TRADE LINE

Coface's magazine for its clients and partners

Issue 19 | March 2012

Coface Country Risk Conference 2012

SPECIAL EDITION

Main lessons drawn from the Coface Country Risk Conference 2012 in Paris

coface

2012 Coface Country Risk Conference: CONTENTS

*We would like to acknowledge **Sébastien Boinot** and **Thomas Gillet**, who contributed to collecting content and writing the articles for this special issue.*

You can consult the speakers' presentations on the site dedicated to the 2012 Conference: **www.coface.com**.

Sébastien Boinot
Intern at the "Economic Studies and Country Risks" Department of Coface. Graduate of the Institute of International and Strategic Relations and ESCE – Paris.

Thomas Gillet
Intern at the "Economic Studies and Country Risks" department of Coface. Graduate of the "International economics and development" master 2 programme at Paris Dauphine.

If you would like more information, drop us a line at: communication@coface.com

or: src@coface.com

or call: 0825 125 125 *(0.15 euro per minute incl. tax)*

Information review published by Coface - 12, cours Michelet - 92800 Puteaux **/// Jean-Marc Pillu,** Publication Direction **/// Marie-Laure Meunier,** Managing Editor **/// Patrice Godeau,** Chief Editor **/// Françoise Crouïgneau, ///** Editorial Advisor **/// ISSN :** 1966-6780

One day to understand the opportunities and risks of 2012

Like at the beginning of each year, Coface organized its 16th conference in Paris on 16 January 2012, which has become the flagship event in the field of country risk, one of its main areas of expertise. An exercise, particularly challenging for 2012. For the coming year, a slowdown in global growth and a sovereign debt crisis in the developed countries are expected. Between the United States, where recovery seems to be underway, Europe, disoriented by the resurgence of its structural and institutional vulnerabilities, and the emerging countries, where growth remains strong but political uncertainties remain real, decision-makers need explanations and reference points more than ever. The discussions that took place during this Conference among renowned French and foreign economists, entrepreneurs, and academics will help them to rely on analysis of changes in the economic, monetary, commercial, and strategic situation in order to assess the business environment, in France and on the international stage, which they must take into account in order to develop their own strategy.

The discussions of the Country Risk Conference were led by **Raphaël Kahane,** *News Anchor, France 24*

François David
Chairman of Coface

Three major risks

At the opening of the conference, François David, Chairman of Coface, emphasized that after a 2011 year marked by contained growth of the global economy, 2012 will be the year of a slowdown. Although businesses have rebuilt their margins since the 2009 crisis, the environment will remain characterised by three main risks.

- The first risk pertains to the uncertainty of the economic situation in the United States: will Republicans and Democrats manage to resolve their budgetary quarrels in this electoral year while household consumption remains the main engine of growth across the Atlantic?
- The second fundamental risk is related to the resolution of the sovereign debt crisis in the euro zone: will Europe manage to strengthen its institutions and governance and reduce its public deficits while creating growth?
- The third risk involves the major emerging countries which will continue to experience steady rates of growth. But the resurgence of political risk, particularly in China and Russia, and the impact of the euro zone crisis could affect their momentum.

"Business as usual, that's over"

Angel Gurria
Secretary-General, OECD

Global growth in 2012: another dip?

According to the Secretary-General of the OECD, 2012 will be the year of a widespread slowdown of the global economy.
Faced with the storm of the sovereign debt crisis, structural reforms must become the "war cry" of governments in order to restore the competitiveness of their economies and boost growth. There will also need to tackle the "human dimension of the crisis, unemployment" and fight rising inequality. In short, "business as usual, that's over".

The storm of the sovereign debt crisis

In its latest economic outlook of December 2011, the OECD forecasts a slowdown in the growth of the organization's member countries. After reaching 1.9% in 2011, it is expected to be limited to 1.6% on average in 2012 and 2.3% in 2013. The economic situation will be particularly sensitive to fiscal tightening in the United States and to a sovereign default in the euro zone. This entails disastrous effects on the banking systems. Although the situation remains uncertain in the United States, Angel Gurría recalls that the euro zone is already in recession, a perspective aggravated by the downgrade of the rating of nine European countries by Standard & Poor's on 13 January 2012. Ten years after the creation of the single currency, Europe is in the midst of the most serious sovereign debt crisis in its history.

An emergency, structural reforms

Faced with the seriousness of the situation, a proactive political action is imposing itself on governments and multilateral institutions. Beyond a stabilization of public finances – particularly in the euro zone and the United States – Angel Gurría calls for the implementation of structural reforms, as States no longer have room for manoeuvre to pursue expansionary budgetary policies like they did during the financial crisis.

These structural responses must be "tailored" based on the problems of each of them. For example, the euro zone is currently facing a paradoxical situation: after pleading for convergence of the economies of the countries that make it up, during the creation of the euro, competitiveness differentials are becoming wider. A better balance should now be targeted between the surplus countries and the deficit countries.
On the budgetary consolidation front, it will be necessary to juggle expenditures, which should be limited and made more efficient. Just like on revenues: by eliminating, in particular, certain tax niche and certain farming subsidies and by making the most of green taxation. For Angel Gurría, "CO_2 is the enemy, carbon must be taxed".

The fight against unemployment among young people is a priority

Such structural adjustments cannot be decided upon without taking their social consequences into account. For the Secretary-General of the OECD, it is the responsibility of the governments to establish safety nets for the populations most harmed by the crisis. And it is a priority to fight against unemployment among young people, which now averages 20% in OECD countries, with peaks at 30% or even 50% in certain cases. For Angel Gurría, if we are not careful, an entire generation could be lost, considering the weak growth and increasing inequalities. And to cite Napoleon I, "misfortune is the midwife of genius", to emphasize the essential nature of political leadership which is able to emerge from the turmoil in the developed countries while having the audacity to innovate and build a strong society.

> "Structural reforms
> must be tailored to respond to the problems of each country"
>
> *Angel Gurria*

Patrick Artus

Jean-Louis Bourlanges

François Heisbourg

Max Otte

Nicolas A. Vernicos

Advanced economies fall victims of their public debt?

In response to the subprime crisis, the governments of the developed countries have taken on debt in order to support their banking and financial system with counter-cyclical policies intended to avoid depression.
The worsening of the budget deficits and the public debt level have brought Europe's sovereign debts to centre stage.
Faced with its first major crisis, how can the euro zone emerge from it?
Does the United States face long-term deterioration of its public finances?
Responses with Patrick Artus, Jean-Louis Bourlanges, François Heisbourg, Max Otte, and Nicolas A. Vernicos.

Specific features of the United States and Europe

According to **Patrick Artus (Director of Research and Studies, Natixis)**, the US strategy differs from the strategy adopted by Europe in three ways.

- First, the United States chose a systematic stimulus policy on both the budgetary and monetary level. It is true that the dollar's dominant place in international trade facilitates the financing of the US budget deficit by central banks around the world. Conversely, the euro zone's member countries have all simultaneously committed to budgetary consolidation programmes, which is harmful to the euro zone's growth.
- Second, the Fed, unlike the ECB, directly finances the US public debt. This policy, known as quantitative easing (QE), allows interest rates to be kept at very low levels and credit to be boosted. In the euro zone, the impact on the real economy of the "financial repression(*)" strategy is much more uncertain.
- Third, this quantitative easing policy has made it possible to boost activity through a more direct channel than credit. QE2 *(see interview with Patrick Artus)* has permitted a decrease of more than 2 points in household savings. The resumption of household consumption has supported investment and employment: for Patrick Artus, there has even been a reindustrialization of the country.

The euro zone is suffering from its misdiagnoses...

As he addresses the problems specific to the European Union, Patrick Artus regrets the misdiagnosis made on the euro zone's crisis. In his eyes, a distinction should be made between solvency crises, like Greece's, and liquidity crises, like those

"The issue of liquidity and the issue of solvency should not be confused"

Patrick Artus

(*) *All of the means used by States to push the financial institutions of their countries to finance their sovereign debt.*

"Economic policies can no longer be designed independently of each other"

François Baroin

The Minister of the Economy, Finance, and Industry, François Baroin, presided over the Country Risk Conference's lunch. During his speech, he expressed the government's willingness to obtain a substantial reduction in public deficits and strengthen the competitiveness of French businesses through reform of the labour market and convergence of budgetary and fiscal policies within the euro zone. Regarding public finances, François Baroin called for a consensus on the "golden rule" and a strict application of the European intergovernmental treaty signed on 9 December 2011, which has the main objective of limiting structural public deficit to 0.5% of the GDP of the signatory countries.

