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PANORAMA

JULY 2016

Barometer of sector risks in the world

COFACE ECONOMIC PUBLICATIONS

By Coface Group Economists



Coface updates its risks outlook for 12 business sectors in 6 regions every quarter. For the first time, these regional assessments are accompanied by detailed sectoral assessments for 17 countries (see *appendixes page 6*): United States, Japan, Germany, France, United Kingdom, Italy, Spain, China, India, Brazil, Mexico, Poland, Russia, Turkey, Saudi Arabia, UAE and South Africa. While the "balance of risks" currently seems to be more even than in Q1 (6 downgrades for 7 upgrades, compared to 9 downgrades for only 2 upgrades in Q1), it continues to mask marked differences from one region to

the next. In particular, sectoral risks continue to increase in the emerging world, where 5 of the 6 downgrades have been noted, whereas they have fallen in Europe despite the risks linked to the result of the British referendum.

Unsurprisingly, the sectors linked to commodities retain a high-risk level in all regions, with the slight rise in their prices that occurred during Q2 being of a very modest size at this stage to form a real breath of fresh air. Conversely, the business sectors that rely on household consumption are holding

on better in emerging countries, due to the trend towards growth in revenue as well as low inflation being still favourable for consumers. The main exceptions are Brazil, South Africa, Russia and the Middle East (downgrades in distribution, textiles, automotive and food-processing), where the policies of cuts in public spending, subsidies under scrutiny and stricter credit conditions are affecting consumers in the region's countries. The latter are also a source of weakness for the construction sector in Asia, where many companies are highly indebted.

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coface
FOR SAFER TRADE

JULY 2016

SECTORAL OUTLOOK 3RD QUARTER 2016



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Table 1: World sectoral outlook

Sectors	SECTOR RISK ASSESSMENT					
	Western Europe	Emerging Asia	North America	Latin America	Central Europe	Middle East + Turkey
Agrofood						
Automotive						
Chemical						
Construction						
Energy						
ICT*						
Metals						
Paper-wood						
Pharmaceuticals						
Retail						
Textile-clothing						
Transportation						

Source: Coface

* Information and communications technologies

Low risk

High risk

Medium risk

Very high risk

The risk has improved

The risk has deteriorated

Sectoral risk assessment methodology

Coface's assessments are based on the financial data published by listed companies in six major geographic regions: Emerging Asia, North America, Latin America, Western Europe, Central Europe and Middle East + Turkey.

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.

The low prices of commodities are still affecting the Middle East, energy and the metal industry

While the rise in the price of a barrel of oil between February 2016 and June 2016 (from under \$30 to around \$50) offers hopes the economies that are not very export diversified, the price remains at a level 55% below that of June 2014 and does not enable companies to increase profitability in the sector worldwide (see graph n°1). The energy sector thus figures in high risk or very high risk in all of the regions. This prolonged period of commodity prices at a low level has compelled more and more governments whose revenues depend on it to adopt measures in order to control the surge in public deficits. In fact, the latter could approach 18% of GDP in Saudi Arabia in 2016, 20% in Oman and 25% in Venezuela according to Coface. The secondary effects of these austerity measures are felt in a number of business sectors.

Construction is the frontrunner (see page 11) because the development of large investment projects committing the public sector have been pushed back or cancelled. For example, it involves projects in the railway sector in Saudi Arabia or in Mexico. Besides Latin America and the Middle East, the risk level of the construction sector is high in Asia, where many companies in the sector are highly indebted and suffer from long payment delays from their clients⁽¹⁾.

Furthermore, household purchasing power has been hampered by the fall in pump subsidies (50% price rise in Saudi Arabia) and which will be strengthened by the addition of a valued added tax in 2018 for the Gulf Cooperation Council countries: Saudi Arabia, Kuwait, Oman, Qatar, Bahrain

and the United Arab Emirates). However, household consumption constitutes a major growth driver, all the more so when the international context is little favourable for exporting countries. In fact, the slowdown in global trade is significant: in March 2016, volumes exported, according to the CPB, increased by only 0.4% over one year, compared to 1.8% in 2015 and 3% in 2014, which were already disappointing years. Thus, the weakness in household consumption in the Middle East has caused a rise in risks for the sector: textiles, food-processing, distribution and automotive. For example, in the automotive sector, according to BMI, the number of vehicles sold in Saudi Arabia could fall by 26% in 2016, 24% in Bahrain and 15% in the United Arab Emirates.

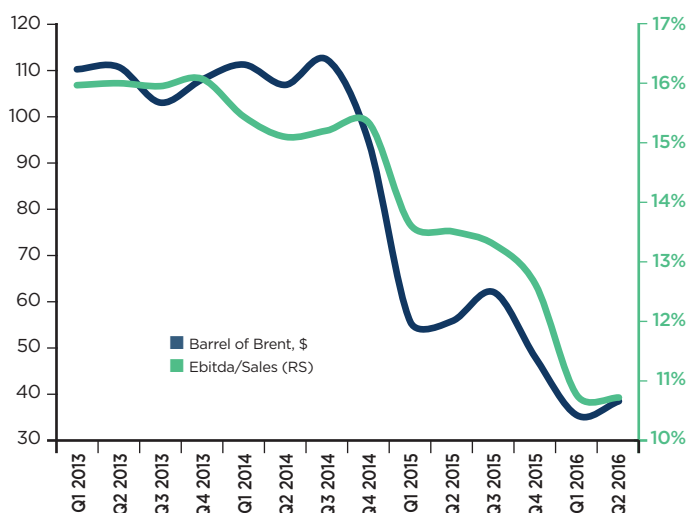
Still on the side of the sectors linked to commodities, the chemicals industry has been affected by the slowdown in emerging countries. Despite a weak price of a barrel of oil from which it benefits, the chemicals industry does not appear to be a low risk worldwide, because this sector is linked to the dynamics of the industry, itself slowed down by China (6.5% forecast growth in 2016). In fact, since 2010 we have witnessed a drop in the impact of the industry (of which the share in GDP fell from 47% in 2005 to 43% in 2014) benefiting services. Therefore, the sector is affected by restricted activity in the Middle East and in North Africa (+2.5% only in 2016) and by a new recession in Latin America (-0.5%).

