Atradius
Managing risk, enabling trade

Atradius Country Report

North American Free Trade Agreement (NAFTA) countries – November 2016

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Contents

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Canada

Main import sources (2015, % of total)	
USA:	53.2 %
China:	12.2 %
Mexico:	5.8 %
Germany:	3.2 %
Japan:	2.8 %

Main export markets (2015, % of total)	
USA:	76.7 %
China:	3.9 %
United Kingdom:	3.1 %
Japan:	1.9 %
Mexico:	1.3 %

Key indicators	2013	2014	2015	2016*	2017**
Real GDP (y-on-y, % change)	2.2	2.5	1.1	1.2	2.0
Consumer prices (y-on-y, % change)	0.9	1.9	1.1	1.6	2.4
Private consumption (y-on-y, % change)	2.4	2.6	1.9	2.1	2.1
Retail sales (y-on-y, % change)	2.2	2.6	0.5	1.9	0.0
Industrial production (y-on-y, % change)	2.2	4.0	-1.1	-1.4	1.7
Unemployment rate (%)	7.1	6.9	6.9	7.0	6.9
Real fixed investment (y-on-y, % change)	-0.5	0.7	-4.4	-3.0	1.2
Exports of goods and non-factor services (y-on-y, % change)	2.8	5.3	3.4	0.5	1.7
Fiscal balance (% of GDP)	-2.7	-1.6	-1.3	-1.5	-1.0
Government debt (% of GDP)	61.8	63.2	66.0	66.4	64.6

* estimate **forecast Source: IHS

Canadian industries performance forecast


Excellent:
The credit risk situation in the sector is strong / business performance in the sector is strong compared to its long-term trend.


Good:
The credit risk situation in the sector is benign / business performance in the sector is above its long-term trend.


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The credit risk credit situation in the sector is average / business performance in the sector is stable.


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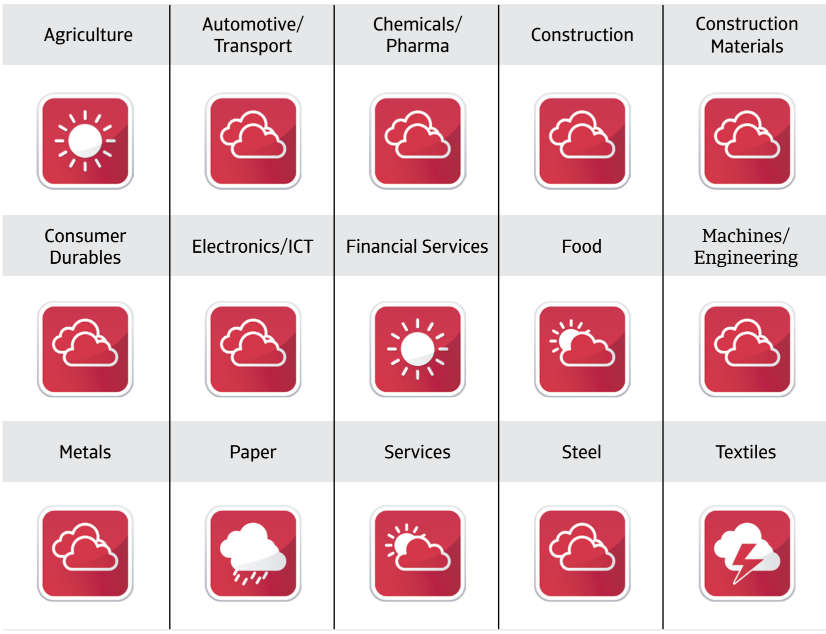
November 2016