"The case of Greece must be isolated"

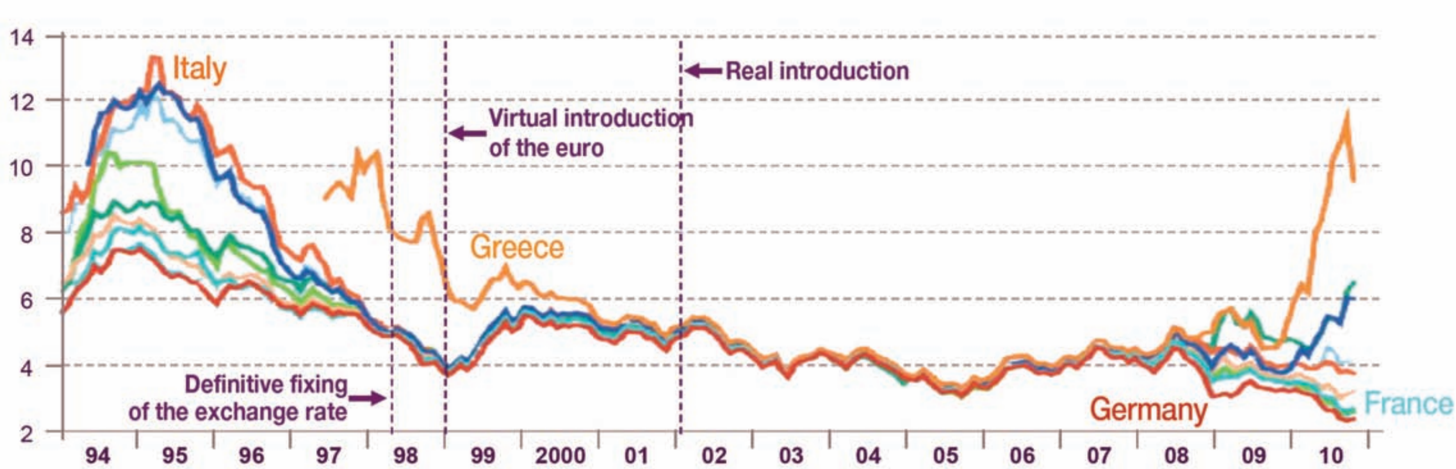
Patrick Artus

seen in Spain and Italy. Unlike the policies previously pursued by multilateral institutions, Patrick Artus recommends them to restructure the Greek debt and to provide a temporary financial aid to Spain and Italy.
For him, "financing by banks of countries faced with a solvency crisis is an inappropriate response, just like the exclusion of certain countries from the euro zone".
The effectiveness of a devaluation, which cannot be avoided in such a scenario, implies the existence of a national industry, which is able to take advantage of the improvement of its price competitiveness.
However, the weakness of Greek industry would make this type of solution counter-productive. Greece, whose imports are 2.5 times greater than its exports, would then be faced with a sharp increase in imported inflation.

...and an unfinished monetary union

After recalling that the origins of the crisis cannot be forgotten, having arisen out of subprime loans in the United States in 2007, **Max Otte (Founder of IFVE Institut für Vermögensentwicklung GmbH & Professor at the Karl Franzens University of Graz)** emphasizes that the European Union's economy is "much healthier" than the US economy. In order to understand the euro's faults: the euro was "poorly designed" to the extent that it cannot rely on a common budgetary policy; the convergence of sovereign risk premiums among member countries ***(see table 1)*** was the symbol of a show of economic unity, behind which profound divergences persist in terms of production structure and competitiveness between the heart and the periphery of the euro zone. Overall, the sovereign debt crisis is a reflection of an unfinished monetary union project and re-establishes a hierarchy among the member countries, previously concealed.

Table 1 - Interest rate spreads



Source: Institut Ifo, Munich

> "Greece, a laboratory for the European Union"
>
> *Nicolas A. Vernicos*

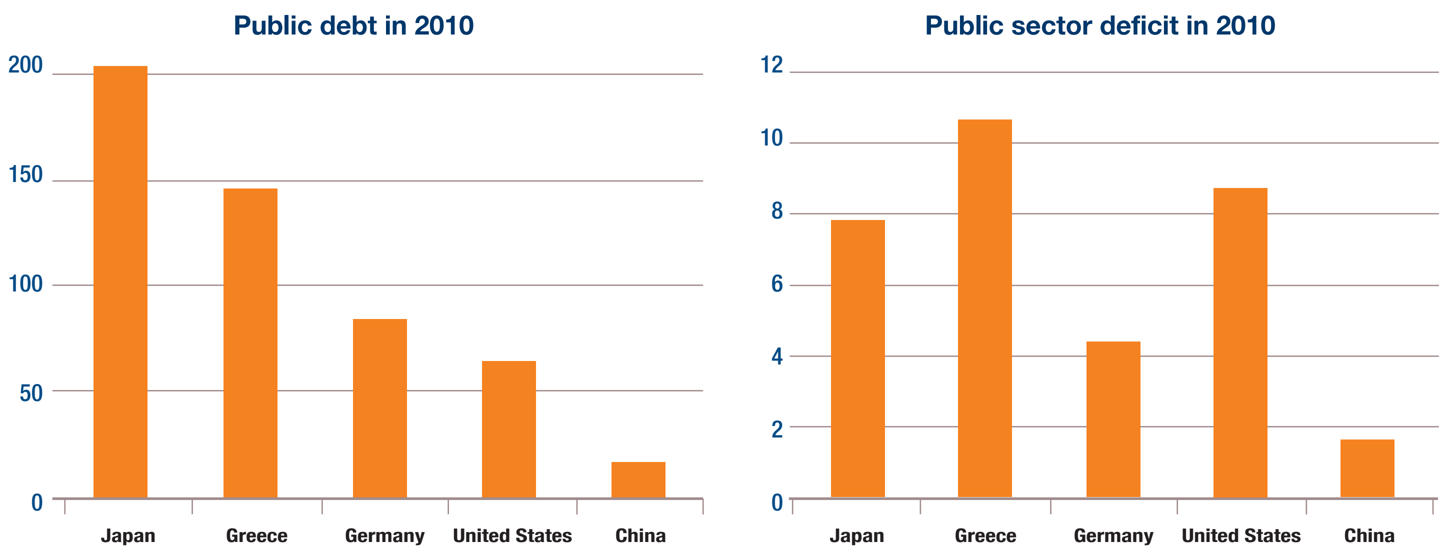
In this respect, Greece is a test country for the European Union, despite its low significance in terms of GDP within the euro zone: the first which suffered sudden mistrust on the part of investors, the first to restructure its debt, and even the first to bring unilateral default to light *(see table 2)*. This is what **Nicolas A. Vernicos (President of the International Chamber of Commerce-Hellas)** empha-sizes. According to him, Greece is quite simply a laboratory for the European Union.
It allows the EU to test its economic policies, as it offers economists the possibility of testing the effectiveness of their theories, particularly on the break-up of the euro and Greece's exit from the euro zone, which most Greeks do not want. He also brings up the vicious cycle related to the euro zone's imbalances, with the current balance deficits of countries of southern Europe being the consequences of the surpluses of the countries of the North. For example, the Greek defence budget (6.5% of GDP) is considered excessive, but its expenditures, devoted particularly to securing the Union's external borders, allow other euro zone countries to sell...military equipment. For his part, **Jean-Louis Bourlanges (Professor, Sciences Po)** regrets the narrow view of Germany's diagnosis of the euro zone's crisis. Without refuting the need to reduce public spending, Jean-Louis Bourlanges insists on the structural dimension of the crisis. The budgetary aspect must not lead the euro zone to conceal its main vulnerability, namely the competitiveness differentials among its member countries. According to him, the gradual increase in unit labour costs in southern Europe has gradually eroded the repayment abilities of the countries currently at the centre of the sovereign debt crisis.

The euro zone crisis, a political issue

According to Jean-Louis Bourlanges, the downgrading of sovereign ratings by Standard & Poor's, like France's and Italy's, must be analyzed through the prism of the flaws in European governance. He also deplores the fact that Europe, under German pressure, has fallen into "the trap of automatic rule" of the return to balance of public finances that applies to all member countries without taking the diversity of national economic situations into account. This is the main defect of the next European treaty adopted on 9 December 2011. Although Standard & Poor's is concerned about the consequences of austerity policies that will curtail the growth of euro zone member countries, Germany should have been downgraded, like the entire euro zone, since it is the one which recommends them irrespective of national situations. "A little spoonful of political sulphuric acid" on a real problem of public finance deficits".
François Heisbourg (Special Adviser, Foundation for Strategic Research) shares this concern. He wonders about the relevance of the restrictive budgetary policy advocated by Germany. According to him, the euro zone's growth will pay a heavy price for the many austerity programmes currently at work. The European treaty of 9 December 2011 involves pulling the structural deficit (corrected for cyclical fluctuations) back down to 0.5% of GDP starting on 1 January 2013. Although he remains sceptical about the ability of the member countries to comply with this, he fears that its consequences will not lead to a recession over several years and will not play into the hands of populist parties.

> "The downgrading by Standard & Poor's is an attack against Europe"
>
> *Jean-Louis Bourlangues*

Table 2 - Public debt (as a % of GDP)




Rajiv Biswas


Yifan Hu


Jérôme Contamine


Yves Zlotowski

Can the BRICS save the world economy?

While developed countries see their growth prospects hampered by the burden of debt, emerging countries seem to have absorbed the recent financial crisis decently. In 2012, global growth should remain dependent on their good health and the rapid development of their domestic market. Yet, despite their robust performance, the BRICS continue to face major challenges. An overall assessment of the influence of the BRICS on the global economy with Rajiv Biswas, Yifan Hu, Jérôme Contamine, and Yves Zlotowski.