Furthermore, the metal industry (see page 13) remains risky or very risky in all of the regions assessed. In fact, the global consumption of iron and steel products in 2016 should fall by 1.6%, after a fall of 2.2% in 2015. The pressure is such that production must be adjusted downwards (-1.8% in 2015) because the user rate of production capacities reached a historic low of 64.6% in 2015. Chinese production (49% of global production) should fall in 2016 by 2.8%, after a fall of 2.3% in 2015.

Despite the British referendum, Europe continues to improve

In Europe, despite the result of the British referendum with major sectoral consequences (see box 1 page 5), economic activity should remain relatively well oriented in 2016, benefiting from a favourable economic environment (expansionist monetary policy, weak euro, fiscal easing, cheap oil, etc.) resulting in renewed confidence of companies and consumers. Thus, the overall indicator of the European commission was 104.7 (+0.7 points compared to April) in May 2016 in the eurozone and in 105.7 (+0.5) for the European Union. The catch-up now in progress in the automotive sector (13 million annual registrations at the end of April 2016 compared to 14.5 before the crisis), and in construction (rise in building permits of 35% in Spain, 12.5% in

Graph n°1: Profitability (Ebitda/Sales) of the energy sector and change in the price of a barrel of oil



Sources: Thomson Reuters, Coface

(1) Panorama Coface, Asia Corporate Payment Survey 2016, May 2016. <http://www.coface.com/News-Publications/Publications/Asia-Corporate-payment-survey>

Germany, 7.6% in France at an annual average in March), are the reflection of this increased confidence. Although always subject to the competition of Chinese steel, the metal sector has been regraded as high risk in Europe, because construction, which accounts for 52% of trade and automotive for 12%, are also the subject of an upgrading of their risk level. According to the World Steel Association, Western Europe should experience a 2.3% growth in its production of iron and steel products in 2016.

Despite the good general dynamic of household consumption in Europe (low inflation, falling unemployment, etc.), the textile-clothing sector (see page 15) has suffered from the fierce competition that its players practice in the middle range segment. The Spanish company, Inditex, a global leader in the clothing industry, and the Swedish group Hennes & Mauritz AB, have harmed the European network where bankruptcies are rising (+1.9% in France at the end of April), contrary to the general fall in bankruptcies observed (-4.1%).

Pharmaceuticals: the dynamic remains positive

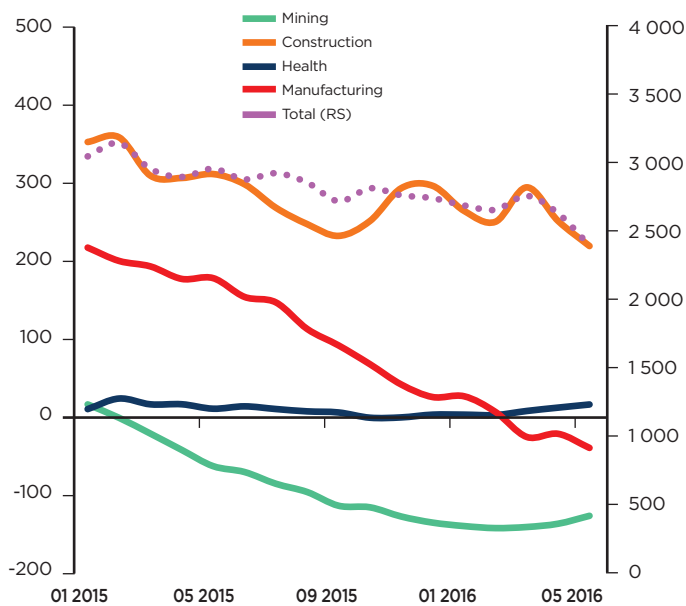
On the positive side, the pharmaceuticals industry remains the least risky sector worldwide among the 12 assessed (see table 1 page 2), notably

because its profitability remains high (see graph n°3). In fact, the ageing of the population and the emergence of the middle classes participate in increasing the demand for healthcare, particularly in emerging countries. Furthermore, despite the crisis undergone by Latin America, healthcare expenditure has only been cut by households as a last resort. The risks are then less than in cyclical sectors such as textiles or automotive. The healthcare systems of advanced economies offer companies in the sector reimbursement guarantees that enable them to invest, particularly in research and development. While the sector in the United States is extremely profitable, it continues to create jobs (16,500 in May, see graph 2).

Food-processing has weathered the storm

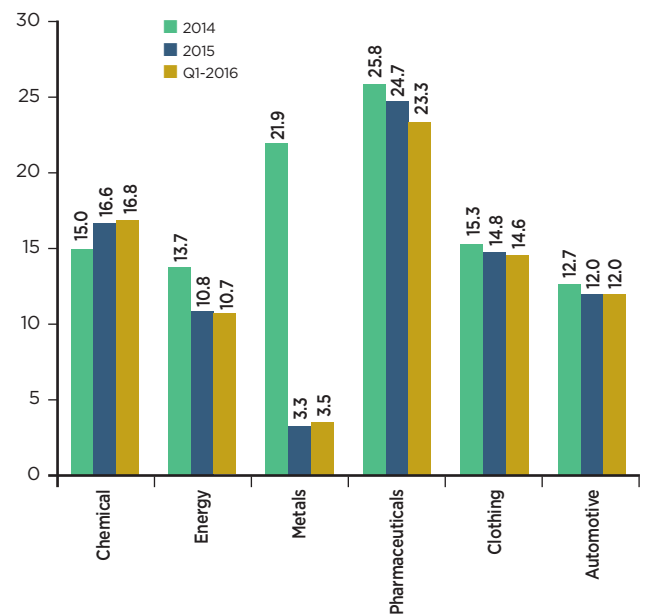
Despite the Chinese slowdown, consumer behaviour continues to change in Asia. Thus, rice consumption will again rise in 2016 as in India (+1.9%) or in China (+0.7%), like that of corn (+3.8%). Overall, the price indices of agricultural commodities will rise slowly in 2016, thus following the trend of mineral commodities. The FAO index of agricultural foodstuffs rose 4% between January and May 2016. However, the feared climate phenomenon, El Niño, will have mainly affected the Indian sugar harvests and palm fruit harvests used to manufacture oil in Indonesia generating a rise in prices.

