

Regional Insights, Upgrades and Downgrades

The Americas ■ Western Europe ■ Eastern Europe and Central Asia
Asia Pacific ■ Middle East and North Africa ■ Sub-Saharan Africa

Global Risk Insights

- The recovery from the 2008-09 recession remains the most challenging in the past century.
- However, the global economy has healed many of its wounds since the crisis.
- As a result we are better positioned than at any point since 2009.
- Headwinds still remain in the form of debt levels, potential asset bubbles, policy-making in the advanced economies, and imbalances in the emerging markets, but...
- Better years are still to come, if corporate strategy and policy deliver.

Global Economic Outlook: Improving Long-Term Sentiments

Over five years since the end of the 2008-09 recession, risks associated with doing cross-border business in the global economy still remain elevated. Although we are optimistic that the global economy is improving, the recovery is the most protracted in the past century and growth remains below long-term trend levels. Real global growth in the period 2000-07 averaged 3.7% per year, compared with an average 2.2% per year in the period 2009-2014.

In order to put this into context, of the 132 countries D&B assesses, 94 are rated worse than at the start of 2008, of which 56 are rated at least three quartiles lower. In contrast, only 16 economies have seen their rankings improve over this period, and only two are rated more than two quartiles better. One sign that conditions are easing is that we upgraded more countries than we downgraded in the first half of 2014 (see Table 1); although this far into the recovery, we would be expecting to have upgraded significantly more countries.

Although the euro-crisis is far from over, European countries were the main beneficiaries of our upgrades; political and

security issues (rather than economic factors) in Argentina, Iraq, Libya and Ukraine, were behind half of the downgrades.

The global recovery is slowly becoming embedded. Since the January outlook, our global economic growth forecasts have been revised upwards for 2015 to 2018 (previously averaging around 3.1% per year), although the 2014 forecast remains at 2.7% (see Table 2). However, the headline figure hides disparities across the regions. Although we are more pessimistic than we were in January about North American real GDP growth in 2014 (down to 2% from 2.8% at the start of the year), the annual average for 2015-18 has increased from 2.9% to 3.5%. In Asia Pacific our forecasts have increased for all five years, with the annual average real GDP growth increasing from 3.8% to 4.7%. Similarly in Sub-Saharan Africa, the picture is one of increased optimism, with annual average real GDP growth increasing from 5.0% to 5.8%. In addition, we are also slightly more optimistic about growth in Europe, with raised expectations in 2014 (up from 1.2% to 1.4%), 2017 (up from 2.2% to 2.3%), and 2018 (2.3% to 2.4%).

The picture is more mixed in the Middle East and North African region, with downgrades to our real GDP growth forecasts in 2014 and 2015 of 1 percentage point (pp) to 3.3% and 3.8%, respectively. In contrast, the annual average should increase by 1 pp to 4.6% between 2015 and 2018. In Latin America and the Caribbean, as well as Eastern Europe and Central Asia, we are now more pessimistic than we were in January for each of the five forecast years. In the former region, our annual average real GDP growth forecast has been reduced by 8 pp to 2.7%, while in the latter the reduction is a less dramatic 4 pp to 2.9%.

TABLE 1: CHANGES IN RISK RATING JANUARY 2014 TO JUNE 2014 BY REGION

REGION	UPGRADED	SAME	DOWNGRADED
Sub-Saharan Africa	0	20	1
MENA	2	15	2
Western Europe	4	26	0
Eastern Europe & Central Asia	5	10	1
Asia Pacific	2	20	1
The Americas	1	19	3
Total	14	110	8

TABLE 2: REAL GDP BY REGION 2012-2018

REAL GDP GROWTH (%)	2012	2013E	2014F	2015F	2016F	2017F	2018F
North America	2.7	1.9	2.0	3.4	3.7	3.5	3.3
Europe	-0.3	0.1	1.4	1.8	2.1	2.3	2.4
Asia Pacific	4.6	4.6	4.5	4.6	5.0	4.9	4.4
Latin America & Caribbean	2.8	2.5	1.8	2.6	3.0	3.0	3.2
Eastern Europe & Central Asia	2.9	2.5	1.7	2.5	3.1	3.5	3.8
Middle East & North Africa	3.6	2.7	3.3	3.8	4.3	4.6	5.0
Sub-Saharan Africa	4.9	5.0	5.2	5.7	6.0	6.1	6.1
World	2.6	2.4	2.7	3.3	3.7	3.7	3.6

Longer-Term Outlook More Positive but Headwinds Remain

Although we are more optimistic about longer-term global growth trends, headwinds could again slow growth going forward. As monetary policy inevitably tightens and interest rates begin to rise, debt burdens (particularly in highly leveraged households) will result in increased exposure to interest rate risks. Relatedly, high liquidity and low interest rates associated with the massive global quantitative easing (QE) programs has potentially boosted asset values into bubble territory: housing in the UK is vulnerable, while several global stock markets are at record levels. In addition, we are concerned that there is little margin for error in the pace and the shifts in monetary policy not only by the Federal Reserve in the US and eventually in the EU, Japan, and the UK. Economic policy-makers in developed countries are still walking a tightrope in attempting to reduce high levels of public debt while supporting growth in their economies. Furthermore, the need to accelerate structural reform is vital for long-term growth potential in developing markets; many countries have yet to reform adequately. Moreover, we are concerned about the cyclical imbalances in the financial sector in a number of emerging markets. In both advanced and emerging economies, political expediency rather than economic necessity could derail progress made to date. Finally, security tensions are growing across the Middle East and in Ukraine; in both cases any lengthy escalation has the potential to raise energy prices as oil prices leap in response to the threat of supply interruptions.

Progress on the Healing Process in the Advanced Economies

In hindsight, the rapid increases in the ratios of debt to GDP in the advanced economies in the years leading to the 2008-2009 recession made them increasingly vulnerable to a change in household and business sentiment over credit accumulation. Levels of household and corporate debt were becoming unsustainable, fuelled by years of cheap credit. During the recession public sector debt increased significantly as tax revenues fell, automatic stabilizers kicked-in and governments hiked spending in order to revive their ailing economies and rescue their banks. The healing process in the advanced economies is under way but uneven (see Table 3).