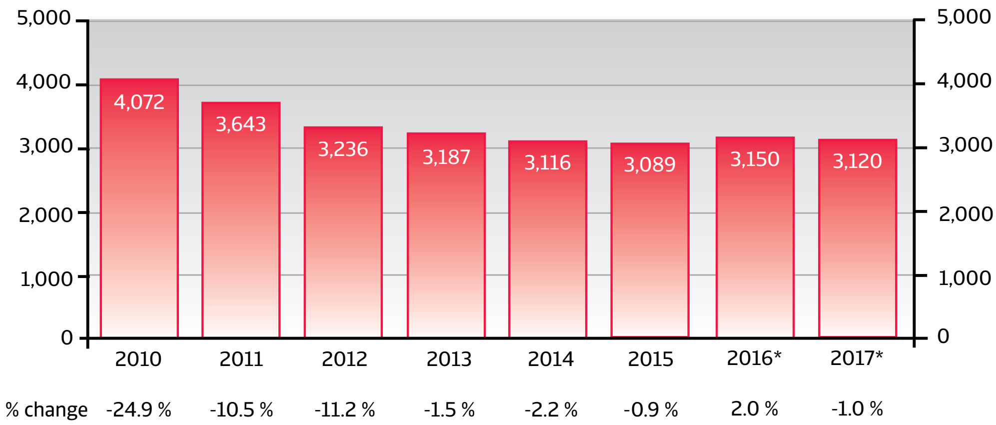
The insolvency environment

Canadian corporate insolvencies are increasing again

After double-digit year-on-year decreases between 2010 and 2012, the pace of insolvency decline slowed down in 2013-2015. Due to the more difficult economic environment and low commodity prices (see explanation below), it is expected that business insolvencies will increase in 2016, by 2% to about 3,150 cases, followed by a modest decrease of 1% in 2017.

Canadian business insolvencies

(Calendar year: % change on previous year)

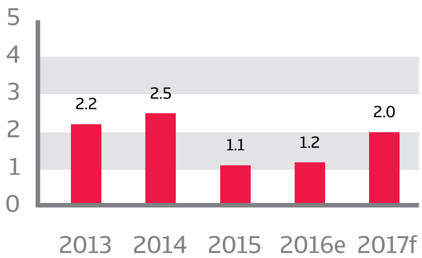


*forecast

Sources: Office of the Superintendent of Bankruptcy Canada; Atradius Economic Research

Main economic developments

Real GDP growth (y-on-y, % change)



Source: IHS

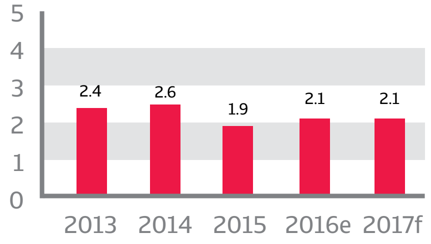
Growth expected to rebound in 2017

The Canadian economy saw robust growth between 2010 and 2014, mainly due to increased global demand for commodities, especially oil. However, as the world´s fifth largest oil producer, Canada has been affected by the decrease in oil prices since mid-2014, suffering a major decrease in investment.

Economic growth slowed down to 1.1% in 2015, and in 2016 a similar growth rate of around 1.2% is expected. The slowdown is mainly a result of contractions in manufacturing, mining, quarrying, oil and gas extraction and wholesale trade, while private consumption continued to contribute positively to GDP. That said, GDP growth is expected to gain momentum at the end of 2016, and in 2017 it is forecast to rebound (grow 2.0%), as investments, industrial production, and non-energy exports pick up and fiscal spending (especially on infrastructure) increases.

However, uncertainty has increased after the outcome of the November 2016 US presidential election. Any moves by the next US administration under president Donald Trump towards more protectionist trade policies and/or renegotiating the North American Free Trade (NAFTA) agreement would have a potential negative impact on the Canadian economy in the future.