Graph n°2: Annual change in additional persons receiving remuneration in the United States (in thousands)



Sources: Thomson Reuters, Coface

Graph n°3: Change in financial profitability data (Ebitda/Sales) per sector worldwide



Source: Thomson Reuters

Box n°1

the consequences of Brexit on business sectors in the United Kingdom

(see table 2)

On 23 June 2016, 52% of the British people voted to leave the European Union. While household and manufacturing confidence is affected by the volatility of the financial markets and by political uncertainties, private consumption and the sectors that depend on it (distribution, automotive, textile-clothing, transportation) will be weakened by an increase in the precautionary savings of households and by a rise in inflation. Between 23 June and 4 July, the pound depreciated 9% against the euro and 11% against the dollar, to reach a 1985 historic low of 1.31 dollar for one pound. Corporate investment could also shrink during Q2 2016, GDP growth only reach 1.2% over the whole year (compared to 1.8% initially forecast by Coface).

Construction, a historic driver of growth in the UK (6.1% of GDP), should be the sector the most affected in the short term by the secondary effects of the referendum because it is affected by the rising cost of imports due to the fall in the pound. The adjustment of the property

market should create negative consequences for household consumption. In fact, the wealth effects linked to the change in property prices in the United Kingdom are a driver of consumption and stronger than the rest of Europe and France. The high debt of British households (128% of disposable income compared to 94% in the eurozone, source Eurostat) also poses a risk to the ability of households to consume.

Among manufactured goods (of which added value represents 9.6% of GDP), the most exported by the United Kingdom are pharmaceuticals (0.8% of GDP and 7.8% of exports) and automotive (0.9% and 11.3%). In the short term, these goods will not benefit or benefit little from the fall in the pound because the demand addressed is barely affected by price falls. On the other hand, any introduction of customs duties in the medium term would be disadvantageous changing the structure of costs of British companies.

Table 2: Sectoral outlook Western Europe

SECTOR RISK ASSESSMENT						
Sectors	Western Europe	France	Germany	Italie	United Kingdom	Spain
Agrofood						
Automotive						
Chemical						
Construction						
Energy						
ICT*						
Metals						
Paper-wood						
Pharmaceuticals						
Retail						
Textile-clothing						
Transportation						

Source: Coface

* Information and communications technologies

Low risk

High risk

Medium risk

Very high risk

The risk has improved

The risk has deteriorated

(2) UK - eurozone: the difference in growth, unemployment, does it mean the British economic model is superior? March 2016, Flash Natixis

(3) The reasons for stronger growth in the UK than in France since mid-2013, March 2016, INSEE

APPENDIXES

Table 3: Sectoral outlook Latin America

SECTOR RISK ASSESSMENT			
Sectors	Latin America	Brazil	Mexico
Agrofood			
Automotive			
Chemical			
Construction			
Energy			
ICT*			
Metals			
Paper-wood			
Pharmaceuticals			
Retail			
Textile-clothing			
Transportation			

Source: Coface

* Information and communications technologies

Low risk
 Medium risk
 The risk has improved
 High risk
 Very high risk
 The risk has deteriorated

Table 4: Sectoral outlook North America

SECTOR RISK ASSESSMENT		
Sectors	North America	United States
Agrofood		
Automotive		
Chemical		
Construction		
Energy		
ICT*		
Metals		
Paper-wood		
Pharmaceuticals		
Retail		
Textile-clothing		
Transportation		

Source: Coface

* Information and communications technologies

Low risk
 Medium risk
 The risk has improved
 High risk
 Very high risk
 The risk has deteriorated

Table 5: Sectoral outlook Emerging Asia

SECTOR RISK ASSESSMENT			
Sectors	Emerging Asia	China	India
Agrofood			
Automotive			
Chemical			
Construction			
Energy			
ICT*			
Metals			
Paper-wood			
Pharmaceuticals			
Retail			
Textile-clothing			
Transportation			

Source: Coface

* Information and communications technologies

Low risk
 Medium risk
 The risk has improved
 High risk
 Very high risk
 The risk has deteriorated

Table 6: Sectoral outlook Middle East + Turkey










SECTOR RISK ASSESSMENT				
Sectors	Middle East + Turkey	UAE	Saudi Arabia	Turkey
Agrofood				
Automotive				
Chemical				
Construction				
Energy				
ICT*				
Metals				
Paper-wood				
Pharmaceuticals				
Retail				
Textile-clothing				
Transportation				

Source: Coface

* Information and communications technologies

Low risk
 Medium risk
 The risk has improved
 High risk
 Very high risk
 The risk has deteriorated

Table 7: Sectoral outlook Central Europe

SECTOR RISK ASSESSMENT		
Sectors	Central Europe	Poland
Agrofood		
Automotive		
Chemical		
Construction		
Energy		
ICT *		
Metals		
Paper-wood		
Pharmaceuticals		
Retail		
Textile-clothing		
Transportation		

Source: Coface

* Information and communications technologies























 Low risk Medium risk High risk Very high risk The risk has improved The risk has deteriorated

Table 8: Sectoral outlook Japan, Russia, South Africa

SECTOR RISK ASSESSMENT			
Sectors	Japan	Russia	South Africa
Agrofood			
Automotive			
Chemical			
Construction			
Energy			
ICT *			
Metals			
Paper-wood			
Pharmaceuticals			
Retail			
Textile-clothing			
Transportation			