TABLE 3: HEALING PROCESS IN SELECTED ADVANCED ECONOMIES¹

REGION	COUNTRY	PROGRESS	TREND
North America	US	G	↑
North America	Canada	G	→
Europe	Germany	G	→
Europe	France	A	↓
Europe	Italy	R	→
Europe	Spain	A	↑
Asia Pacific	Japan	A	→

¹ G Progress has been made since 2008

A Little/no progress achieved since 2008

R The situation has deteriorated since 2008

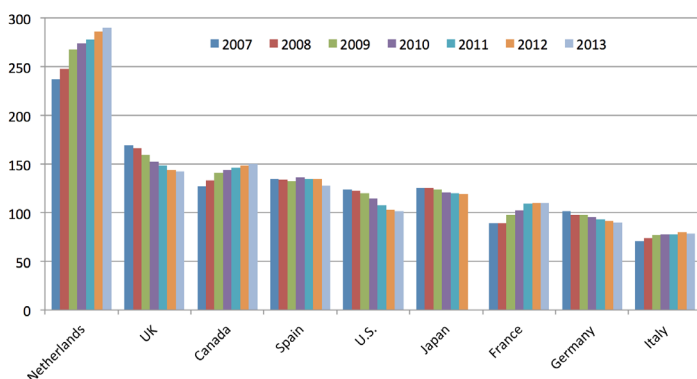
↑ Improving

→ Status Quo

↓ Declining

In terms of household debt, Germany, Japan, the UK, and the US have all experienced significant deleveraging, with levels in relation to GDP falling since their peaks at end-Q1 2009. In the US levels have fallen from 95.6% of GDP at end-Q1 2009 to 77.6% of GDP at end-Q1 2014, while in Germany they have fallen from 65.2% of GDP to 56.9% of GDP at end-2013. In the same period in the UK, levels have decreased from 108.7% of GDP to 94.3% of GDP. Although levels fell in Japan from the peak of 82.7% of GDP to 75.9% of GDP at end-Q3 2013, they have climbed in the past two quarters to 77.6% of GDP. Progress was slower to commence—in chronological order—in Spain (peak at end-Q2 2010, 82.9% of GDP at end-2013), France (peak at end-Q3 2011, 69.6% of GDP at end-2013), Greece (peak at end-Q1 2012, 71.8% of GDP at end-2013), and Canada (peak at end-2012, 77.4% of GDP at end-Q1 2014). Progress is also being made in The Netherlands; although it remains stubbornly elevated at 127.3% of GDP at end-Q1 2014. However, in Italy little progress has been made since its 57.4% of GDP peak at end-2012, hovering consistently around 56.7% of GDP.

TABLE 4: HOUSEHOLD DEBT AS % OF DISPOSABLE INCOME 2007-13, SELECTED COUNTRIES



The picture in terms of non-financial sector corporation deleveraging is mixed. In the US, the deleveraging process bottomed out at end-Q4 2010 at 48.9% of GDP; since then the level has risen to 56.6% of GDP at end-Q1 2014, significantly above the earlier peak of 52.6% at end-Q1 2009. In contrast, levels have fallen in Germany (from 105.7% of GDP to stabilize around 88-90% of GDP since end-Q1 2011), Japan (from 154% of GDP to 142.5% at end-Q3 2013, and 145.6% of GDP at end-Q1 2014), Spain (from 199.5% of GDP to 171.8% at end-2013), and the UK (from 118.5% of GDP to 103.5% at end-2013).

Little progress has been made in deleveraging in the non-financial corporate sector in Italy, France, and The Netherlands. In Italy levels peaked at 122.9% of GDP at end-2011, but have stabilized around 117% of GDP for the four quarters to end-Q1 2014. In France debt levels peaked at 154.4% of GDP at end-Q2 2012 but have remained stubbornly above 152% of GDP to end-2013. The Netherlands has been more successful but levels have only fallen from a peak of 151% of GDP at end-Q2 2012 to 147.4% of GDP at end-Q1 2014. Meanwhile, in Greece and Canada debt levels of the non-financial corporate sector have increased: in Greece from a post-recession low of 71.7% of GDP at end-Q1 2011 to 78.3% of GDP at end-2013, while in Canada the post-recession low of 57.2% of GDP at end-2010 has increased to 62.6% of GDP at end-Q1 2014.

Financial sector deleveraging has been substantial in the majority of countries highlighted. In Germany (from a peak of 123.7% of GDP to 80.3% of GDP), Canada (58.2% of GDP to 49.8% of GDP) and the US (118.9% of GDP to 81.4% of GDP), the deleveraging process has taken place from end-H1 2009 to present. In the UK this process commenced a little later, with debt levels falling from 270.6% of GDP at end-Q3 2010 to 222.2% of GDP at end-2013. In a third group of countries, the peak occurred even later but levels have since fallen consistently in each: in France and Spain the peak was at end-Q1 2012; in The Netherlands at end-Q3 2012; and in Italy and Greece at end-2012. The only country that bucks the trend is Japan, where financial sector debt levels are virtually the same at end-Q1 2014 as they were at end-Q1 2008 (around 186% of GDP), although they hit a low of 169.3% of GDP at end-Q2 2010 and a high of 190.1% of GDP at end-2013.

However, the build-up of public sector debt has created the greatest concern, impeding governments from pump-priming their demand-deficient economies, leaving long-term debt hangovers, and curtailing productive investment. Significantly, general government debt as a percentage of GDP in the majority of the major economies still rose on a year-end basis at end-2013: Japan (234.7% of GDP); Greece (175.1% of GDP); Italy (131.9% of GDP); Spain (93.9% of GDP); France (93.6% of GDP) and The Netherlands (73.5% of GDP). However, between end-2012 to end-2013 limited progress has been made in the US (from 126% of GDP to 125.3% of GDP), the UK (109.1% of GDP to 107.6% of GDP), and Canada (80.7% of GDP to 78.6% of GDP). The best performing country is Germany, where public debt levels have fallen from 82.7% at end-2010 to 78.3% of GDP at end-2013.

Progress on Restructuring in the Emerging Markets

As we argued in our January 2014 Global Outlook, resurgent growth in the emerging markets was the key driver dragging the global economy out of the 2008/09 recession. However, the success of the emerging markets in the years prior to and following the recession masked the need for structural reform in many economies. As global growth has struggled to maintain momentum, the difficulties facing many emerging markets have become more apparent and urgent. Indeed, it is increasingly obvious that the emerging economies cannot be treated as a homogenous set.

