. The worldwide market for cotton was disrupted by the announcement by the Chinese authorities in September 2014 that they were going to reduce their imports of cotton in order to clear national stocks, which represent more than 100% of annual production. To do this, they are imposing taxes on imports. Volumes of imported cotton therefore dropped by 23% at the end of October 2015 over one year.

Sectorial risk assessment

Hierarchy sectors



↗ The risk has improved ↘ The risk has deteriorated

* European Union 15

** Information and communications technologies

(32) Asia challenged by China's slowdown", Coface, September 2015

RESERVATION

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