Source: Coface

* Information and communications technologies

 Low risk Medium risk High risk Very high risk The risk has improved The risk has deteriorated



SECTOR RISK ANALYSIS – JULY 2016

AGROFOOD

ASSESSMENTS BY COFACE

NORTH AMERICA



MEDIUM

LATIN AMERICA



HIGH

EMERGING ASIA



MEDIUM

CENTRAL EUROPE



MEDIUM

WESTERN EUROPE



MEDIUM

M. EAST + TURKEY



HIGH

RISK ASSESSMENT

HIGHLIGHTS

For meteorologists, this year's El Niño, one of the most intense on record along with 1982/83 and 1997/98, is now over. Despite everything, it affected commodity prices less than expected. Although the FAO's global food price index (consisting of the average of five commodity group price indices) recovered by 4% between January and May 2016, this needs to be read in context. In January, the index reached its lowest point since April 2006 and in May, it was 8% down on the previous year.

Other than the milk price index (-12%) which continues to suffer from the scrapping of European milk quotas in April 2015, the price of all other agricultural commodities has been climbing since January. The price of sugar (+21%) and oils (+17%) posted the strongest growth. According to the International Sugar Organization, global sugar production is expected to fall below global consumption in 2016 for the first time in six years. The poorer outlook for production in India (May 2016), the world's second largest producer, has put added pressure on prices. As for oils, the slump in palm oil production in particular has triggered an increase in prices. Lack of rainfall in previous years has meant smaller harvests and will bring about a 1.8% fall in production in 2015/2016, according to the EIU. Something that hasn't been seen since the 1997/1998 season.

The more modest recovery in meat (5%) and cereal (2%) prices is mechanical. It is a reaction to the rock-bottom prices at the start of the year, which fell to their lowest point since February 2009 for meat and September 2006 for cereals.

Strengths

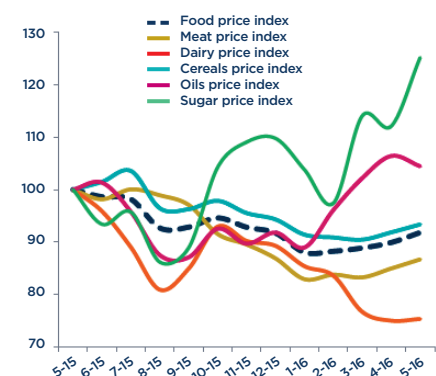
- End of El Niño with no record impact
- Demand bolstered by household consumption in emerging countries

Weaknesses

- Sector subject to fluctuations in weather
- High cereal stocks

Trends in agricultural commodity prices,

(May 2015 = 100)



Source: FAO

AGROFOOD

DEMAND

Demand for agricultural commodities is likely to remain firm in 2016, given the predicted increase in global population (1.1% according to the Institute for Demographic Studies).

In Asia, the food sector remains buoyant despite the Chinese slowdown. The outlook for rice consumption (+1.2% year-on-year in 2015/2016 - hereafter 2016 - the reference year running September to September in line with the harvesting season) has been sustained by demand from the Asian continent. Rice consumption in China, India and Indonesia, (60% of global consumption) is likely to grow by respectively +0.7%, +1.9% and +1.4% year-on-year in 2016. Still for cereals, there ought to be vigorous growth in the Chinese demand for corn (+3.8% year-on-year), which accounts for 22% of global demand. Moreover, the fall in soy bean prices is good news for China, the world's top consumer (30%), whose demand is stimulated by the vigorous growth in aquaculture farms (62% of installed capacity worldwide, according to the FAO). According to the EIU, growth was 6.4% year-on-year in 2016 in China, i.e. a higher-than-average growth in global consumption of soy beans (+4.3%) in the same period.

In North America, demand for corn (the most-consumed cereal in the world and mainly produced in the United States), 60% of which is used to produce animal feed, 30% goes for industrial processing (ethanol-fuel and starch) and 10% is consumed directly as food, **is expected to remain stable in 2016.** The Russian food import embargo on 15 February 2016 against American soy beans (around 2 million tonnes) and corn (less than 1 million tonnes) should have a relatively modest impact on the American sector. These figures pale in comparison to the 30 million tonnes of soy bean imported from the USA by China.

South America should experience the strongest growth in demand for soy beans according to the USDA (+7% on average) in 2016, especially Brazil and Argentina. These two countries together consume as much as China, i.e. 30% of global consumption, and use it mainly for animal feed. In Brazil for example (16% of global beef production), the USDA expects meat production to increase by 2.1% in 2016, bolstered by the weaker real.

According to the EIU, the European Union (the biggest consumer of wheat, accounting for 17.8% of global consumption), will see a 2.8% rise in wheat consumption in 2016. According to the FAO, this growth will be driven by the need for animal feed. The EU, which is the world's third biggest consumer of beef (13% of global consumption in 2015), should see consumption figures rise by 2% in 2016, twice the average growth of all other players. Lastly, the agrofood sector as a whole will probably remain weakened by the Russian import embargo on foodstuffs from the United States and the European Union (fruit, vegetables, meat, poultry, fish, milk and dairy products), which has been extended until January 2017.

SUPPLY

As with cereal, milk and meat production, there will be a global surplus of agricultural commodities in 2016. El Niño has affected mainly sugar and oils.

In South East Asia, Indonesian palm oil production (53.6% of global production) finally buckled under the severe droughts at the end of the year, with an estimated fall of 1.6% in 2016 (EIU). With a predicted 2.9% rise in demand in May 2016 (EIU), prices look set to go up by the end of the year. The fall in the global sugar supply in 2016 is due in particular to the decline in Indian production, (the second largest producer in the world) which was affected by El Niño more than expected (-10% year-on-year in 2016). This impact can be seen in prices, which rose by 25% in May 2016 (year-on-year). For rice, high stock levels mean prices have remained stable despite a slight dip in global production (-0.8%).