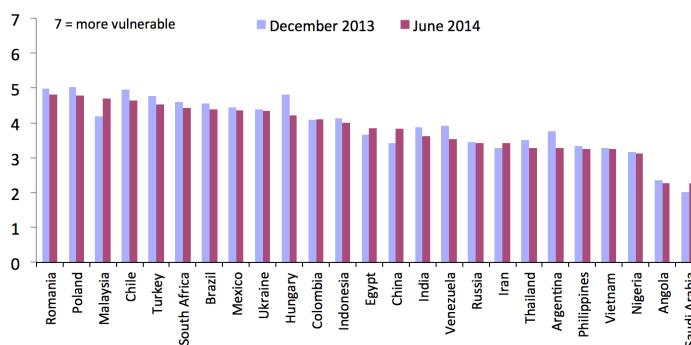
By analyzing economies across three dimensions—external balance vulnerabilities, longer-term supply side restructuring, and political and social vulnerability—we can highlight their relative strengths and weaknesses. We have assessed 25 of the leading emerging markets (Angola, Argentina, Brazil, Chile, China, Colombia, Egypt, Hungary, India, Indonesia, Iran, Malaysia, Mexico, Nigeria, Philippines, Poland, Romania, Russia, Saudi Arabia, South Africa, Thailand, Turkey, Ukraine, Venezuela and Vietnam) in order to ascertain the risks and opportunities of cross-border trade and investment with counterparties in these countries.

By assessing macro-economic indicators over the past five years (which previous research indicates are significant indicators of national external balance vulnerability), we have created an analytical framework that scores the external balance vulnerability of these 25 major emerging economies against each other in a comparable fashion. Our analysis includes an evaluation of the economy's vulnerability to a slump in energy and/or food commodity prices and net portfolio inflows, while taking into account mitigating factors such as high foreign exchange (FX) reserves.

As of June 2014, the countries most vulnerable to external balance risks are Romania, Poland, Malaysia, Chile, and Turkey. Since December 2013, Hungary dropped out of the top five while Malaysia defied the general trend and increased its vulnerability. At the other end of the scale, the Philippines, Vietnam, Nigeria, Angola, and Saudi Arabia were less vulnerable to the negative impacts of sudden short-term capital outflows; these countries were also the least vulnerable in our December 2013 rating. This was due primarily to the strength of their FX reserves, lower relative capital inflows, and reduced financial openness to global capital markets.

The majority of the 25 countries assessed are marginally less vulnerable to external balance risks than six months ago (see Figure 1). This reflects our belief that, in general, emerging markets are more strongly positioned entering H2 2014 than they were in January. Columbia, Egypt, China, Iran, and Saudi Arabia have also joined Malaysia in defying general trends.

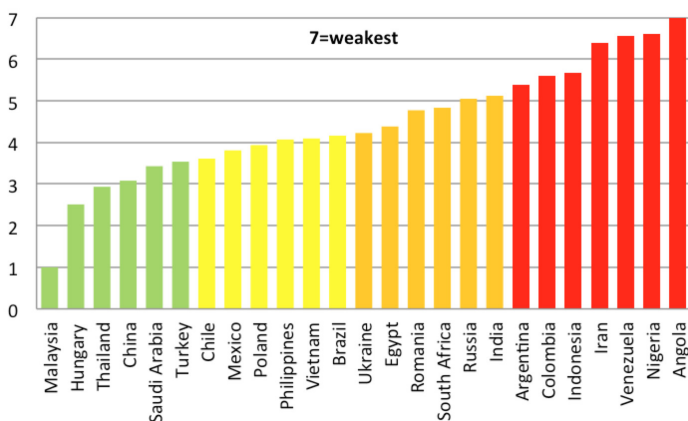
FIGURE 1: EXTERNAL BALANCE RISK



Short-term external vulnerabilities can hide more positive news about the longer-term strength of the economy; similarly countries that appear to be able to weather short-term crisis are less well-structured to grow at their maximum potential. We have assessed changes in four pillars on the supply side over the past decade to ascertain how well the country has used the capital inflows experienced during the boom years. The four pillars are 1) human capital, in which we measure the quantity and quality of a country's labor force; 2) physical capital, in which we measure gains in productive capacity through infrastructure and innovation; 3) competitiveness of the economy, in which the comparative advantage over its peers is assessed; and 4) openness of the economy, in which the country's integration with the rest of the world is assessed.

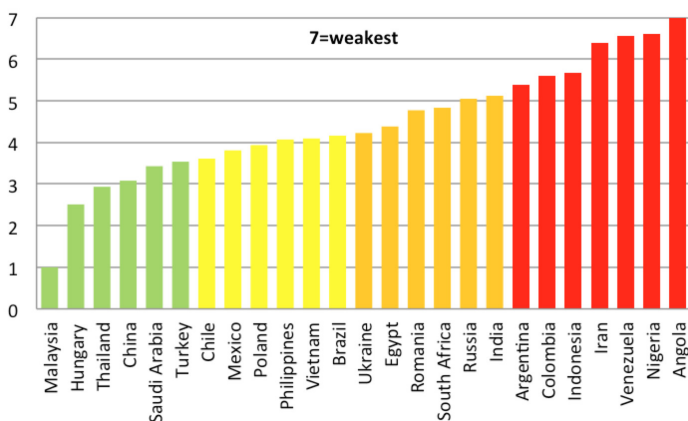
In Figure 2, the seven lowest ranked countries include Argentina, Colombia, Indonesia, Iran, Venezuela, Nigeria, and Angola. The position of Angola and Nigeria, which were ranked as favorable countries in terms of vulnerability to short capital outflows (mostly because of a lack of openness of their capital markets and relatively low inflows in the last few years), highlights the importance of our multi-dimensional analysis. Furthermore, while Malaysia and Turkey are susceptible to external balance vulnerabilities, these economies are more strongly placed in the long-term analysis, due to significant restructuring over the past decade. There is a lower indication of a misallocation of those inward capital flows.

FIGURE 2: LONGER-TERM SUPPLY SIDE RESTRUCTURING



Political and institutional factors, the third leg of our assessment, can impede or assist with implementation of necessary supply side restructuring and capability in dealing with a short-term financial crisis. By assessing the timing of the next elections (the closer to January 2014, the less likely the country is to start on a painful restructuring path), the capability of the institutions to implement policy change, and the type of political system, we highlight seven countries in which impediments to change and positive reaction are high. These are Thailand, Ukraine, Venezuela, Angola, Iran, Egypt, and Nigeria. In contrast, Chile, Poland, Turkey, Hungary, South Africa, and the Philippines have political environments and institutions that would be able to better adapt to and cope with a sudden change in global investor sentiment, in our view.