A reservoir of growth for the global economy

With growth prospects of around 7% to 8% per year in India and China, the momentum of the BRICS and the growth of their domestic market should support the global economy over the coming years and offer developed countries new opportunities to take advantage of increased domestic demand.

Jérôme Contamine (Executive Vice President, CFO, Sanofi) confirms this. Considering this rapid growth of domestic markets, during the next decade, it will be impossible to ignore emerging countries as drivers of growth for many industries of developed countries.

Rajiv Biswas (Senior Director and Asia-Pacific Chief Economist, IHS Global Insight) specifies that, in the medium term, the domestic markets of India and China present colossal development potential, particularly in India because of a demographic outlook that is more favourable than in China. Although Brazil and Russia will benefit from growing demand for commodities from India and China, developed countries will not be left behind with new markets to be conquered.

Yifan Hu (Managing Director, Head of Research & Chief Economist, Haitong International Research Limited) shares this point of view, recalling that the BRICS currently represent 40% of the world's population and 20% of global GDP. "It is a tremendous reservoir of growth that will support the global economy over the next twenty years". However, Yifan Hu dampers this enthusiasm, emphasizing that the upturn in activity of developed countries will involve, above all, the resolution of their internal problems, starting with their ability to develop new segments of growth on their own domestic market. In brief, she believes that China, which is wondering about the way to manage its internal problems and its rise in power, is in a situation of "adolescent frustration", while the United States, which has entered "middle age", can rebound, and the European Union has entered "old age" in terms of both its institutions and its industry.

> “Nobody can ignore the emerging markets as drivers of growth of any industry”
>
> *Jérôme Contamine*

> "The growth of India and China will promote regional momentum"
>
> *Rajiv Biswas*

According to Rajiv Biswas, the fact remains that in Asia, the sustained growth of India and China will promote regional momentum through the amplification of trade of semi-finished products intended for assembly and export to the major developed countries. The current uncertainties about the strength of the recovery in the United States, the risks of recession in Europe, and the sluggishness of growth in Japan are still risks of decline in activity for the BRICS.

The hierarchy of country risk assessments has changed

In terms of risk assessment, the refocusing of global growth to emerging countries changes the analysis of country risk. According to **Yves Zlotowski (Chief Economist, Coface)**, the new fact that emerges from the current crisis is the change in the hierarchy of risks: a clear improvement in emerging countries – although there is still a problem of financing of investments – in sharp contrast with the deterioration of the situation within developed countries. The Coface assessments of nearly all of the countries of southern Europe are thus currently lower than those of China, India, and Brazil. Another major change lies in the "quasi-sovereign" risks of public entities. The assessment of risk must thus be revised in light of, for example, the swelling of the portfolio of the Brazilian public bank BNDES, large public enterprises in Russia, or local authorities in China.

New challenges for China...

Despite their intrinsic strengths, the BRICS must still take up significant challenges. While acknowledging China's strong potential, Yifan Hu brings to light the primary vulnerabilities of the country that she considers to be a "superpower of the future". Among the challenges is the absolute need to redirect a model overly focused on exports toward the domestic market. This means economic, political, and social reforms essential for the increase in per capita GDP and the growth of consumption: between 15% and 20% of household resources are still devoted to covering their social needs in health, education, etc. Lastly, China will need to do its best to accelerate the rise in significance of its industry, with 60% of current exports resulting from an assembly process with low added value. On this point, Rajiv Biswas feels that this necessary rise in significance will inevitably generate increases in wages and the relocation of certain production units to the centre of the country or to neighbouring countries presenting more competitive production costs..

...and for all of the major emerging countries

Other challenges are not specific to China: all of the BRICS have to manage the strong acceleration in investment. However, according to Yves Zlotowski, there is still a problem of access to credit in many emerging countries because of the limited financing capacities of the national banking sectors. Although China is experiencing rapid growth in credit, Russian and Brazilian businesses are widely limited to financing themselves abroad and taking out loans denominated in foreign currencies. In addition, despite impressive potential, large emerging countries are still facing corruption problems and, in the case of Russia, a worrying demographic situation, not to mention a lack of transparency of corporate accounts and an instability of property rights that leads to capital outflows valued at 8 billion dollars per quarter.

A more fragmented club than it seems

As Jérôme Contamine points out, the strong growth of the BRICS hides very diverse national and regional situations, in terms of both demography and business environment. Rajiv Biswas feels that Russia's erosion in the BRICS hierarchy will be confirmed because of its ageing population, a limited domestic market, and a business environment that is unfavourable on the long term. In addition, Yves Zlotowski emphasizes that the potential unity of emerging countries is undermined by China's growth model. The Chinese, through their imports of commodities, contribute to the deformation of the productive structure of other major emerging countries and, in Brazil, a beginning of the deindustrialization of its economy.

> "What is spectacular is the shift in the risk hierarchy"
>
> *Yves Zlotowski*

The West is out of step with a strategic analysis

Hubert Védrine

Former Minister of Foreign Affairs,
Managing Partner of Hubert Védrine Conseil

Political and economic uncertainty in emerging countries

According to Hubert Védrine, the growing influence of emerging countries in international power relationships is, above all, the act of the West, which has been lagging in its strategic analysis since the fall of the Berlin Wall and the disappearance of the USSR. The "end of history" assumption, which made a splash during the 1990s, then the focusing on the fight against international terrorism during the 2000s blinded Westerners, which was considered as emerging "markets" proved to be true "emerging powers". The creation of the G20 illustrates their economic boom: looking into the near future, the sum of the GNPs of the G7 will be exceeded, in 2020, by that of the GNP of the top seven emerging economies.
Their geo-strategic consequences need to be better assessed, and a realistic, lucid, coordinated policy should be chosen in order to safeguard the West's regulatory capacity.

The influence of the BRICS should still be put into perspective

For the Former Minister of Foreign Affairs, the growing influence of emerging countries – and particularly the BRICS – should still be put into perspective. After underestimating the power of the BRICS, are we currently underestimating their weaknesses? Four factors are to be noted.

- First of all, the persistence of political risk. The risk of instability remains strong in Russia and China, while a deteriorated business environment continues to curb economic performance in India.

"After underestimating the power of the BRICS, are we currently underestimating their weaknesses?"

Hubert Védrine

- In terms of economic, the triumphant decade of the 2000s seems to be over. Some analysts suggest the upcoming emergence of bubbles, the slowdown in foreign demand, and the maintaining of strong inflationary pressures as brakes to the growth of the BRICS.
- The social difficulties remain numerous. In China, there are more than 200,000 cases of annual confrontations between the population and the controlling forces, mainly around social and environmental issues.
- The unity of emerging economies tends to be overestimated. Beyond their protesting tone with international institutions, the BRICS are far from being uniform. On the contrary, they remain competitive on many levels, and strong historical rivalries persist.

Putting the power of the BRICS into perspective has become a necessity. This is especially true given that this causes an underestimation of the western capacity for resilience and rebound. Although there is a great uncertainty regarding Europe, the military potential and influence of the United States remain significant.

In addition, few emerging countries wish to face China alone so the West remains a sizeable counterweight to an overly strong Chinese influence.

We must overcome the prevailing pessimism

For the next thirty year, if the strategic scenario cannot be based on the assumption of western supremacy, we cannot believe, conversely, in the predominance of the emerging countries, even by taking the significance of China into account. Despite this apparent lack of cohesion, the world will not be a "strategic chaos", to cite Pierre Hassner, but a fragile environment is changing. For Hubert Védrine, it has become necessary to overcome the prevailing pessimism and avoid any strategic utopianism.

The West must define a realistic policy of extreme lucidity. It must overcome "western-centrism" without sinking into despair. Three factors will determine the success of this strategy. It must first go through the revitalization of western economic potential. In this sense, the ecologization of the economy will constitute one of the main challenges of the next thirty years. Then, it must be sustainable, just like the US strategy of containment against the USSR, which survived the succession of the various administrations. Lastly, it will need to be coordinated among the various western countries and with certain emerging countries. By applying these recommendations, the West will be able to preserve its global regulatory capacity, as the Former Minister of Foreign Affairs claims.

"Agenda"

"Country Risk" events in 2012

Coface is organizing Country Risk Conferences in 2012 in countries where it is directly established.

- Barcelona: 23 May
- Bucharest: 26 September
- Buenos Aires: 19 April
- Casablanca: 10 May
- Lisbon: 22 May
- Madrid: 5 June
- Mainz: 26 April
- Mexico City: 7 May

- Milan: 9 May
- New York: 10 May
- Prague: 18 April
- Riga: 8 November
- Singapore: 11 june
- Vienna: 9 May
- Vilnius: 7 November
- Warsaw: 11 October

For more information: communication@coface.com

Laurent Bresson

Olivier de Boysson

Political shocks in emerging countries: reasons for hope?

Mamoudou Gazibo

2011 will be remembered as the year of "revolutions" in North Africa and in the Middle East and the return of political risk to centre stage. In an environment marked by many uncertainties, 2012 will be marked by the persistence of major political issues. Although the political transitions suggest great opportunities, they contain a real risk, one of radicalization.

Laurent Bresson, Olivier de Boysson, Mamoudou Gazibo, Deniz Gökçe and François Heisbourg are taking stock of political risk in emerging countries.