Private consumption (y-on-y, % change)

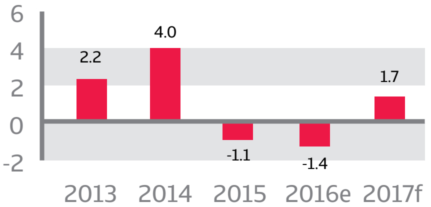


Source: IHS

Private consumption growth rebounds, but high household indebtedness could pose a risk to the economy

After growing 2.6% in 2014, private consumption growth slowed down to 1.9% in 2015, but is expected to rebound slightly in 2016 and 2017. Household debt expanded in recent years, with most consumer borrowing going into buying homes, as property values have gone up and interest rates are low. However, it is estimated that housing is currently overvalued, and household indebtedness has increased to more than 150% of disposable income. This could pose a risk to the economy, especially if interest rates and unemployment were to increase in the future. Any potential economic downturn could turn the consumer debt issue into a real problem. That said, the unemployment rate is expected to remain stable for the time being, at around 6.9% in 2016 and 2017, and the Central Bank has maintained the overnight lending rate at 0.5% since mid-2015.

Industrial production (y-on-y, % change)



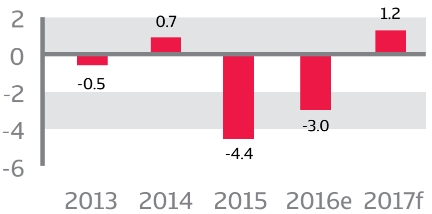
Source: IHS

Industrial production to contract again in 2016

The lowering of the interest rate twice in 2015 was seen as a move by the Canadian Central Bank to boost investments and to make Canadian exports even cheaper. However, the weaker exchange rate and lower interest rate have not led to a real surge of exports of manufactured goods to the US, which accounts for more than 75% of Canadian exports. Industrial production contracted in 2015 and 2016. The potential of manufacturing to compensate for deterioration in the energy sector is limited, as manufacturing contribution to GDP has steadily decreased in recent years. At the same time, the Canadian manufacturing sector has lost international competitiveness, as currencies of other countries exporting to the US have also depreciated against the USD. Additionally, Canadian wages are high by international comparison.

The growth in exports of goods and non-factor services is expected to improve to 1.7% in 2017, on the back of a weaker Canadian dollar (CAD) and subdued growth of 0.5% in 2016. The current account deficit is expected to decrease to 3.0% of GDP in 2016 and 1.7% of GDP in 2017). However, any future trade frictions with the US could actually dampen Canada´s export performance in the future.

Real fixed investment (y-on-y, % change)

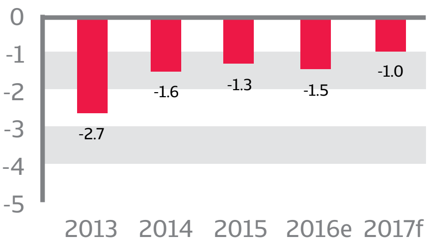


Source: IHS

Problems in the oil sector triggered investment contraction

Energy firms, which account for about 30% of capital spending, sharply reduced investment in 2015 and 2016, by more than 50%. At the same time, investment in the manufacturing sector remained subdued. Real fixed investment in Canada decreased 4.4.% in 2015, followed by an expected 3.0% decline in 2016 and a modest rebound of 1.2% in 2017.

Fiscal balance (% of GDP)



Source: IHS

Public deficit increases, but government debt remains manageable

Canada´s budget deficit has increased in 2016, as the government under Prime Minister Justin Trudeau decided to increase fiscal spending in order to stem decreasing growth rates. Government debt is relatively low compared to the US and most Western European countries, helped by the fact that Canada did not suffer a major downturn after the 2008 financial crisis.