FIGURE 3: ABILITY TO IMPLEMENT POLICY CHANGE



Assessing the three dimensions of risk, the weakest five countries overall are Nigeria, Venezuela, Iran, Indonesia, and Angola. Each of these countries was in the bottom five in terms of their respective lack of long-term supply side improvement, and was also among the six most vulnerable countries in terms of ability to implement necessary political and policy changes. However, in terms of the short-term vulnerability to external risk, these countries were considered to be less vulnerable. Indonesia stood at 12, Venezuela at 16, Iran at 18, and both Nigeria and Angola among the least vulnerable countries in terms of external balance vulnerability.

At the other end of the scale, the least vulnerable countries in our assessment are Chile, Malaysia, Saudi Arabia, Hungary, and Poland. Chile, Poland, and Hungary were rated the top three most likely countries to implement necessary political and policy changes. Malaysia, Hungary, and Saudi Arabia ranked in the top five in long-term supply side adjustment, with Chile and Poland both in the top 10. However, these countries were paradoxically among the most vulnerable to external risk (with the exception of Saudi Arabia). Our results highlight the importance of taking a holistic view to assess the vulnerability of emerging markets to different risks.

Ten Key Risks Emanating from the Regions

The D&B Overall Global Business Impact (GBI) score for July 2014 stands at 285 (out of a maximum 1,000), up from 265 in April 2014. This is the highest level since the introduction of our Global Risk Matrix (GRM) in 2013. The increase in the aggregated score of our top ten globally systemic risks mostly reflects the deteriorating situation in Iraq and Syria since our last review. In addition, risks remain elevated with regard to the political crisis in Ukraine, potentially frothy asset markets, and the ability of the US Federal Reserve to unwind its massive monetary easing program without destabilizing global financial markets. Outside of these three risks, the headwinds facing the cross-border business community are relatively stable since our last review but high by historical standards.

As with the April 2014 risk matrix report, our major global risk is associated with the unwinding of the Federal Reserve's monetary easing program, highlighting the need for policy-makers to end this unprecedented experiment in an orderly (and transnationally coordinated) fashion. This difficult transition will require effective signaling to the markets to prevent any misreading of the situation. It also requires that the tapering and future upward move in rates is not implemented too rapidly for markets or emerging economies to react appropriately. The GBI score remains elevated at 60 (out of a maximum 100).

Rising security concerns in the Middle East associated with the rapid advance in Iraq of the militant Sunni group Islamic State

(IS, formerly known as ISIS) highlight the growing impact of security issues in D&Bs GRM. In second place with a GBI score of 40, our concern is that an escalation of the security situation will interrupt trade routes across the region (including oil), potentially raising global energy prices significantly.

Tied for second place with Middle East security concerns, Ukraine's ongoing political crisis similarly stems from security issues. We remain concerned that the situation will disintegrate into outright civil war. We rate this as a 50% possibility with a potential global impact of 4 (out of a maximum of 5), with a GBI score of 40. The risk that the crisis will lead to a fundamental realignment of energy cooperation between Europe and Russia earned fifth place in the GRM (GBI score of 24).

TABLE 5: TOP 10 RISKS BY D&B GLOBAL BUSINESS IMPACT SCORE FOR THE GLOBAL BUSINESS ENVIRONMENT

REGION	RISK	LIKELIHOOD OF EVENT (%)	GLOBAL IMPACT (1-5) ²	GLOBAL BUSINESS IMPACT SCORE (1-100) ³
North America	US and global financial volatility multiplies as market participants try to predict the pace and timing of interest rate hikes after the Fed's asset purchase program ends.	60	5	60
Middle East & North Africa	Civil wars in Iraq and Syria spread into neighboring countries closing trade routes and destabilizing oil supplies.	40	5	40
Eastern Europe & Central Asia	Escalation of crisis in Ukraine leads to full civil war.	50	4	40
Western Europe	EU banking stress test leads to bigger than expected refinancing needs	35	4	28
Eastern Europe & Central Asia	A Fundamental realignment of energy cooperation between Russia and Europe.	40	3	24
Asia-Pacific	Default contagion spirals out of over-capacity sectors in China and triggers a shocking and steep crash in output.	25	4	20
North America	Protracted lull in the housing market delays its much-anticipated boost to growth.	20	5	20
Asia-Pacific	A substantial correction in China's property market triggers emergency capital issues and state rescues for mid-tier banks.	45	2	18
Western Europe	Delayed implementation of reforms in peripheral economies delays a sustained recovery.	30	3	18
Western Europe	Political tension at European level rises as the European Central Bank deploys QE to stave off deflationary risks.	25	3	15

²D&B's assessment of how an event might occur globally, by depth (seriousness) or breadth (number of countries affected). For instance, limited effect would total 1 (confined regionally or low impact on the global environment); high impact would total 5 (all countries are significantly affected).

³Ranks the impact of an event on the global business environment. The score is totaled by multiplying the probability of the event by its global impact, then dividing by 5 to arrive at a result between 1 and 100. The higher the score, the more negative the impact on cross-border trade.

Three of the top ten risks are associated with Western Europe. In fourth place (down one place from April but with the same GBI score of 28) is our concern that the stress tests on EU banks will produce larger than anticipated refinancing needs (estimated at a 35% likelihood). This would place a systemic strain on the financial sector with global ramifications. In eighth equal place is the risk of delayed reforms in peripheral EU economies, undermining a European-wide recovery (GBI score of 18). In tenth place with a GBI score of 15 is the risk that the European Central Bank's (ECB) attempts to fight deflation will lead to inter-government political tensions undermining the continued stability of the EU.

Risks emanating from Asia-Pacific, in particular China, account for two of our top ten globally significant risks. In sixth place (GBI score of 20), we are concerned with the ramifications of a possible default contagion emanating from those economic sectors in China that have too much capacity—such as steel-making, ship-building, solar panels, and coal (and possibly cement, glass-making, aluminum, and commercial real estate in the Yangtze river delta). This would trigger a steep crash in business confidence and output in those provinces dominated by those industries, as well as in allied sectors in 2015. The other China-related risk is that a substantial correction in the housing market triggers problems in the financial sector, necessitating state rescues and emergency capital issues (eighth place with a GBI score of 18).

The final risk, tied for sixth place with a GBI score of 20, is related to property in the US, where a protracted lull in the housing market would delay the strengthening of the US economy.