Deniz Gökçe

François Heisbourg

Arab awakenings, between risks and opportunities

As **Olivier de Boysson (Chief Economist for emerging countries, Societe Generale)** points out, the revolts in North Africa and the Middle East have had very different impacts according to the countries. In Tunisia, Egypt, and Lebanon, democratic aspirations have resulted in regime changes, whether peaceful or violent. In the monarchy countries, Morocco, Jordan and Saudi Arabia, popular uprisings have been contained by public spending on social efforts or, like in Bahrain and Oman, by security measures. These upheavals constitute a major step in a process of transition toward modernity, marked in recent years by an increase in the literacy rate and a demographic shift, as these countries have seen a spectacular decrease in their fertility rates. If they are well managed, the "Arab awakenings" should have positive consequences on the savings capacity of households and permit an increase in rates of investment and growth.

> “Some countries have experienced revolutions, others evolutions”
>
> *Laurent Bresson*

Much progress must be made in terms of economic and social policies. In most countries, growth still brings too few new jobs, as evidenced by the high unemployment rate among young people and the dualism between a small number of large businesses and very small businesses often confined in the informal economy. These businesses, with few exports, also suffer from low competitiveness and an unfavourable business environment. There is also the problem of financing the political transition period. Although uncertainties about maintaining the exchange rate in Tunisia are low, certain countries, such as Egypt, are experiencing a drop in their revenues in foreign currencies because of the contraction in tourism and the decrease in direct foreign investments. For **Laurent Bresson (Managing Director, Maersk Maghreb)**, economic activity in Turkey, Egypt, and Libya has been profoundly disrupted by revolts. He also feels that the political transitions will be long and will need to be financed in the short term. Political risk should fade in the long term, but authority, whether political or economic, will need to be embodied more clearly. For **François Heisbourg (Special Adviser, Foundation for Strategic Research)**, moderate Islamic parties in Egypt and Tunisia will play the economic liberalism card. However, he worries about the growing strength, previously underestimated, of radical Islamic parties in Egypt.

Turkey, a growth model into question

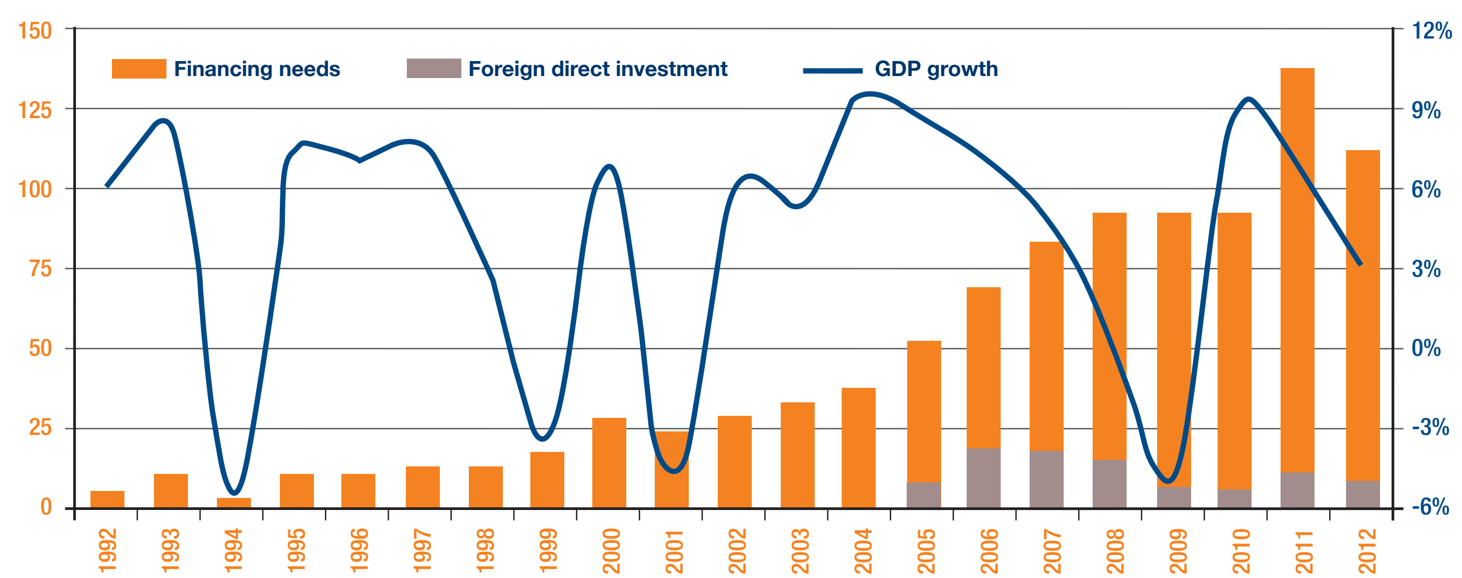
Over the last decades, Turkey has undergone profound changes. As **Deniz Gökçe (Professor, Ankara University)** describes, the urbanization of the population, the changes in family structures, and the feminization of the labour market have made it possible to reinforce the economy's productive structures. With half of the population under age 25, Turkey has a significant demographic advantage. Tertiarization of the economy, control of budget deficits, and control of inflation have also made it possible to establish economic leadership in the region. On the political level, the arrival to power of the AKP in 2002 favoured the country's political stability and the implementation of pragmatic reforms. In addition, the growing influence of Ankara on the international stage and its independent stances have made this country an indisputable regional player.
Yet, despite its many advantages, the Turkish model remains handicapped by much vulnerability. According to François Heisbourg, the volatility of Turkish growth in recent decades *(see table 3)* illustrates the weakness of the model, and he does not exclude a possible authoritarian trend from the AKP, judging from the policy on freedom of the press and the control exercised over the judicial system, in an environment in which credible opposition parties have struggled to emerge.

> "In the 1990s, Africa had its 'spring'"
>
> *Mamoudou Gazibo*

Highly variable protest potential in sub-Saharan Africa

According to **Mamoudou Gazibo (Associate Professor, University of Montréal)**, in the 1990s, sub-Saharan Africa saw protest movements comparable to those currently observed in Arab countries. The continent has thus moved from phenomena of "political poaching" to true mobilizations calling for democratic change.
These movements have made it possible to contribute more political pluralism and freedom of expression, even though the degree of change has remained very different from one country to another. Today, in sub-Saharan Africa, the institutionally strong countries are less prone to political upheavals. On the other hand, these countries also remain characterized by a break between the State and the civil society particularly conducive to popular uprisings.
Protest movements in the countries of North Africa and the Middle East have had a significant impact on sub-Saharan Africa, as the demonstrations in Sudan, Senegal, Burkina Faso, and Cameroon show. However, the magnitude of these movements has remained contained and without comparison with those that took place in Tunisia, Egypt, and Libya. One of the main reasons is the absence of drivers of change, such as education level, Internet access, structuring of the civil society, and the existence of a credible political alternative. In addition, a kind of weariness has settled in many countries. For Mamoudou Gazibo, the potential for mobilization and the emergence of a large-scale protect process depends on a multitude of factors, both endogenous to social movements and exogenous to the dynamics of power.
François Heisbourg's analysis is more positive. According to him, significant political risks persist, given the ethno-religious rivalries, as is the case in Nigeria, a country faced with significant tensions between the Christian and Muslim faiths. Yet, according to him, Africa remains a land of hope with high growth levels, and the rapid development of new technologies such as mobile telephony and associated banking services provides more optimism about the continent's future.

Table 3 - Turkey: financing requirements coverage and growth



Yves Zlotowski
Chief Economist, Country Risk and Economic Research Department, Coface