Mexico

Main import sources (2015, % of total)	
USA:	47.4 %
China:	17.7 %
Japan:	4.4 %
South Korea:	3.7 %
Germany:	3.5 %

Main export markets (2015, % of total)	
USA:	81.2 %
Canada:	2.8 %
China:	1.3 %
Brazil:	1.0 %
Colombia:	1.0 %

Key indicators	2013	2014	2015	2016*	2017**
Real GDP (y-on-y, % change)	1.6	2.2	2.5	2.1	2.2
Consumer prices (y-on-y, % change)	3.8	4.0	2.7	2.9	3.2
Private consumption (y-on-y, % change)	2.4	1.8	3.1	2.8	2.5
Retail sales (y-on-y, % change)	1.3	2.6	5.1	7.1	3.4
Industrial production (y-on-y, % change)	-0.5	2.6	1.0	1.3	3.4
Unemployment rate (%)	4.9	4.8	4.4	4.2	4.1
Real fixed investment (y-on-y, % change)	-1.5	2.8	3.9	2.4	2.3
Export of goods and non-factor services (y-on-y, % change)	2.3	6.9	9.1	2.4	3.8
Fiscal balance (% of GDP)	-2.3	-3.2	-3.5	-3.8	-3.4
Government debt (% of GDP)	34.6	37.2	41.3	41.2	39.4

* estimate **forecast Source: EIU, IHS, IMF

Mexican industries performance forecast

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The credit risk situation in the sector is strong / business performance in the sector is strong compared to its long-term trend.

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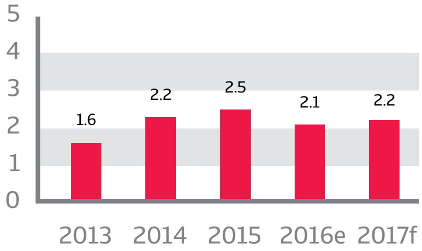
November 2016

Agriculture	Automotive/ Transport	Chemicals/ Pharma	Construction	Construction Materials
				
Consumer Durables	Electronics/ICT	Financial Services	Food	Machines/ Engineering
				
Metals	Paper	Services	Steel	Textiles
				

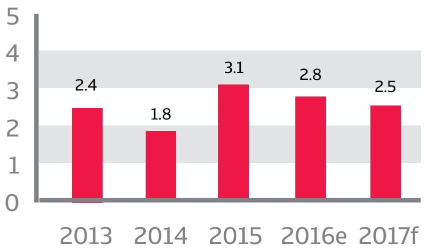
Main economic developments

Real GDP growth
(y-on-y, % change)



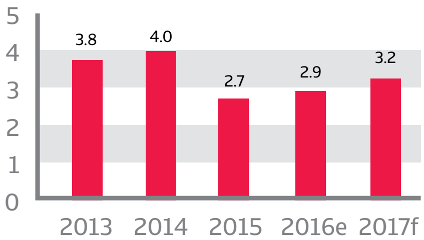
Source: IHS

Private consumption
(y-on-y, % change)



Source: IHS

Consumer prices
(y-on-y, % change)



Source: IHS

The US presidential election: potential impact on the Mexican economy

It remains to be seen what will be full impact of any Mexico policy shift under the new US administration. However, given Donald Trump´s announcements of a radical change in his Mexico policy during the campaign, exchange rate volatility increased over the last couple of months, with a Mexican peso depreciation by more than 10%. Exchange rate volatility is expected to continue over the coming weeks, until the US policy towards Mexico under president-elect Trump becomes clearer.

While the exchange rate acts as a shock absorber for the Mexican economy, the peso depreciation has pushed up inflation. As a consequence, the Bank of Mexico has increased the benchmark interest rate several times since the beginning of 2016 – from a record low of 3% at the end of 2015 to 4.75% in October 2016, and in the short-term additional interest rate hikes to more than 5% are expected.

However, this monetary policy negatively impacts domestic demand in times of an already sluggish GDP growth rate of just about 2% in 2016 (mainly due to decreased oil prices, lower oil production, tighter fiscal policies and low productivity growth). At the same time on-going domestic political woes (the still unstable security situation caused by drug-related crime incidents and widespread corruption) continue to affect business and consumer confidence.