Key Observations: Positives, Negatives, and Key Risks

- + Advanced economies are better positioned than at any point since the crisis
- + Forward-looking indicators show positive momentum
- + Major emerging markets are considering deep supply-side policy reform
- Recoveries and financial markets are highly dependent on monetary policy
- The 'new normal' is sub-par compared to pre-crisis growth levels
- Post-crisis growth is overly focused on wealth effects of rising asset prices
- Debt burdens: households are highly leveraged and exposed to interest rate risk
- Asset valuations in housing, stock markets, and credit spreads in bubble territory?
- Failure to adopt necessary restructuring and concerns over financial sector imbalances in emerging markets
- Policy-makers fail to ensure sustainable growth in advanced economies
- Uncertainty and instability as monetary policy inevitably tightens

Regional Insight: The Americas

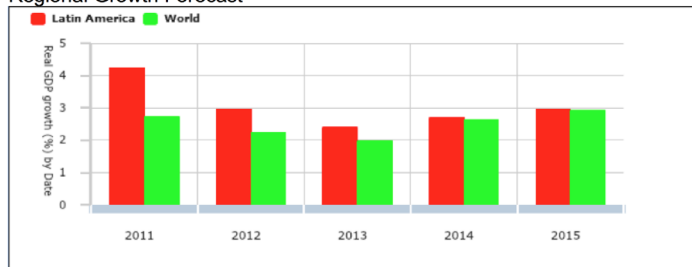
Trend: *Stable*

Headline Regional Issues

- Key currencies remain weaker against the US dollar compared with a year ago; some softening is anticipated in coming quarters as the US Fed's tapering continues
- Divergent growth rates in the main economies continue, with aggregate real GDP projected to moderate to 2.4% in 2014, exacerbated by China's cooling demand for commodities
- Stubborn inflation pressures challenge authorities in Venezuela and Argentina, while there has been some moderation in Brazil in Q1. Inflation accelerated in the second quarter in Colombia, while other economies should see a more gradual uptick in prices in H2 as spare capacity narrows
- Crucial structural reform is unlikely to be undertaken by incumbents facing re-election in 2014; instead, stop-gap measures to appease disenchanted voters are likely
- International reserves are broadly solid, providing adequate buffers against moderate external shocks in the near term

Regional Outlook

Regional Growth Forecast

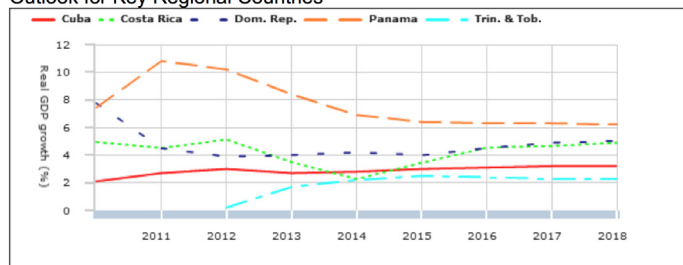


Source: Haver Analytics/D&B

We anticipate a modest recovery in 2014, with regional Our regional growth forecast has declined to 2.4% for 2014 (against 2.7% in 2013) as four of the five full members of Mercosur continued to underperform in Q2. Varying degrees of progress on structural reform and improvements in macroeconomic fundamentals underpin an uneven growth pattern among the main economies. China's weaker commodity demand is expected to lead to additional pressures on the external accounts of commodity-driven economies and further constrict fiscal flexibility. Investor concerns continue to weigh on business confidence in Brazil, but we still project strong foreign direct investment (FDI) inflows for Peru and Mexico.

Our real GDP forecast has been reduced for a second time amid indications of a sluggish Q2. The Mexican economy expanded by 0.6% year-on-year as oil exports and production declined, while demand from the US was weaker than expected due to bad weather. An anticipated acceleration in the US in H2, supported by a rise in private sector investment in Mexico and higher government spending, will

Outlook for Key Regional Countries



Source: Haver Analytics/D&B

support stronger expansion in the last two quarters of the year, albeit with strong downside risks. We maintain our less sanguine outlook for Brazil (which is projected to grow by 1.7% this year). Unsurprisingly, fiscal deterioration, supply-side constraints, and the government's reluctance to implement political and economic reform weigh heavily on Brazil's near-term prospects. Barring radical political and economic reform, the commercial environments in Venezuela and Argentina will deteriorate further in 2014 on account of heavy government intervention and a sharply weakening external position, leading to real GDP contractions of -0.8% for Argentina and -1.8% for Venezuela.

Recommendations

- Plan for higher corporate tax liabilities in Chile as President Michelle Bachelet is set to make good on her commitment to fund social reform via higher taxation
- While anti-government protests have petered out in Venezuela, political tensions remain high, and firms should have contingency plans to minimize the impact of possible disruption to business operations in the coming quarters
- Other regional governments with legislative and presidential elections this year will face persistent public protest on a range of issues including high prices, corruption, perceived government economic mismanagement, and income inequality
- The commercial climates in Venezuela and Argentina will deteriorate further in the near term as government intervention in the markets deepens and their external positions weaken amid steadily declining international reserves
- Identify and explore potential investment opportunities in large infrastructure projects as key governments lean toward more public-private partnership arrangements to facilitate capital works

Regional Insight: Western Europe

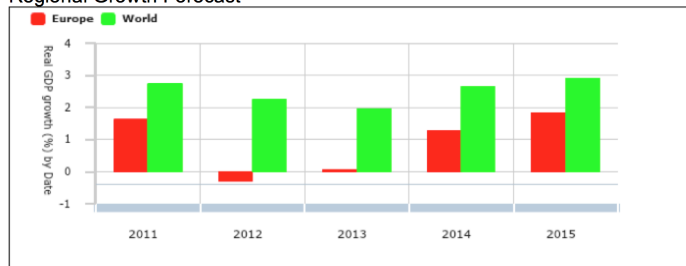
Trend: Improving

Headline Regional Issues

- The ECB cut its main refinancing rate to an all-time low of 0.15% in June
- In addition, the Bank will launch long-term refinancing operations in September and December aimed at stimulating lending to the private sector
- Germany and especially the UK will outperform the other big Western European economies in 2014-15
- High unemployment rates remain a pressing issue in most countries and, although risks have subsided, the long-term survival of the euro zone is still endangered