Risks overview

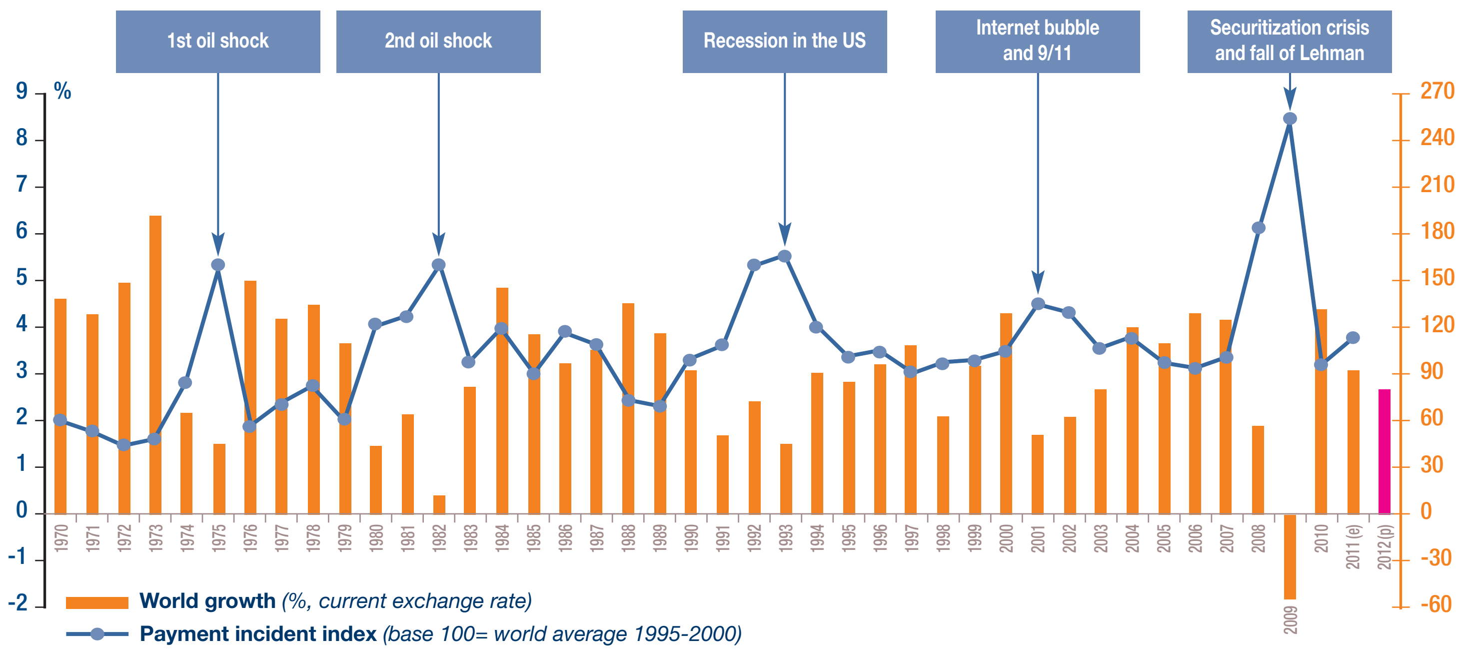
For Coface's Chief Economist, we have entered a "truly different" type of crisis. Previously, the cycles were characterized by five to seven years of strong growth, followed by two years of high payment incidents noted by Coface and weak growth *(see table 4)*. This time, the bright spell lasted only two years: since mid-2011, the global economy has slowed down, especially in Europe and payment incidents are increasing again.

Nagging, the current crisis is, like past crises, a crisis of debt. However, it is not a crisis of corporate over-leveraging. Except in Spain and the United Kingdom, no trend of massive corporate over-leveraging is emerging. The specific characteristic of this crisis is not related to the over-leveraging of States. In a period of slower activity, it is common for States to take on debt in order to implement the counter-cyclical budgetary measures to avoid recession or even depression. Thus, the increase in government debt observed since 2008 falls within the tradition of historical experiences.

“Regardless of the treatment of the sovereign crisis, it will be costly for businesses”

Yves Zlotowski

Table 4 - Growth and payment incidents noted by Coface since 1970



> "Because of financial overlapping, a local sovereign crisis is becoming a global, systemic crisis"
>
> *Yves Zlotowski*

However, the current crisis is peculiar because of:

- A size effect that weakens and thereby makes all of the announced bailout plans less credible. Greece's default is an event to which it is possible to provide an answer, with public debt representing 4% of the euro zone's GDP. But the problem takes on a totally different magnitude with Italy's entry into the turbulence. Its public debt is 22% of the euro zone's GDP, and its foreign debt represents, in chained dollars, seven times the Argentine foreign debt and eight times the Russian debt at the time of their payment defaults in 2001 in the Argentine case and 1998 in the Russian case *(see table 5)*.
- Strong global financial integration that goes beyond the euro zone's member countries in order to involve countries like United Kingdom or the United States and transforms a "local" sovereign crisis into a systemic crisis.

What are the solutions for managing Europe's sovereign debts? According to past experiences, there are several crisis treatments, but all affect businesses. The first is radical: like during Russia's unilateral default in 1998 and Argentina's in 2001 on their market debt. There was a disastrous recessive shock for businesses.

The second option is illustrated by the cases of Brazil and Turkey. It is based on the implementation of restrictive budgetary policies over time. Considering the high potential growth, these two countries have been able to avoid an extended period of economic anaemia, which is not the case for the euro zone's member States. Needless to say, a long period of austerity would be very costly in terms of growth and therefore activity for European businesses. Lastly, the third solution would be to implement a policy of "financial repression", as was the case in India and Lebanon.

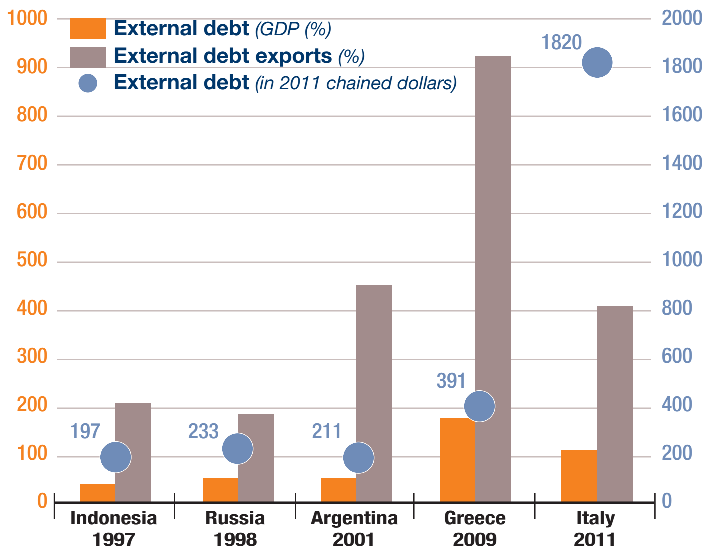
This means encouraging or coercing, through formal regulation or informal persuasion, local financial players to purchase sovereign debt securities. The resulting eviction effect has an impact on the private sector, with the supply of financing being biased in favour of the public sector.

In any event, 2012 is off to a difficult start for businesses. Coface expects an increase in payment incidents in the United States. However, since mid-2011, the deterioration has been concentrated on the euro zone, with a 20% increase in non-payments. Times are hard for French businesses, as they depend much more on credit than US businesses, which generally have stronger self-financing capacities. As for German businesses, they are highly dependent on changes in global trade. For example, a 40% increase in non-payments is expected in Spain and 52% in Italy. These two countries are now rated A4 by Coface, lower than Brazil.

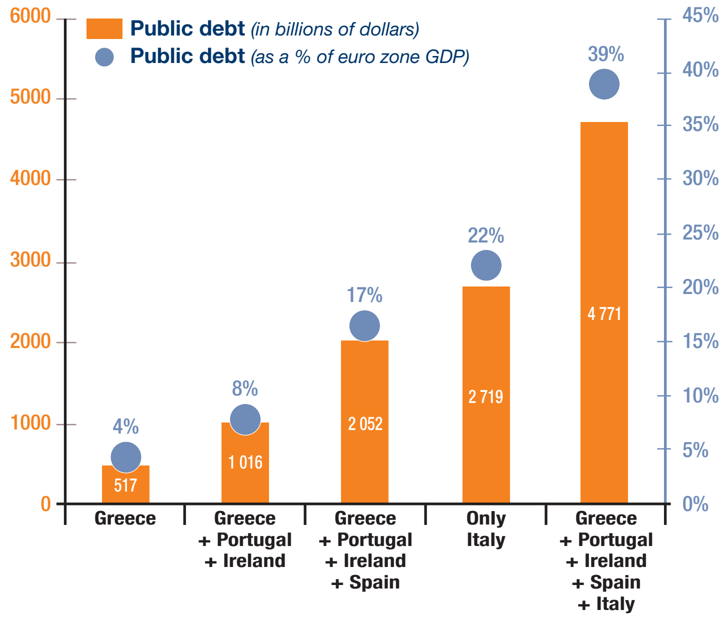
> "Payment incidents will increase in the United States, but especially in the euro zone"
>
> *Yves Zlotowski*

Table 5 - With Italy, the crisis is changing in size

Italy versus emerging crises



Italian debt: a centre weight in the euro zone



The US economy is vulnerable, but a reindustrialization movement is emerging

Patrick Artus

Director of Research and Studies, Natixis

Trade Line (TL): The US is enjoying very low yields on its 10-year Treasury Bonds, despite the loss of its AAA rating. How come?

Patrick Artus (PA): Because the dollar has held onto its status as a reserve currency, accounting for 64% of the planet's total reserves, and because it continues to finance most global trade. Central banks therefore continue to buy US Treasuries, which has helped to keep their yields low, without any real connection with the country's agency rating. Moreover, under operation "Twist", the Fed sold short-dated Treasuries massively, using the proceeds to buy other, longer-dated Treasuries, to push down interest rates on their long-term financing. This is one way to boost corporate investment and consumer spending, via the channel of credit.

TL: In order to reduce the budget deficit, what would be the method the least costly for the US growth: to increase receipts or to cut spending?

PA: The process of budget deficit reduction has already been launched in the US for about two years. Although it will take a long time, the US will shrink its budget deficit through a recovery in growth and/or a reduction in certain public expenditure, for example military outlays. That said, the increase in healthcare and pension spending could complicate things. But the US imposes a light tax burden. An increase in the capital gains tax rate, currently 15%, gives the US leverage that it could use if necessary. This is leeway that European countries no longer have at their disposal.

TL: With savings outflows and stagnating wages, how will US households be able to maintain their expenditure?