America, the leading producer of soy beans and corn, is likely to see production stagnate in 2016. The overall fall in the price of all agricultural commodities has resulted in a drop in the net income of American crop and livestock farmers. After a 38% fall between 2014 and 2015, **the USDA predicts a further drop of 3% in 2016.**

In South America, the entire sector is vulnerable to rising interest rates on loans and to weak currencies, and this has led to a rise in certain import prices. Nevertheless, average fertiliser prices (denominated in USD) should fall by 15% in 2016. The deregulation of the agricultural sector in Argentina, accompanied by a weaker peso (-13% year-on-year in June 2016), is likely to encourage exports of agricultural commodities in 2016. This will be helped by President Macri's decision to scrap export duties on corn and wheat, and reduce them for soy beans. Argentinian corn production is predicted to rise by 7% in 2016, despite forecasts of a global downturn in production (-4.1%) in 2016. The same applies in Brazil where, according to the EIU, exports of soy beans should go up by 2.6% in the same period.

Turkey, the leading exporter of fruits and vegetables, is suffering from the embargo imposed by Russia following the diplomatic crisis of February 2016. It had accounted for 17% of Turkey's total fruit and vegetable exports in 2015.

In Western Europe, after a fall in prices in early 2015, sugar producers have been enjoying a marked increase since January 2016 (+21% globally). This is largely due to the drop in global supply, related to the effects of El Niño. Nevertheless, in addition to India, the European Union (8.9% of global production), suffering from a reduction in land available for sugar beet, should see its supply of sugar decrease by 21.5% in the same period. **Lastly, in Eastern Europe, the impact of the Russian embargo on food producers has been significant (Polish potato farmers in particular).**



SECTOR RISK ANALYSIS – JULY 2016

CONSTRUCTION

ASSESSMENTS BY COFACE

NORTH AMERICA



MEDIUM

LATIN AMERICA



VERY HIGH

EMERGING ASIA



VERY HIGH

CENTRAL EUROPE



MEDIUM

WESTERN EUROPE



MEDIUM

M. EAST + TURKEY



HIGH

RISK ASSESSMENT

HIGHLIGHTS

In 2015, industrialised countries saw their property markets benefit from the rise in household income, which in turn was buoyed by very low inflation. Low rates also acted as catalyst, with a slight rise in home loans (+5.4% end of April in the USA, +2.3% in 2015 in Germany). Supported by sustained growth in Europe, this trend was confirmed in the first half of 2016. Tightening monetary policy in the USA has not affected the sector, although there has been a slight downturn in growth.

Coface has reassessed the sector and given Europe a medium risk rating. Companies are looking relatively solid, thanks to a decrease in insolvencies in the construction sector across most European countries in 2015, such as Germany (-2.7%), Sweden (-17%) and the Netherlands (-18%). In France, sector insolvencies fell by 7% at the end of March 2016 compared to the previous year, but over the Channel, the UK looks set to suffer from the fallout of the referendum on 23 June, with a fall in household confidence and the depreciation of the pound sterling which has pushed up the cost of imports.

The risks are higher in emerging markets, with emerging Asia having been downgraded to very high risk. In China, even though the residential vacancy rate in Beijing peaked in December 2015 (21.7%), the Government's announcement of a \$720 billion incentive over three years has meant annual sales rallied over the first four months of 2016 (+61%), before running out of steam somewhat in May (+53%). In South America, the market will continue to be hampered by unemployment and inflation. In the Middle East, changes in oil prices and security risks are penalising the sector.

Strengths

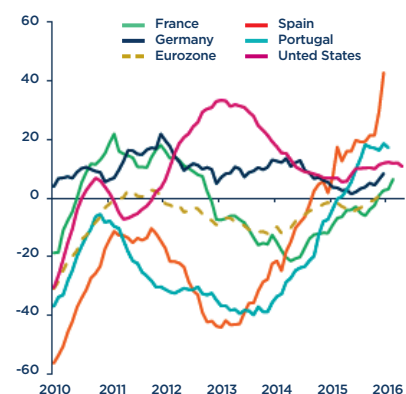
- Global demographic growth and a trend towards urbanisation underpin demand for housing
- Low interest rates boost borrowing

Weaknesses

- Property prices remain overvalued in many OECD countries
- High household debt
- Overcapacity in China

Building permits

(Annual change, as %)



Source: Instituts de statistiques nationaux

CONSTRUCTION

DEMAND

Households appear resilient and prices have been picking up in advanced economies in 2016. But this recovery comes at a time when house prices continue to be overvalued (United Kingdom, Canada, Sweden, Belgium, France) and households remain highly indebted (United States, United Kingdom). In the emerging countries, **housing demand in Asia is resisting pressures, though a fall in commodity prices has upset household incomes in South American and the Middle East.**

Inflation forecasts for 2016 are low for advanced economies (0.7%). The interest rates offered by the main central banks will therefore remain low. We also forecast an upturn on the job market which will lead to **another year of growth in household purchasing power and the demand for housing.** Although the American cycle seems to be doing a turnaround, the construction sector is unlikely to feel the effects in 2016. In fact, **America's infrastructure is ageing and will need modernisation, with a 10.9% year-on-year increase in building permits to the end of April 2016.** In Europe, the demand for housing will also be bolstered by the arrival of immigrants (3 million in 2016 and 2017 according to the European Commission) in need of accommodation. In Germany, orders for homes rose by 15% in the first quarter. In addition, the recovery in the south of Europe (2.8% in Spain, 1.1% in Italy and 1.6% in France) will carry the sector and has led **Coface to revise its risk rating from high to medium, as in North America.**

Although **emerging oil and metal exporters** benefited from a slight rise in prices in the first quarter 2016, the impact of the lower prices in 2015 (Brent crude down 46%) has resulted in either the introduction of taxes or the cutting of grants in order to protect the public accounts (Brazil, Colombia, Ecuador, Malaysia, Saudi Arabia). This **additional cost for households will hamper their recovery and put a brake on property purchases.** But, despite these taxes, exporting nations have seen an increase in their national deficit and have cut back on their infrastructure investment plans, for example Brazil, Saudi Arabia and Qatar.