The projected Mexican GDP growth rate of about 2% in 2017 and 2018 could end up much lower if Donald Trump puts into practice some of the announcements he made during the campaign period, e.g. renegotiate NAFTA or even withdraw from it, imposing import tariffs on Mexican goods, impose capital controls over remittances (which account for 2.5% of Mexican GDP) and order mass deportations of illegal immigrants. Increased economic insecurity could also hamper foreign direct investment in Mexico, especially in the oil sector (international tenders for deep water oil fields).

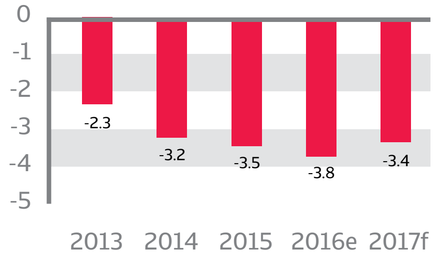
Potential impact on Mexican businesses

The peso depreciation mainly affects companies that depend on imported goods and/or are indebted in US dollar. Cash flow is affected if higher producer prices cannot be passed on to customers. Some businesses have already started to delay payments, waiting for the peso to strengthen again.

Rising interest rates could adversely affect businesses that are already financially stretched, limiting their ability to repay interest and capital and/or renew their bank lines, which could lead to breach of covenants and default.

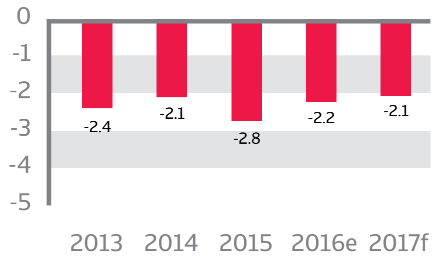
Any import taxes imposed by the US on trade with Mexican businesses would severely hurt exporters and those in the value chain that sell their goods to exporting companies. The main affected Mexican sectors would be car manufacturing, electronics, machinery, and oil.

Fiscal balance (% of GDP)



Source: IHS

Current account (% of GDP)



Source: IHS

Concerns about government creditworthiness have increased

Concerns about government finances have increased, due to growing public debt (56% of GDP in 2016 compared to 50% of GDP in 2014) and rising spending pressures, which are related to major problems at the state-owned and heavily leveraged oil company Pemex. In 2015 and early 2016 Pemex's net losses doubled, while arrears to providers have mounted and liquidity has decreased. Subsequent government support for Pemex weighs on sovereign creditworthiness. Despite major cost-cutting plans and debt restructuring, it cannot be ruled out that the company could require additional support on top of the already provided capital injections, reduced tax tariffs and credit lines from state-owned banks.

Some shock-absorbing capabilities

That said, Mexico´s fiscal framework has improved and tax revenues have increased, following a tax reform passed in 2013. The share of oil in government revenues declined from more than 30% to 20%. Given the persistently low oil prices, fiscal consolidation measures have been implemented.

Moreover, Mexico's resilience is underpinned by a flexible exchange rate and solid external balances, with limited external refinancing needs. While the current account deficit increased to 2.8% of GDP in 2015 due to low oil prices, it is expected to decrease again in 2016 and 2017, in line with gradually recovering energy prices. There is additional liquidity potential from a precautionary IMF credit line of USD 70 billion on which Mexico can draw in times of adverse global credit conditions. The solvency situation is also robust, with foreign debt ratios under control.

Crucial reforms have been passed

Since 2013 the Peña Nieto administration and the Mexican Congress have passed some comprehensive reforms to overcome the economy´s structural weaknesses: low earnings capacity, limited fiscal flexibility and high dependency on volatile portfolio capital inflows.

With oil production decreasing over the last ten years and the government´s high dependence on oil revenues, the centrepiece of the reform efforts has been the reorganisation of the energy sector. Pemex, the state-owned oil and gas company, lacks the know-how and financial resources to invest in exploration and production, mainly because it pays 90% of its revenues to the state. Pemex therefore urgently needed permission to cooperate with private (foreign) investors for joint exploration, refining and distribution. Constitutional changes implemented at the end of 2014 have put an end to Pemex's 75-year monopoly and have enabled foreign companies to invest in the exploitation of offshore oil fields and shale gas. In the face of still low oil prices, the government has so far adopted a pragmatic approach in its auctions to sell oil exploration rights to foreign companies, e.g. by adjusting contract terms to make them more friendly to investors.