PA: QE2 (Quantitative Easing 2, which some call "monetisation of debt") was conducted by the Fed from November 2010 to June 2011 to encourage households to sell their public debt securities. Americans did so aggressively, to the tune of about 600 billion dollars. And households spent their resulting capital gains, thus jump-starting consumer spending and, hence, corporate investment, real estate and employment. US authorities have thus used this non-conventional mechanism to manufacture an economic recovery, as recoveries traditionally occur through the channel of credit.

At the same time, there has been a process of reindustrialisation in the US, facilitated by wage costs that are lower than in other OECD countries. One hour of labour, for example, costs 20 euros in the US, vs. 34 euros in France. For two years now, the number of industrial jobs has already risen sharply, and the trade deficit in industrial goods has almost vanished. Meanwhile, the US has begun to produce very cheap shale gas. The energy sector is benefiting from this trend and is playing a large role in the reindustrialisation of the US by developing gigantic energy projects. This will ultimately reduce the US's oil bill and reduce its trade deficit.

TL: However, the recovery in US economic activity is still soft, and the long-term debt outlook is a cause for concern. Will the US's sovereign rating be downgraded again in 2012?

PA: Despite these industry-favourable trends, three factors are still hindering US economic growth: 1) fiscal policy is still expansionist, but less than before; 2) real per capita wages are falling, thus burdening consumer spending; and 3) the euro zone crisis has slowed exports to Europe. In this context, only an upturn in residential real estate could consolidate growth in the US economy (see above).

But, as I've just said, there are some positive trends. With the public deficit that is shrinking, growth is giving signs of a very gradual recovery; the trade balance is improving; the country is reindustrialising and becoming increasingly energy- independent, thanks to shale gas. The US economy therefore still has significant growth potential, which is more important for ratings agencies than the long-term outlook for public debt, which could hit 180% of GDP in 2030!

So I don't expect the US' sovereign debt rating to be downgraded in 2012. However, uncertainties on budget forecasts after 2013 could lead agencies to review their position.

What is your opinion of Standard & Poor's' downgrading of France? Why haven't yields risen, just like it was feared?

PA: In Europe, domestic actors play an increasing role in public deficits. And in France, we have very large institutional investors (such as insurance companies and the Caisse des Dépôts) likely to finance the public deficit. Moreover, non-residents' share of outstanding French public debt has fallen sharply, from 71% one year ago to 65% today. And domestic investors are pulling out of

the euro zone peripheral countries to invest in French Treasuries. Nationalizing the holding of debt is very stabilising and is helping to keep the refinancing rate relatively low.

However, I am more worried about the structural situation in France. For the moment, it is rated far better than Italy, which is hard to understand, given the structural differences between the two countries. Italy has twice as much industry as France, three times more exporting companies, and a 50 billion euro industrial trade surplus, vs. a 45 billion euro deficit for France. Only its public debt is higher than France's, at respectively 120% and 90% of GDP. It is therefore hard to find a rational explanation for the sovereign rating gap between these two countries or the gap in market yields, which is bad news for France's rating.

TL: Could we see a unilateral and disorderly default by Greece? If so, could contagion affect other distressed countries?

PA: Greece's public debt amounts to 180% of GDP, and its exports have shrunk by 40% since 2007. It is unable to reduce this public deficit due to falling tax receipts, rising bankruptcies, and tax evasion, which is only increasing. In fact, Greece is insolvent. Mere debt restructuring won't be enough.

This leaves two options. The first one would consist in cancelling its public debt outright, with each investor then having to take his losses. Indeed, a €100 billion reduction would lower Greece's debt burden from 180% to "only" 145% of GDP, which would change nothing in terms of solvency. The second option, advocated by the Germans, would consist in placing Greek debt in a "defeasance" structure that would cancel it gradually over the next 40 years. This would be a way to spread out the cost of default over the very long term.

Total debt cancellation would save Greece almost 6 percentage points of GDP, which is equivalent just to the amount of its interest. Its foreign deficit would shrink drastically, which would allow it to invest in its economy. But Greece has 400 billion euros of debt! Writing it off would not be without risks for foreign banks or for the European Central Bank. Greek banks, meanwhile, would not survive a hit like that and would go bankrupt. The second solution, gradual debt cancellation, would offer the advantage of spreading out the shock over time. I would like to point out that the situation is not at all the same for Portugal, Italy or Spain. Portuguese industry exports and the government is cutting its deficits, two improvements that the markets have thus underestimated. Italy and Spain, meanwhile, face a crisis of liquidity that they are absorbing by using domestic savings to finance the public deficit. The danger would be that domestic investors might refuse to continue financing their own public Treasury, as was the case in Greece with the massive withdrawals of bank deposits.

TL: Does financing public deficits using domestic savings raise the problem of hindering companies' access to credit?

PA: For the moment, companies have no real financing needs. They have raised their profits and lowered their capital expenditure. Financing of public obligations by investors and banks therefore does not raise the issue of eviction, as the use of banking intermediation to refinance governments has no impact on the real economy. However, if this drags out for 20 years, as it has in Japan, bond financing of private companies would become a problem. However, bank financing of public deficits publics is not meant to be a permanent solution. From a longer term view, having each country's Treasury renationalise savings is not a desirable outcome for euro zone countries. This is a stopgap and not a definitive remedy to the problem of government financing.

TL: In this context, should European governments adopt the golden rule?

PA: Europe needs common fiscal rules in terms of public deficits. However, we should be wary of hard and fast rules. The golden rule cannot replace a detailed economic assessment of how European Union countries use public monies. The budget surpluses that Spain ran between 2002 and 2008, which were created by the real estate bubble, did not prevent the crisis. A golden rule, if it had existed back then, would have changed nothing, as Spanish public finances were in surplus. There is such a thing as healthy debt, for example, that is used to invest in innovation or education, like the French Grand Emprunt launched in 2010. It is the nature of public expenditure that is at issue. A deficit caused by creating new public-sector jobs is not the same as debt used to finance research & development expenditure or the construction of universities. The golden rule has the virtue of simplicity, but is not the way to resolve the crisis or to restore growth.

TL: Will the austerity measures taken to varying degrees by European Union governments lead to recessions (negative growth) of soft growth in 2012?

PA: Growth in 2012 will be nil or almost nil. That's a fact. That is no longer at issue. What is more of a concern is the absence of strong potential growth in the coming years, especially as all euro zone countries are reducing public investment and as private-sector capital expenditure continues to shrink. We are therefore in the process of undermining European economies' ability to generate long-term growth. It would be wiser to spread fiscal consolidation out over time, but this is not possible, given the pressure being exerted on governments. During the 1990s, Sweden managed to reconcile fiscal rigour with investment spending. While public expenditure was cut by 20 percentage points of GDP, spending on research & development actually rose sharply. What should be done in Europe? We could use European structural funds to manufacture long-term growth, while governments continue to deleverage.

Inflation, consumption, energy, specific challenges for emerging countries

Rajiv Biswas

Senior Director and Asia-Pacific Chief Economist, IHS Global Insight

INDIA

Trade Line (TL): With a current account deficit and a still high inflation rate, India seems to have problem in curbing overheating. What are the main reasons why India is facing such difficulties?

Rajiv Biswas (RB): The problem of India on inflation began with the food and oil prices shock. India is a very energy dependant country and with oil prices still high it is an issue because the currency has depreciated by 18% last year against the US dollar. However domestic factors are playing a significant role too. Thus food price inflation pressure is partly due to a supply side issue, with the lack of investment in the development of the agricultural sector. Inflation is also generated by rising food prices. Moreover, there is an increase in wages, especially in the skilled sectors such as value-added manufacturing or financial services. In 2012 inflation will slowdown remaining at around 7% and the central bank will probably ease monetary policy from the middle of the year but only very gradually.

Actually the oil price increases has contributed to widen the current account deficit despite the performance of the export sector in the last five or six years, with strong IT and service sectors exports. However, I expect a softening of this issue in the coming couple of years. Growth momentum of India is moderating and that should undermine the imports demand. Moreover, Indian government has 300 billion dollars of foreign exchange reserves, so for one or two years, they can handle the external account at least, but of course not in the long term.

TL: With high public debt, how can the Indian government stimulate economic development?

RB: With a debt level around 80% of GDP, India is one of the Asian countries facing the most severe problems in terms of government debt. That means the government faces many constraints in using public spending to improve infrastructure, a very key bottleneck for the development of the Indian economy. The standard of infrastructure is very low compared to China for example. The only solution for the Indian government is to rely on public-private partnerships with both domestic and foreign investment. But with high inflation, the rate of return that an investor needs to get has to be quite high. So, India needs to see inflation slowing down notably. Additionally the Indian government has to focus on how to generate a sufficient rate of return on their project agreements to make them attractive for foreign investors. Actually, things have improved and infrastructure has gained more momentum in the last few years compared to the last three decades. It is encouraging but India is still far behind.

On the education side, it is a mixed picture. India has been successful in achieving higher education standards: the tertiary education system is relatively good and this is why sectors like IT have performed so well. But the main problem is brain drain and the shortages in skilled work force generated by this situation. That is particularly true in the manufacturing sector and especially in aerospace. This is a key future priority for India.

TL: Could a rupee depreciation and capital outflows increase the risk of default of Indian firms with foreign currency debt?