After a solid period of growth in China, the property sector is slowing down due to overcapacity. Although the banks saw their minimum compulsory reserve requirement cut by half a percentage point in February 2016, down to 17%, after five previous cuts in 2015, investment still slowed down (+1.2% in the five months to the end of May 2016). It is becoming increasingly likely that adjustments will be needed in the sector. Coface's Study of Payment Practices in China (March 2016) also revealed numerous payment delays within the sector. **It has therefore downgraded Emerging Asia to a very high risk.**

SUPPLY

In Europe, construction companies are benefiting from healthy demand in 2016 after a long period of sluggishness. Seen as an advantage due to the increasing trend for urbanisation, the presence of multinationals in emerging countries is more risky in the short term.

The LafargeHolcim Group, world leader in sales of construction materials, recorded a similar turnover in the first quarter 2016 as the first quarter 2015 (+0.1%). **The Group has attributed this to a slight recovery in cement prices during the first quarter (+2.1% a quarter) and in volumes (+1.4%),** which reflects supply constrained by a healthy demand, especially in Asia (+6.6% by volume) and the USA (+18.9%). Regionally the Group is experiencing significant variation, since its improved turnover is thanks primarily to the USA, but is being held back by Brazil. In fact, Brazilian companies are threatened by a slump in the sector (-7.1% over the 12 months to the end of March 2016). **Predictions of a further downturn in business in 2016 (-3.4%), especially in construction (-3.1%), mean the sector keeps its very high risk rating in Brazil and the whole zone.** In fact, in Mexico, despite better growth (+2.3% in 2016), the fall in commodity prices between June 2014 and June 2016 (from \$110 to \$50 a barrel) drove the Government to cut costs. It cancelled two passenger railway projects (the Mexico-Queretaro and Merida-Cancun lines), and announced in 2016 that it was reducing its infrastructure spending by \$720 million. Mexican investment in the construction sector will fall by 17% compared to 2015. **Likewise, although in the Middle East housing supply is being supported by several infrastructure projects, such as in Qatar (2022 World Cup) and Dubai (Expo 2020), low oil prices have resulted in a fall in the number of development plans for the region. Its public deficit has sky-rocketed, and Saudi Arabia and Oman have cancelled two railway projects.**

The UK construction sector is likely to suffer from the fall-out of the referendum on 23 June, with a loss of household confidence and the depreciation of the pound sterling pushing up the cost of imported goods. In France, **employment in the sector rose during the first quarter, and is up on last year for the first time since 2012.** Although, structurally speaking, there is a shortage of new homes, the renewal of the Pinel Act is supporting housing projects for the rental market. The French Government has set itself the target of building 500,000 new homes a year. **The situation is similar in Germany, with a year-on-year rise in employment in the sector at the end of March 2016, after a decline between 2011 and 2015.** As in America, 2016 will continue to see cheap mortgages which will put greater pressure on housing supply. Prices in these regions will continue their upward trend.



SECTOR RISK ANALYSIS – JULY 2016

METALS

ASSESSMENTS BY COFACE

NORTH AMERICA



HIGH

LATIN AMERICA



VERY HIGH

EMERGING ASIA



VERY HIGH

CENTRAL EUROPE



HIGH

WESTERN EUROPE



HIGH

M. EAST + TURKEY



VERY HIGH

RISK ASSESSMENT

HIGHLIGHTS

Key metal prices continue to struggle, despite an upturn in March 2016 due to hopes of a fiscal and monetary support programme for China which would have boosted the demand for steel. Nevertheless, neither the lacklustre global growth (2.5% in 2016 according to Coface) nor the lagging demand from China have pulled down prices since the first quarter 2016.

Several industries are still dealing with overcapacity. For example, year-on-year iron and steel production in China was down by 2.4% at the end of April 2016, and the main producers could not maintain their prices. According to the SteelHome SHGSI index, the period between these two dates saw 26.6% being wiped off the average monthly price for iron and steel. Other metals are also buckling under this downturn in demand. Aluminium saw its LME monthly average spot price per tonne fall by 13.8% year-on-year to May 2016, despite the good performance of the automotive sector in Europe, the USA and China. The LME monthly average spot prices for copper, nickel and zinc followed the same trend, with sharp falls of 25.9%, 35.6% and 17.8%, respectively.

China is continuing to flood the global market with its steel exports, with a 2.4% year-on-year rise in finished iron and steel goods at the end of May 2016. This caused a slump in steel prices, especially in Western Europe, and has affected local manufacturers. According to Eurofer, **the rise in demand from Europe in 2015 has been almost completely met by imports from China.** Over the coming months, the introduction of customs duties for Chinese steel will have a positive effect for the European markets in terms of their bottom line.

Strengths

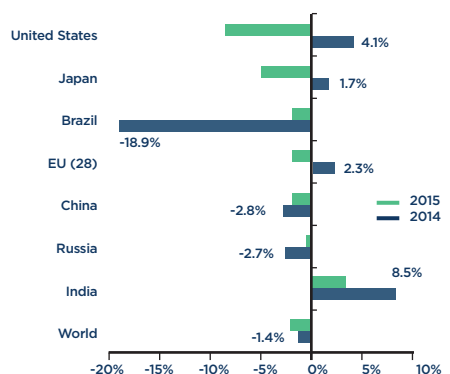
- Increased buoyancy of vehicle sales across the world
- Greater use of electrical batteries (transport, connected objects)
- Restructuring of sectors (nickel, rare earth metals, aluminium) and falling production costs

Weaknesses

- Production capacity utilisation rates lower than the 2003-2007 levels
- Fall in global prices
- Slowdown in Chinese growth

Annual steel production

(annual change, as %)



Source: World Steel Association

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METALS

DEMAND

According to the World Steel Association, the world total apparent steel use will shrink by 1.6% in 2016, following on from a 2.2% fall in 2015. This can be explained by a downturn in consumption in China, which has not been offset by the rest of the world. There is a risk that the measures taken to tax Chinese steel products will penalise the client sectors which currently benefit from very good value iron and steel imports.