Regional Outlook

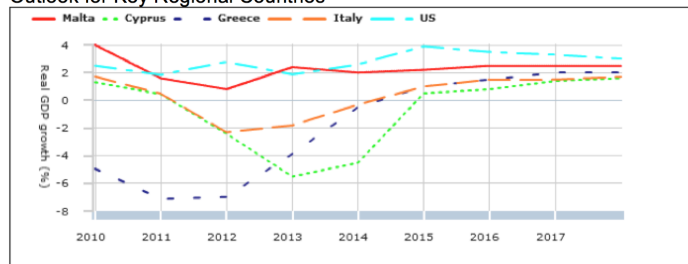
Regional Growth Forecast



Source: Haver Analytics/D&B

Real GDP growth in the region will accelerate in the outlook period, but in general the rate of expansion will remain below the levels of pre-crisis years. While countries like Germany, Sweden, and especially the UK lead the recovery, the southern European economies still struggle. Monetary policy will remain supportive for growth in the euro zone; the ECB lowered its key policy rate, as well as its deposit rate, by 10 basis points in June. In the UK, interest rates will go up in late 2014 or early 2015 in order to cool down the economy (the real estate sector in particular). The return to growth in most euro-zone countries has so far not fed through to the labor market. We expect only modest improvements in the remainder of 2014 and early 2015. Positively, we expect real GDP growth in the five biggest economies in the region to pick up in 2014: the U.K. (2 percent) and Germany (1.7 percent) will outperform France (0.7 percent), Spain (0.1 percent), and Italy (-0.3 percent). In addition, Sweden (2 percent) will also see a healthy recovery, supporting its trading partners around the Baltic Sea.

Outlook for Key Regional Countries



Source: Haver Analytics/D&B

While Ireland and Portugal have successfully exited the EU's bail-out procedure, Greece and Cyprus still have a long way to go until their public finances and competitiveness levels are restored. The worrisome gap between the French economy and the UK and German economies continues to increase; the French government is unable to implement far-reaching and initially painful reforms of its rigid labor market. As a result, unemployment in France stood at 10.1% in May, compared with 5.1% in Germany.

Recommendations

- Despite recent improvements, expect the recovery in the euro zone and the wider region to remain shaky and weak, as downside risks remain significant
- Although it is not our core scenario, a break-up of the euro zone still cannot be ruled out. Monitor the news flow closely as the frequency of events is high
- Maintain tight payment terms for customers in the Mediterranean countries, as insolvency risk is on the rise and payments performance is still poor
- With a new European Commission coming into office, monitor the progress of negotiations with the US on a free-trade agreement

Regional Insight: Eastern Europe and Central Asia

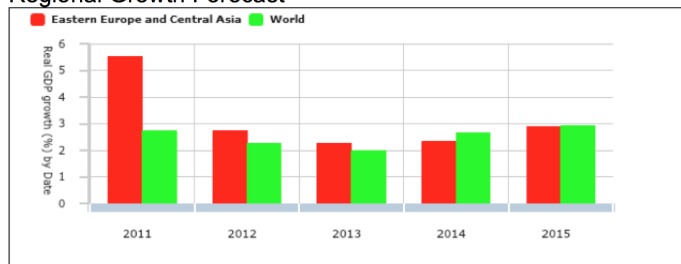
Trend: *Deteriorating*

Headline Regional Issues

- We expect the Eastern Europe and Central Asia region overall to grow at a slightly slower pace than the global average in 2014
- Downside risks include the Ukraine crisis, re-balancing in China, and the end of the commodities super cycle, whereas the long-awaited euro zone recovery is an upside factor
- The imposition of economic sanctions against Russia by the G7 countries has a negative impact on regional currencies, trade, and investment channels in the whole region given Russia's systemic importance

Regional Outlook

Regional Growth Forecast

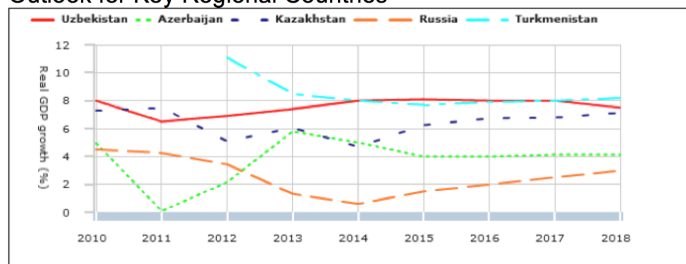


Source: Haver Analytics/D&B

The Eastern Europe and Central Asia region encompasses a large variety of economies with diverse growth perspectives. Growth in emerging Europe will be around 2.5% on average in 2014 thanks mainly to relatively robust performance in the Baltics. Latvia's adoption of the euro since the start of 2014 will have a positive economic effect, as will Lithuania's accession to the euro zone (expected in 2015). In contrast, net export producers in Central Asia will perform at a strong 5.8% in 2014, underpinned by relatively high commodity prices and growing production volumes. European CIS countries will be the worst performers in the region, with negative growth of 0.9% as a whole in 2014.

Downside risks for the region prevail. Among them are the escalating political and economic crises in Ukraine, which could have further international implications. Potential economic sanctions against Russia imposed by the G7 will have negative impacts not only for the Russian economy but for the region as a whole given Russia's systemic importance. Another risk, which has already taken a toll on regional currencies, is the transition of US monetary policy to a less accommodative stance.

Outlook for Key Regional Countries



Source: Haver Analytics/D&B

We expect Russia's real GDP to grow at just 0.6% in 2014, lower than in 2013. This stems from a rapid deterioration of investment (curbed by intensified capital flight triggered by the Ukraine crisis) and a deceleration of domestic demand (subdued by rising inflation and sharp rouble depreciation). The biggest downside risk for Russia is the Ukrainian crisis and potential economic sanctions from the US/EU. After flat growth in 2013, we expect Ukraine's economy to contract by 5% due to the abrupt rupture of trade and economic ties with Russia and Eurasian Economic Union countries, severe damage caused by the military conflict in the east, and a fiscal consolidation.