RB: I think it is actually an important risk and definitely a big concern right now with the deterioration of the external current account, the big depreciation of the rupee and also the capital outflows. European banks deleveraging is reducing access for Indian corporates to funding in US dollar and even in euro. That could increase the risk of defaulting and should be a key priority for the Central Bank and the government to insure liquidity on the market. During the 2009 financial crisis, the Central Bank has helped the corporate sector to refinance their dollar borrowings. I think that in case of a significant deterioration in terms of refinancing, the Indian Central Bank could also play a role in providing US dollar liquidity by the Indian banking system for corporates to refinance their debt. But still some over-leveraged companies will face problems to refinance in any case. So, you are right, this is a very important problem.

TL: Is there a serious governance problem in India as compared to other BRICS?

RB: We have seen cases of Indian past and present government ministers and key business leaders, at both national and state level involved in corruption scandals. The big public demonstrations in the big cities against this corruption have compelled the government to act, but in terms of tackling corruption, India remains below-average. If we look at the corruption perception index of transparency international, India ranks 95. It is a very low ranking and it is below China's and Brazil's index. So it's performing relatively

poorly and I think it's a key priority for the future. The Arab spring has fuelled the public protest movement after the case of acceptation. So we see a lot of improvements at least with regards to investigation by the police and so on. Although in the near term this situation is a key constraint to the business climate in India, in the long term tackling corruption would improved the business climate. And it will take time with strong legislation to be implemented, and courage, in the face of the powerful part corrupted people play politically and electorally. But not doing anything would cost India a lot in government expenditure efficiency.

CHINA

TL: As part of its 12th five-year plan, China has confirmed its determination to shift its growth model toward household consumption. By scaling down exports, could European crisis – and to a lesser extent US slowdown, speed up this process?

RB: I think that is the case. The global financial crisis made China realise that its dependence on exports as a growth engine is no longer sustainable and that the model associate to shift to domestic consumption. But the problem is that in the last thirty years the share of private consumption in GDP fell very significantly from 55% in the early 1980's down to 34% now. The rise in private consumption will happen over the next decades and this year will be a key year for the government to boost the share of consumption in GDP because of the euro zone slowdown. But it will take time in order to see a significant shift in the share of GDP. But I am optimistic because when you look at the per capita income of China, it is now about 5 thousands dollars per head, and when we look at the history of Japan, Korea or Thailand, when income have reached this kind of level then the saving ratio has started to slowdown and consumption in share of GDP has gone up. However, this is a slow process. For now, China is vulnerable because it still depends on its exports growth model.

TL: Wage increases put pressure on businesses' profit margins and access to credit remains difficult. Should we expect funding difficulties for Chinese private sector companies and a rise in defaults of companies and banks in 2012?

RB: We are already seeing a lot of SMEs especially in the export sector going bankrupt because of funding difficulties with the tightening of credit during 2011. This was exacerbated in the export sector by the rising exchange rate, the Yuan appreciating against the US dollar by 7%, and thus affecting the competitiveness of Chinese companies in the international market. So all of this has created a difficult environment for Chinese exporters and has resulted in increasing defaults and failures. Even if inflation is cooling down and the Yuan remains undervalued, Chinese companies will suffer from the European slowdown. 2012 will be a tough year for Chinese business as we can expect an increasing problem with servicing debt too.

TL: Then how hard do you think the Chinese growth will be affected by the euro zone crisis?

RB: The euro zone is still an important market for China but China has diversified to other markets as well. So when I look at 2012 I think we will certainly see quite a slowdown in Chinese exports to Europe. But other important markets are still doing relatively well, particularly the United States which is the other key market for China. And importantly there is the third largest economy, Japan, which is rebounding in our view this year. The Japanese production should go back to normal in 2012 as reconstruction is continuing in the North East region. So we are forecasting a 3% growth in Japan this year and exports to Japan are slightly picking up again. Another thing that will underpin China's trade is the demand from developing countries growing quite rapidly, such as, for example, India and Brazil. So these are the reasons why Chinese exports are still growing positively. All of these things are mitigating the impact of the euro zone crisis. We do expect a sharp slowdown in exports like in 2009.

BRAZIL

TL: Now if you look at Brazilian currency during the last decade, the exchange rate appreciated, especially because of increasingly natural resources exports. Is there deindustrialization in Brazil because of exchange rate appreciation?

RB: This is a problem Brazil had to face, as well as other highly performing economies and the cost has been the exchange rate appreciation. So the long term trend has worked against the competitiveness although now we can observe a depreciation of the real from its recent peaks. I think the underline problem of competitiveness is an issue affecting many manufacturing firms in Brazil especially against Asia with quite low cost manufacturing. So I think they do face that challenge right now. In the future this could still be an issue because Brazil has discovered huge oil and gas resources offshore. It will take many years to develop but it will constitute a significant part of Brazilian economy. And of course this could contribute to an exchange rate appreciation. So I think this is why exchange rate will be a key issue for Brazil and could be a threat to the manufacturing sector. Of course this is not an excuse for any country to deindustrialize and they need to move up the value adding chain. Brazil is no longer a low cost manufacturing economy and it has to move to higher value added production. Brazil has strong advantages such as technologies, skilled workforce and its economic needs to shift from a medium to a higher manufacturing economy.

RUSSIA

TL: Could Russia go back to its pre-crisis economic dynamism? Is it still relevant to include Russia in the BRICs?

RB: I think you can still include Russia in the BRICs category because it is still a very large developing country in terms of population and a strong resource economy. But I think the demographic evolution is unfavourable in the medium term: the population is ageing and this means that the outlook for Russia as a consumer market is relatively less positive. Industrial growth is also weaker compared to other BRIC countries: it is an oil and gas exporting country and the dynamism of the economy will rely on this sector in the future. Actually China is increasingly considering Russia as a source of supply of natural gas. So this is of course very positive but it also means that Russian economy will not diversify as it should do. Moreover business climate is very weak, impacted by high level of corruption. Foreign investors do not want to take any risks in Russia because they have been given a rough time there too often. It is a dangerous environment for foreign investors and I think it is not going to change any time soon. The business climate index of the World Bank has reached 120 in 2010, much lower than China's and India's index. Russia will not be a consumer demand driven economy like we expect China, India, Brazil will. It is just a resource exporting country with very poor governance.

TL: Is Russia vulnerable to a fall of oil prices?

RB: Definitely I think it's a key vulnerability. But oil prices should not fall unless world economy experiences a long recession. This is not my scenario. Prices will be sustained by the buoyant demand from developing countries like China and India and by the significant long term issue regarding the depletion of existing oil fields. So I think Russia is still in a good situation in short term despite its high dependency on oil revenues.

BRICS

TL: Could the euro zone crisis curb BRICS's expansion in the next few months?

RB: It will depend on how the crisis develops. We expect a mild recession in the euro zone this year minus 1%. It means then that the world economy can deal relatively well with that. The US should be growing by 2%, China by 8% and Japan by 3%. But there is a downside scenario for the euro zone, which is not our central expectation but it is a risk. If that risk happened, there will be global transmission effects: a deeper recession in Europe that could push US into recession and would propel the rest of the world in a 2009 crisis type. Among the BRICS, Russia, Brazil would be more severely hurt. As for China, even if it is more vulnerable because its export sector is already under strain, it will probably take more fiscal stimulus measures.

TL: Will the BRICS save the euro zone from crisis?

RB: I think the solution is what the euro zone government themselves are doing right now. This is the key to the answer. The second line of solution should be coming from the US and Japan as the other G3 players. In 2012, I would like to see them supporting the eurozone through their own action. Japan has been a major buyer of the EFSF issuance last year. So they have played a role but they haven't reported that to the market: they pick up the issuance but what we need is a signal that would say in advance 'yes we guarantee to take up a lot of European bond issuance'. Additionally, we should also see the same from the US. For political reasons, because it is happening during election time, the US is very quiet on this, they put work back on the euro zone all the time, and they never want to show any leadership on this. So I think that is a real issue. But I think that is the second line of solution for the euro zone problems. If the US and Japan take major steps in financing the issuance of the euro zone debt, China could then shows some positive signals, but it won't be the solution in the near term. The way I think the BRIC would "save" Europe is much more in the long term. Europe is now facing a lost decade and the European domestic market is going to weaken for long time with the deleveraging of banks and households. At the same time Asian markets like China, India and Indonesia will grow very quickly and will become a real growth engine for the world economy particularly for European exports. Large European companies are really benefiting from the dynamism of these countries. It is different for European SMEs which are not familiar with the market and which need the support of trade finance and insurance. The BRICS will save euro zone countries by becoming strong consumer markets for European companies.

2012 will be the year of the debt war

François Heisbourg

Special Advisor of the Foundation for Strategic Research

Trade Line (TL): Since the Lehman Brothers bankruptcy and the outbreak of the euro zone crisis, the economy has once again become a key political issue. Has the world emerged from the post-11 September era?