China is set to see a 3% fall in consumption in 2016, following on from a 4.8% drop in 2015, according to the World Steel Association. This half-hearted demand is primarily due to a lack of investment, which has tailed off dramatically at just 9.3% year-on-year to the end of May 2016. Private investment has slowed down even more markedly over this same period, reaching only 3.9%. Finally, new car sales had shrunk slightly at the end of April 2016 compared to the previous year (6.8% vs. 8.9% at the end of April 2015), despite the effects of tax breaks for smaller-engine vehicles, which ought not to last beyond 2016. The 13th five-year plan (2016-2020) predicts investment of nearly \$538 billion into railway infrastructure. This probably will not counteract the shrinking of the manufacturing sector in 2016. Indian iron and steel consumption is unlikely to take off this year, despite Government efforts. One of the suggested reasons is the lack of enthusiasm among private enterprises for public/private partnerships.

According to the World Steel Association, Western Europe should see a 3% rise in consumption in 2016, ranking it second among developed countries. Domestic products are reaping the benefits of a healthy European automotive market, and they are now better positioned in the high added-value steel products market. New car registrations rose by 8.5% over the first four months of 2016, compared to 5.2% in just the first quarter. On the production side, figures recently published by the ACEA indicate a 3.9% rise in the first quarter 2016 for the whole of the EU. Low interest rates and an improvement in household finances are boosting the market. According to the latest figures from Eurostat for EA-19, the number of building permits granted continued to rise at the end of February 2016 with a 1% increase, following on from rises of 1.7% and 2.4% in January and December.

The USA will experience the strongest rise in iron and steel consumption of all industrialised nations in 2016, with 5.5% growth according to the World Steel Association. This growth is being driven largely by the buoyancy of the construction sector. According to the National Association of Home Builders, we will see a 13% rise in single family homes in 2016. However, one of the factors driving iron and steel consumption has stalled. New car sales are slowing down, with a 6% slump in May 2016 alone. Coface predicts a slight rise of 2% in car sales in the USA this year.

In Brazil, demand will continue to shrink in 2016, with a 33% fall according to the World Steel Association due to insufficient construction and a weak manufacturing sector.

SUPPLY

Global steel production experienced turbulence in 2015 with a 1.4% fall in volumes (World Steel Association), and production capacity usage rates fell to a record low of 64.6% in 2015. However, prices could level out in 2016 because of incipient cuts in production capacity among steel manufacturers, mainly in China.

Chinese production ought to decline by 2.8% in 2016, after a 2.3% fall in 2015. This country is at the crux of the issue, as it continues to flood the rest of the world with its iron and steel exports. Chinese production is focusing mainly on low-added value products for the construction sector (accounting for nearly 60% of iron and steel demand, according to PIMCO). It is also largely decentralised and is experiencing fierce opposition from the provinces to reduce this fiscal resource. Indian production looks set to grow by 8.5% in 2016. This rate falls well short of the central government's 13% annual growth target for 2015-2025. In fact, Prime Minister Modi hopes that the country will be producing around 300 million tonnes of iron and steel a year by 2025. Bottlenecks persist: a lack of public funding and poor infrastructure, especially transport. In addition, the country is suffering a severe shortage of iron ore, but unlike certain European countries it cannot rely on recycling.

Western Europe is likely to see a 2.3% growth in its production of iron and steel products in 2016. This growth conceals the sources of the demand, especially for factories producing low added value steels. In the UK in particular, the local iron and steel industry is having a tough time, as seen by Tata Steel's procrastination over withdrawing from the Port Talbot plant, having received assurances that the British government will give it a loan thought to be to the tune of several hundreds of thousands of pounds. However, that does not affect the commercial situation because no buyer has yet made an offer for the site or the rest of company's UK operations. Hampered by high energy costs compared to competitors, and the slow decline of the country's industry, the outlook does not look good and the sector remains at very high risk.

For the USA, iron and steel production looks set to increase by 4.1% in 2016. Local producers have benefited from the Federal Government's decision to put a 266% tax on certain steel imports from China (as well as from Brazil, Russia and Japan). At the end of May 2016, the hot-rolled coil price index had risen 60% compared to the previous year. Under pressure from Chinese steel, America has seen its steel production fall by nearly 11%.



SECTOR RISK ANALYSIS – JULY 2016

TEXTILE

ASSESSMENTS BY COFACE

NORTH AMERICA



MEDIUM

LATIN AMERICA



HIGH

EMERGING ASIA



HIGH

CENTRAL EUROPE



MEDIUM

WESTERN EUROPE



HIGH

M. EAST + TURKEY



HIGH

RISK ASSESSMENT

HIGHLIGHTS

Textile sales remain upbeat in North America, but much less so in Western Europe. France and the UK saw a year-on-year fall in sales of 0.5% and 0.2%, respectively. This is the first time the United Kingdom has seen a downturn since July 2012. However, households in both countries are finding themselves better off and the major brands are experiencing growth in online sales. In emerging Asia, textile production remains hampered by China's decision to limit duty-free cotton imports since 2013. **However, Chinese industrials have been sourcing quality cotton from outside the country, which is driving up production costs.**

The textile sector is marked by an **increasing trend to replace cotton with synthetic fibres (polyester, acrylic, viscose)**. Globally, cotton accounted for only one-third of textile consumption in 2014 versus one-half in 1994. In Europe, synthetic fibres accounted for 54% of textile consumption in 2013, according to Eurostat. Cheaper, easy to mix with other fibres and more environmentally friendly than cotton, synthetic fibres represent the technological progress of the textile sector. Moreover, there has historically been a correlation between the price of polyethylene terephthalate (PET) and that of oil, from which it is derived. In June 2016, with oil prices having fallen 40% year-on-year, the cost of PET fell by 20% and returned to the level seen in early 2009, thus making synthetic fibres **even more competitive compared to cotton.**