Other reforms (liberalisation of the telecommunications and the labour market, a reform of the tax system to broaden the tax base and to open the monopolised electricity sector) have made slow, but steady progress so far.

A comprehensive implementation of the reforms would increase investment and significantly improve the economy´s productivity and competitiveness, raising Mexico´s potential annual GDP growth rate from around 3.0% to 4%-5% in the long term. However, public protests and political struggles between the main parties could still derail proper implementation.

Internal security and law enforcement remain issues

More needs to be done to tackle the poor domestic security linked to drug-related violence and rampant corruption, which severely affect the business climate and hamper economic performance by discouraging investors. At the same time, the profitability of many businesses has suffered from threats and violence against business owners, including the kidnapping of their family members. For a solid recovery of the country's medium-term earnings capacity, Mexico would need to improve its law enforcement, the independence of the judiciary system and to overhaul police institutions.

USA

Main import sources (2015, % of total)	
China:	21.8 %
Canada:	13.0 %
Mexico:	12.9 %
Japan:	5.8 %
Germany:	5.5 %

Main export markets (2015, % of total)	
Canada:	18.6 %
Mexico:	15.7 %
China:	7.7 %
Japan:	4.2 %
United Kingdom:	3.7 %

Key indicators	2013	2014	2015	2016*	2017**
Real GDP (y-on-y, % change)	1.7	2.4	2.6	1.5	2.2
Consumer prices (y-on-y, % change)	1.5	1.6	0.1	1.3	2.3
Private consumption (y-on-y, % change)	1.5	2.9	3.2	2.8	2.6
Retail sales (y-on-y, % change)	2.3	2.5	2.2	1.5	1.7
Industrial production (y-on-y, % change)	1.9	2.9	0.3	-0.9	1.4
Unemployment rate (%)	7.4	6.2	5.3	4.9	4.8
Real fixed investment (y-on-y, % change)	3.1	4.2	3.7	1.0	4.2
Exports of goods and non-factor services (y-on-y, % change)	3.5	4.3	0.1	-0.4	2.8
Fiscal balance (% of GDP)	-4.5	-3.8	-3.5	-3.9	-3.5
Government debt (% of GDP)	121.6	121.2	121.5	123.6	121.5

* estimate **forecast Source: IHS

US industries performance forecast


Excellent:
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Agriculture	Automotive/ Transport	Chemicals/ Pharma	Construction	Construction Materials
				