François Heisbourg (FH): The post-11 September era has undeniably ended. The economy has become a bigger issue than security, even if the current crisis has, or will have, security repercussions. This crisis has also highlighted the shifting "pivot" – to use the basketball term that Barack Obama likes so much – of US politics and strategy towards Asia. The US is reacting to China's emergence. It is trying to rally its forces to face down the Chinese rival and focus its resources on this major objective. In the future, the US will not intervene unless its interests are at stake. In early January 2012, for example, the US Defence Secretary announced the withdrawal of two of the US's four combat brigades stationed in Europe. Similarly, the US supported the Libyan war but not as a leader, that was left France and the UK. The US will get directly involved if, for example, the Iranians close the Strait of Hormuz and/or if the Israelis launch an offensive against Iran. In such a case, its vital interests would be threatened.

TL: 2012 is an election year in several countries. What are the main stakes of these elections?

FH: The main US campaign issue is the economy. All the cards are still on the table. In my view, if one of the Republican candidates were to win, it would have a significant regressive economic impact. The Federal Reserve Bank's efforts to boost the economy would be counteracted by a Republican creed featuring a strongly anti-Keynesian tilt. Growth would take a hit and would look disturbingly like Europe's over the last decade, i.e., closer to 1.5% than 3% or 3.5%. And weak growth would ultimately trigger a market attack on US debt, even if the US has the dollar's status going for it. For at least the current decade, the dollar will remain the main reserve currency, as the internationalisation of the Yuan is not yet one of the Chinese authorities' priorities. One day, the Yuan will be an international currency fit to rival the dollar, but the process will be long. However, if Barack Obama is re-elected, will he be able to get Congress on his side? It could happen, but this political infighting is likely to continue to place a burden on the economy.

In China, there will be a change in leadership this year, albeit through non-Democratic means. The new team will have to provide substantive answers to the issue of China's international posture, particularly regarding the US, while balancing exports against domestic consumption. It will also have to deal with the rise of the middle class and the emergence of provincial Communist leaders, who will make it increasingly difficult to govern the country from the centre. These provincial leaders, such as in Szechwan and Kwangdon, are trying to leverage popular discontent to consolidate their hold on power. While communism will remain the country's blueprint, the central government's monopoly on power could be dented. From a geopolitical perspective, it is worth keeping an eye on these developments.

In Russia, the outcome of the presidential election will depend on oligarchs' political ambitions vis-à-vis Vladimir Putin, who has been unable to modernise the economy or keep the people quiet. Economically, Russia is still too dependent on oil and gas, with a classic negative impact on the real economy. Politically, the Prime Minister still depends on the "power vertical". I don't expect any strong movement from the street or even a palace revolution but, rather, tighter control of Putin by the "power vertical".

TL: What is your analysis of the situation in the euro zone?

FH: The crisis has crippled the European Union, at least for now. Continental countries are now negotiating treaties without it, although the official objective is to shore up ties within five years. Such a split has strategic and societal consequences. What will become of the military partnership between France and the United Kingdom, which has been pushed to the sidelines? This split will also have societal consequences. An austerity without growth would provoke as Mario Monti, the Italian Prime Minister, recently said, social problems and a rise in populism. Germany will be unable to push through its agenda without at least one or two European partners to defend its interests. A Franco-German couple is there-fore essential for the EU. The May 2012 French elections have strong European stakes, as the opposition has served notice of its intention, if elected, to renegotiate the content of the new treaty.

TL: What role could the major emerging countries play in the euro zone crisis?

FH: The BRICS have the means to help Europe. They could have done so when the European Financial Stability Facility (EFSF) was

set up in its initial version. But let's admit that Germany's refusal to chip in, while asking the BRICS to do so, was not exactly a ringing endorsement. I believe that Brazil and China would have bought massive quantities of Euros if there had been an agreement to create euro-bonds. This would have triggered excessive liquidity and a sharp run-up in the euro, which would have been hard to manage but probably easier than the current situation.

➔ TL: Are you expecting a currency war in 2012?

FH: Not a currency war, but, rather, a debt war. The US, Europe, and Japan want to obtain liquidity from emerging economies, particularly Asian ones. This is a true competition that will not help relations between the US and Europe. Regarding the euro, I do not believe there is a US plot, as France and Germany sometimes imply. The US knows perfectly well that a euro zone breakup would have disastrous consequences for it, as well. To keep the euro from being overvalued, the policy of the European Central Bank (ECB) will be vital. The ECB's opening of its windows to banks and the weakening of the euro that this triggered are the two pieces of good news so far this year. Moreover, the US probably approves of any ECB intervention of this type, as that can only reduce demand for foreign currency. That the ECB continues to demonstrate its independence is good news. This could help clear the way to quantitative easing, as long as Germany agrees to modify the ECB's mandate.

➔ TL: Let's move onto the Arab world: what do you think of the "revolutions" that have occurred there?

FH: When André Malraux asked Chou en-Lai what he thought of the French Revolution of 1789, he reportedly replied "it's too early to tell". Similarly, any assessment of the Arab revolutions would be premature. However, they can be compared to 1848 revolutions in Europe – they were simultaneous, parallel revolutions, with similar sources of inspiration but without coordination. At first they failed in Germany, Austria-Hungary and Italy. Louis-Philippe was overthrown in France but only to be replaced by Napoleon III. And yet, no historian would now say that these revolutions were not important. They undeniably served as a model for what would become the rise in nationalisms and the end of European monarchies – the true shift to political modernity. In the Arab world, we are only at the start of the process. The countries where revolutions are under way are most often republican states like Yemen and Syria. Monarchies (except in Bahrain) have managed to undermine revolutionary fervour by throwing out a bone at the right time, thus providing for a reasonably quiet transition.
Tunisia is something of a special case. The economy is once again doing well, apart from tourism. If tourists return to the fold, all factors will be in place for growth, which was 5% under Ben Ali, to reach 7%. But tourists could be frightened away again by Salafist demonstrations.
The situation is far more complex in Egypt, due mainly to the special role played by the army and the country's social structure. Egypt has almost no middle class and its social structure is still at pre-industrial stage, which is no doubt why the Salafists did so well in the most recent elections. Yemen is a similar case. Syria is another source of concern in the region. With a population of more than 20 million, it is a major regional player, comparable to Algeria and Iraq. The more Syria sinks into violence and repression, the less its chances of effecting a calm, democratic and liberal transition. The scenario is more like a sudden transition that could trigger a split in the country. The Arab League, which has grasped this risk very well, has so far been unable to create the conditions for national unity under anyone other than Bachar el-Assad. The outcome will be extraordinary violent and destabilising.
Several other issues could shift the course of these revolutions. An Israeli strike against Iran could give them an anti-Israeli, and hence anti-Western, flavour. The future of the oil-monarchies is also a source of concern but in the longer term, as most of their populations are foreign nationals. In Qatar or the UAE, a large portion of the population is Indian, which poses no problems in the immediate term, as India has no expansionist designs and the Indian population is generally quiet and concerned solely with individual success. But history shows us that this cannot last long and that political strategic consequences are inevitable. For long-term Western investments, like the construction of a nuclear power plant, we cannot but wonder what the United Arab Emirates will look like in 40 years. Will they still be emirates, still Arab and still united? The time has passed when these foreign populations were mere adjustment variables. During the 2009 recession, the United Arab Emirates expelled or declined to renew the work contracts of about 600,000 persons, or 15% of the working population, including very few Indians, who account for a large portion of the middle class. If they had left, that would have triggered organisational problems and political problems with India.
As I said earlier, the United States has served notice that it will no longer involve itself in Middle East conflicts if its vital interests are not at stake. This pullback is being encouraged by energy market trends. Technological developments, particularly in shale gas, will make North America (the US, Canada and Mexico) a net energy exporter within 15 years. The US economy will therefore be less and less vulnerable to risks incurred by importing energy from the Middle East.

➔ TL: Let's change continents and have a look at the situation in Central Asia.

FH: There have also been important shifts in Central Asia, sometimes of an extremely violent nature, as in Uzbekistan, Kirghizia and Kazakhstan recently. These are more ethnic than political in nature. Despite an increase in oil production, Central Asia sells less than two million barrels per day, which is not much. The region also has considerable reserves of gas but these are not easily exploitable. Politically and strategically, over the next 10 years the region will have to deal with a Chinese presence within its borders that is already great and that will increase.

TL: And what's in store for Africa?

FH: Africa presents risks but also considerable opportunities. Demographics, for example, is one of Africa's major weaknesses, as it has not yet, in most cases, entered into transition. Africa can be compared to India 35 years ago. But, above all, I see opportunities in Africa. Information technology has allowed it to skip stages of economic development. People have mobile phones, and most urban residents and a large portion of rural residents can use these to integrate into banking channels and, hence, into the formal economy. This is essential if there are to be any prospects for development. Interestingly, local and foreign banks in Africa have adapted their business models to the mobile phone.

Nigeria has huge, and for the moment underexploited, potential. Its future, and more generally that of Western Africa, depends on whether and how it will overcome the split between north and south and between Muslims and Christians. But Nigeria has something special going for it – democratic governance, which the people have taken on board, even if it is disorderly and highly corrupt.

Ghana is a good example of a successful transition. It has managed to emerge from a constant series of coups d'états and settle into effective democratic governance. Its economic growth hovers around 7%. Similarly, there is no reason for a once again peaceful Ivory Coast not to achieve the same economic success.

12 Cours Michelet
La Défense 10
92800 Puteaux
France

www.coface.com