Strengths

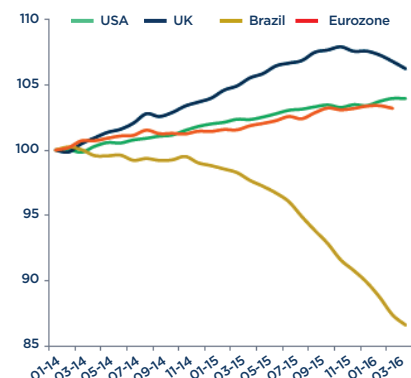
- Growing middle class in emerging countries
- Fall in prices of cotton and synthetic fibres
- Growth drivers via e-commerce

Weaknesses

- Substantial cotton stocks in China, where destocking is hampering demand on the global market
- Sluggish demand in Latin America
- Downturn in US sales

Retail sales of textiles

(January 2014 = 100)



Source: national statistics

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TEXTILE

DEMAND

After three seasons of mediocre growth (2012-2015), global demand for cotton is expected to have fallen by 2.4% between the July-July 2015/2016 season, according to the EIU. **However, consumption in developed countries looks set to continue to grow in 2016, firming up the demand for textiles.** Nevertheless, the strong dollar risks exerting a downward pressure on demand by increasing the cost of imports. This is particularly the case with **South America, which has the additional problem of persistently subdued household spending.**

In the United States, unemployment has risen slightly to 5.2% in the first half 2016, which is likely to affect consumer spending on clothes. But in the region as a whole, **textile sales should continue to grow in 2016, following on the good momentum seen at the end of 2015, especially in Canada (+6.8% in volume). In 2016, with unemployment inflection in the European Union is continuing to record healthy sales, even though** the situation is not quite as positive as on the other side of the Atlantic, because 10.3% of working age European were still unemployed in the first half of 2016. Since September 2015, the growth in retail clothing sales has slowed down considerably in the UK, but has recovered slightly in France. The big European economies are having difficulties boosting their textile consumption, and are unlikely to be able to mobilise the clothing sector in 2016.

Emerging Asia will remain the most dynamic market in 2016. This is despite the fact that demand for cotton in China, the world's biggest importer, is expected to fall 5.5% in 2016. Nevertheless, China is still seeing two-figure growth in its clothing sales. In value terms, demand was up 11.6% in 2015 (vs. 10.7% in 2014), and is expected to increase a further 10.9% in 2016, according to the EIU.

This momentum can also be seen from the sales posted by the large international groups. The Inditex group (Zara and others) has forecast a 15% rise in turnover in 2015/2016. China and the United States will remain the two most buoyant markets in terms of store openings in 2016. Also, **the growth in online sales is giving a new boost to existing markets.** This is the case for H&M with, in particular, openings scheduled for 2016 in Japan, Ireland and the Baltic states, following on from many European countries in 2015 (inter alia, Switzerland, Portugal and Belgium). The momentum being shown by these big groups, which offer several collections every year, and the resulting economies of scale, has meant that clothing is now much cheaper around the globe. Although, on the one hand, this is bad news for some of the more long-standing brands (in France, for example), global demand is rallying thanks to the presence of these large groups. Clothes are now more affordable for consumers, and the rapid renewal of ranges means a more comprehensive offer.

SUPPLY

Cotton production is declining amid listless global demand. The latest global cotton harvest (July 2015) was relatively stable (-0.4% in volume terms), but it is expected to decrease by nearly 16% in 2016, making it the fourth consecutive year of decline.

Despite a smaller drop in production in 2015, prices look set to continue to fall in 2016. The start of 2016 (average over the first five months) saw a fall of only 4%, although figures slumped the previous year (down 21% in 2014-2015). Cheaper prices are even more inevitable due to stock surpluses, despite the downturn in production predicted for 2016. **These stocks should represent around 10 months of consumption in 2016, compared to 10.7 the previous year.** With 12 million tonnes (compared to 3 million five years ago), Chinese reserves account for 60% of global cotton stocks, i.e. 18 months of consumption. In 2013, the Chinese government introduced import quotas in order to force the textile sector to use domestic cotton. Non-quota imports (over 894,000 tonnes) are subject to a 40 percent tariff. **However, although gross stock levels should fall by 8% by July 2016, their proportion of total demand (which is falling) will only drop by 0.7 points compared to the previous year.** This reduction in demand, expected to be 5.5% in 2016, is consistent with the downward trend in imports by volume (down 20% between 2014 and 2015, after a 26% fall between 2013 and 2014). In fact, cotton stocks should remain high in the short term, and gradually decrease. **It will nevertheless take time for supply to adapt to this declining demand. Cotton prices should therefore remain low, at least until the Chinese quotas are scrapped in late 2016.**

Other cotton producing countries are experiencing a similar pattern to that seen in China. Although the fall has been less remarkable in India, where it is expected to drop by 9.4% in 2016, the USA and Pakistan (the world's 3rd and 4th biggest producers) should experience a much steeper decline in 2016. After a record increase in cotton harvests in 2015, the United States will probably post a marked fall in 2016 of 21% due to concerns about demand from China, its largest client. Finally, with forecasts predicting a 34% decline in 2016, Pakistan continues to be affected by an unreliable power supply.

The fall in cotton prices has not made it possible to improve competitiveness as prices of synthetic materials have followed the same trend. Emerging Asia is home to nearly 90% of global polyester production. The comparative advantages of synthetic materials outweigh those of cotton, the use of which will continue to decrease. In the long term, demographic growth will encourage greater farming of arable land. The moderation of cotton prices and the increase in demand for food will drive farms to switch to more profitable crops.

RESERVE

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