Recommendations

- Downside risks for doing business in the region prevail; moreover, different combinations of downside risks in different locations require an in-depth assessment of particular countries
- Strict trade terms are recommended

Regional Insight: Asia-Pacific

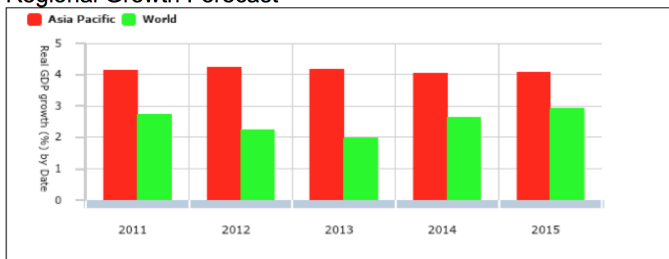
Trend: Stable

Headline Regional Issues

- A more mixed picture of diverging fortunes within the region is becoming clearer; this holds across currencies, investment, stock markets, manufacturing, and credit growth
- Inflation risks remain contained and most regional currencies have arrived at sustainable and defensible valuations against the US dollar in recent months

Regional Outlook

Regional Growth Forecast

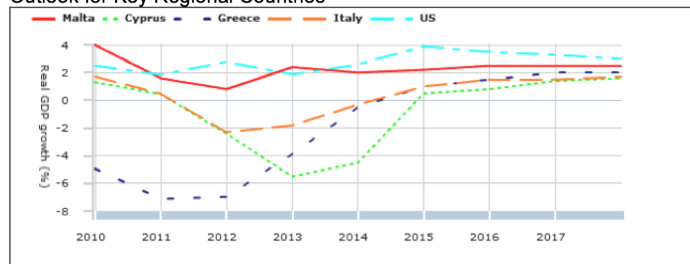


Source: Haver Analytics/D&B

Our current real GDP growth forecasts imply China will again avoid any hard landing in terms of its national GDP, with real GDP growth in Q2-Q4 2014 to average just over 7%. The same figure for Japan is 1%, and for Indonesia and the Philippines (two emerging markets in a region of promise for Asia's growth frontier), real GDP growth will be just over 6% and 5%, respectively. Bond yields have broadly fallen across the region since the January mini-crunch in emerging market currencies, with the exception of the Philippines, owing to its strong growth profile. Asia's real GDP can grow by close to 4% again in 2014 as in 2013, provided global liquidity and external demand conditions remain supportive, near-term credit growth is moderated, and asset valuations are kept sustainable.

Corporate interest rate coverage ratios look weak in China and India, raising concerns over credit quality. The main challenge is how debt-fuelled growth strategies will adjust once interest rates start to normalize. The risk of 'popping' asset and debt bubbles in Asia due to reversing capital flows has weakened over the short term in light of the moderating pace of US growth (even allowing for weather). However, even 2% average real GDP growth for 2014 in the US will imply quite a strong bounce-back, which will test investor confidence in returns in Asia-Pacific local assets.

Outlook for Key Regional Countries



Source: Haver Analytics/D&B

The chief question mark in China is whether the incipient decline in first-tier urban home prices (more advanced in more peripheral cities) severely undermines the real GDP target of at least 7.2% growth in 2014, via default contagion and falls in investment. Real estate accounts for up to 20% of GDP. The overhang of unwanted commercial and residential construction in eastern China, imploding profitability of the coal sector, and large swathes of over-capacity in a string of upstream heavy industries could trigger sectoral debt crises in 2015.

Across Asia, the economies most exposed to Chinese demand are broadly Malaysia, Thailand, Vietnam, and the Philippines. This picture blurs the distinction between export categories, as food and energy exports to China could still grow even with a recession in heavy industry. In the financial markets, the Asian corporate bond market has remained open for inexpensive issuance as US 10-year government bond yields have helpfully remained below 3%. The Asian now-sizable corporate bond market is valued at close to a quarter of emerging Asia's GDP in Q1 2014. Bank lending has continued to expand at double-digit year-on-year rates across Southeast Asia (including Myanmar at almost 50% year on year) in 2014.

Recommendations

- Use a mix of open-account (OA) and documentary credit terms across different sectors in one country as economies diversify and the near-term picture remains complex
- Use your negotiations over trade terms to gauge customer and supplier liquidity and optimism in what will be a complex, shifting picture in 2014; be prepared to give more generous terms in cyclical sectors

Regional Insight: Middle East and North Africa

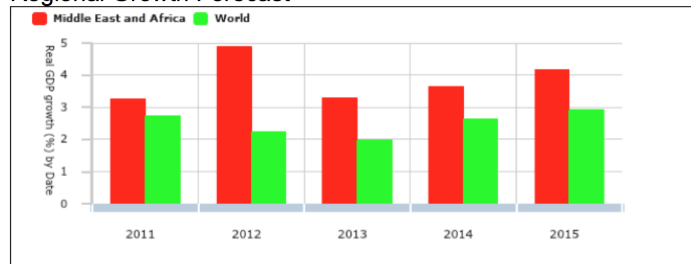
Trend: *Deteriorating Rapidly*

Headline Regional Issues

- The rapid advance in Iraq of the Sunni militant group Islamic State (IS, formerly known as ISIS) threatens the already-weak security outlook across the region, but particularly in Jordan and Lebanon and possibly also Turkey and Iran
- The violence has resulted in an 'Iraq' premium in the oil market; we forecast an annual average oil price of \$113.5 per barrel in 2014, up from \$108.6 per barrel in 2013
- Regional growth is driven by government spending of hydrocarbon revenues, even in non-oil economies, which benefit from increased trade, investment, jobs, and remittance flows
- The risk of military strikes against Iran's nuclear sector has receded in the short term.

Regional Outlook

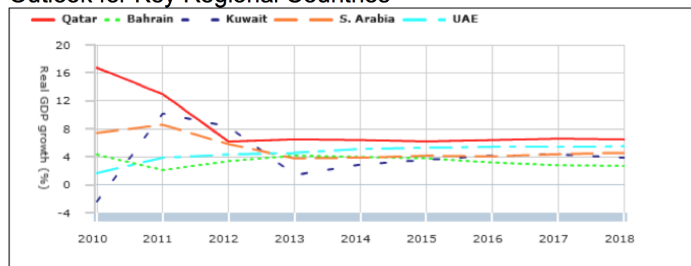
Regional Growth Forecast



Source: Haver Analytics/D&B

Despite a relatively flat oil price in 2014 and 2015, government spending of oil revenues will drive growth in oil-rich countries through a series of infrastructure development mega-projects. Meanwhile, oil-poor countries will continue to benefit from job opportunities in, trade with, investment from, and economic assistance from the oil-rich countries. Overall, we expect growth in the region to increase from 2.7% in 2013 to 3.3% in 2014 and 3.8% in 2015. These forecasts are subject to downward revision following the latest outbreak of violence in Iraq. Other headwinds include, in the short term, global economic uncertainties amid the end of the massive US (QE) program. In the medium term, headwinds come from the impact of US shale oil and gas on global oil prices and restructuring in emerging markets.

Outlook for Key Regional Countries



Source: Haver Analytics/D&B

The region's largest economy, Saudi Arabia, will see real GDP growth fall for a third consecutive year to 3.9% in 2014 (from 4.0% in 2013) before rebounding to 4.2% in 2015, driven by infrastructure spending. Similarly, Qatar's prodigious double-digit growth rate in 2006-11 has slowed but will still average 6.3% in 2014-15 and 6.5% in 2016-18, driven by government expenditure ahead of the 2022 soccer World Cup. In addition, the UAE will continue its recovery from its 2009-10 debt crisis, expanding by 5.5% in 2014 and 5.6% in 2015. Although progress on the Iran nuclear issue continues, the impact of international sanctions (not expected to lift before the end of 2015) will continue to curtail growth, with the Iranian economy remaining virtually stagnant in 2014 and 2015.

Meanwhile, among the larger non-hydrocarbon-dependent economies, Egypt will continue to suffer from the unstable political situation despite recent elections, with growth remaining at 2.1% in 2014 before climbing to 3.2% in 2015. The Israeli economy is expected to bottom out in 2014 at 3.3% (the same as in 2013) before rebounding to 3.7% in 2015. In North Africa, the importance of the agriculture sector is reflected in Morocco's volatile growth: 4.4% in 2013, 2.9% in 2014, and 4.1% in 2015.

Recommendations

- Monitor the situation in Iraq, as it will impact supply chains internally and across the region; payment performance in Jordan, Lebanon, Turkey, and Iran will also be affected
- In addition, closely monitor political and security developments in all countries, particularly in Algeria, Bahrain, Egypt, Iran, Jordan, Lebanon, Libya, Syria, and Yemen, as these will impact business risk
- Note that opportunities related to the construction sector and upstream/downstream hydrocarbon sectors will be available in the oil-rich countries as they boost their infrastructure and production capacities
- Monitor closely negotiations between Iran and the international community over the nuclear issue; a resolution would open the Iranian economy to significant opportunities, particularly in the upstream and downstream hydrocarbon sector

Regional Insight: Sub-Saharan Africa

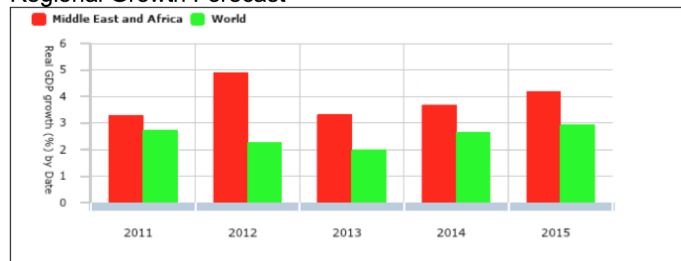
Trend: *Stable*

Headline Regional Issues

- Sub-Saharan Africa will start H2 on solid footing, building on the healthy growth of H1
- We expect growth in 2014 to slightly outpace 2013, thanks to an overall improvement in the global economy
- The US Federal Reserve's exit strategy could cause currency volatility and roil capital flows for the region's frontier economies
- Geopolitical insecurity and violence, precipitated by domestic and intra-regional conflicts, have joined the top risks facing the region

Regional Outlook

Regional Growth Forecast

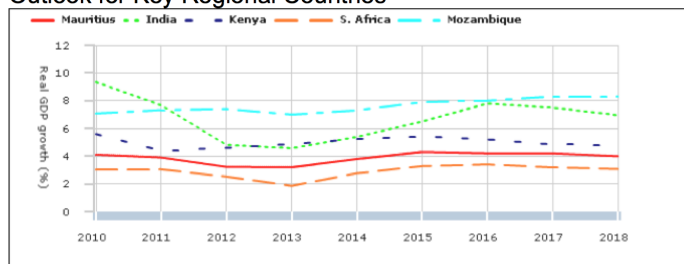


Source: Haver Analytics/D&B

Sub-Saharan Africa's regional risk profile points to continued expansion. The region has delivered steady, solid growth, driven by robust domestic demand (thanks to healthy population growth) and heavy public sector spending (thanks to governments investing in road and energy infrastructure across the region). As the US expansion switches into higher gear in H2 2014 and the slowdown in emerging market economies fades, increased demand for sub-Saharan Africa's exports will aid regional growth. FDI and portfolio investment flows are also strong and will continue to provide support, especially in industries linked to resource extraction.

Commodity exporters will stay ahead of others. Economies based on resource extraction have done little in recent years to diversify sources of growth, but China's structural transformation to a consumer demand-driven growth model could finally force these countries to rethink their overdependence on commodity exports. At the same time, this could create new industries in sub-Saharan Africa and foster diversification. The commodity super cycle has ended and diversification will be crucial for the region to sustain high growth rates in the long run.

Outlook for Key Regional Countries



Source: Haver Analytics/D&B

Average growth for the region will be solid but the outlook varies significantly from country to country. Labor disputes continue to cloud South Africa's near-term outlook. The five-month strike in the platinum sector finally ended, but engineering and metal workers launched a new strike almost immediately. Growth is expected to reach 2.2% in 2014 and 3.0% in 2015, provided the new strike does not weigh on growth for too long. Nigeria's risk profile has taken a turn for the worse in the past few months. While economic activity generally remains healthy and GDP growth is forecast to top 7% in 2014, insecurity risks have multiplied as illustrated by kidnappings and bombings of civilians. Such violence is expected to continue in the run-up to the general elections in February 2015.

Renewed attacks by Somali terrorists have elevated insecurity risks in Kenya. Tourism, a key driver, will be the main casualty, although the outlook for robust overall growth is little changed. Risks are nevertheless rising. We have downgraded the risk rating for Ghana by another quartile as a consequence of further depreciation of the cedi and increasing inflation. Rumors persist that the government may seek assistance from the International Monetary Fund. Consequently, we maintain our forecast for real GDP growth of 4.5% for 2014 and a budget deficit of 10.0% of GDP. One of the best performers of East Africa over the last decade, Ethiopia's risk profile remains stable and the economy is estimated to have grown 7.7% in calendar 2013, with 7.8% growth forecast in 2014.

Recommendations

- Mining companies should be aware that they are at high risk of being targeted by militias
- Investors should beware of forced contract renewals as governments attempt to maximize returns and as resource nationalism rises
- We recommend stricter trade terms for local counterparties
- Monitor FX liquidity in countries with balance of payments difficulties and weak currencies
- Companies are advised to take out adequate security and political risk insurance coverage



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103 JFK Parkway
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