Consumer Durables	Electronics/ICT	Financial Services	Food	Machines/ Engineering
				
Metals	Paper	Services	Steel	Textiles
				

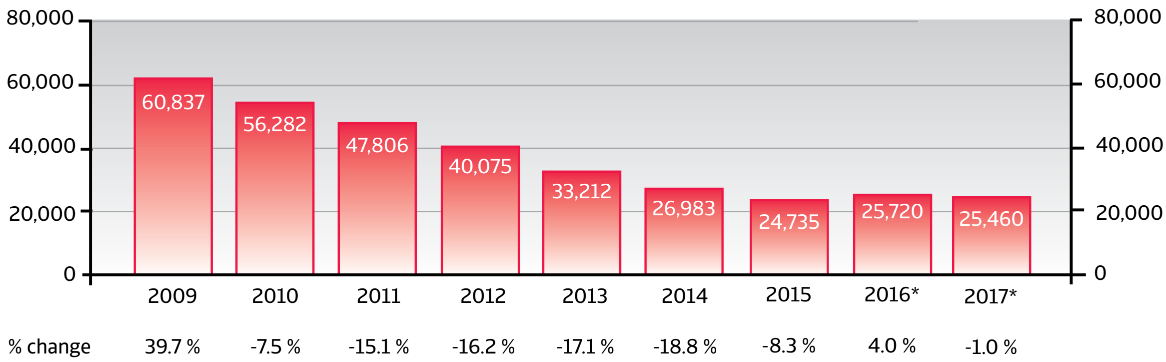
The insolvency environment

US corporate insolvencies to increase again in 2016

After sharp year-on-year increases in 2008 and 2009, the number of corporate insolvencies has steadily decreased every year since. According to figures provided by the US Courts, the number of business bankruptcies filed in Federal Courts declined 8.3% year-on-year in 2015, to 24,735 cases.

However, in 2016 business insolvencies are expected to increase again, by around 4%, as exporting businesses struggle with lost competitiveness due to a stronger US dollar and the on-going problems in the oil and gas sector. The loss of profits has forced many oil and gas businesses to file for bankruptcy. Many companies are highly leveraged, having taken on a lot of debt during the boom period. At the same time, access to bank funds as well as access to capital markets has been reduced. In 2017, a modest insolvency decrease of 1% is forecast.

US business insolvencies
(Calendar year: % change on previous year)

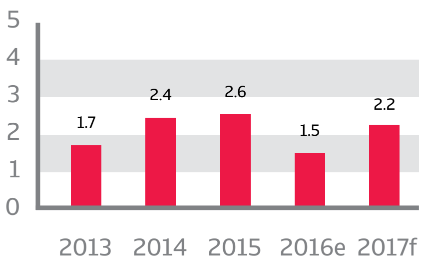


*forecast

Sources: Administrative Office of the U.S. Courts; Atradius Economic Research

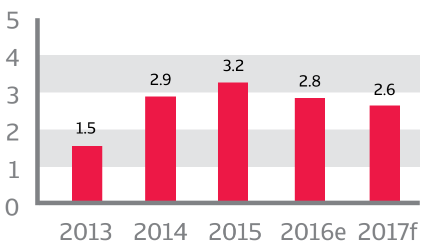
Main economic developments

Real GDP growth
(y-on-y, % change)



Source: IHS

Private consumption
(y-on-y, % change)



Source: IHS

Steady but uneven economic growth

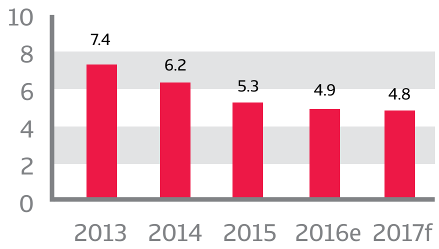
After increasing 2.6% in 2015, US economic growth is expected to slow down to 1.5% in 2016, followed by a rebound of 2.2% in 2017. While domestic demand is the main driver of economic expansion, manufacturing and exports continue to suffer from a strong USD, and investments are still hampered by the current problems in the energy sector. Downside risks have increased over the last couple of months due to increased volatility in the world economy and international markets, which could hurt US consumer confidence and business sentiment.

Private consumption growth expected to remain robust

Household consumption accounts for almost 70% of US GDP and has been the most important engine of growth since 2014. Private consumption is expected to further sustain US economic growth, increasing 2.8% in 2016 and 2.6% in 2017.

Household consumption has been aided by a strong USD, low inflation and low interest rates. Due to the low interest rate environment, US consumers have increased their purchases of big-ticket items like cars and houses. The US consumer price index (CPI) decreased since mid-2014 as a result of declining oil prices, to 0.1% in 2015, and then increased to just 1.3% in 2016. While the lower oil price has reduced the profits of producers, it has benefitted consumers, who have spent extra money.

Unemployment rate (%)



Source: IHS

Another important factor for rising consumer confidence and spending is the lower unemployment rate, which decreased from 7.4% in 2013 to below 5% in 2016, and is expected to decline further in 2017. Job security has increased and nominal wages have finally begun to tick up, albeit modestly.

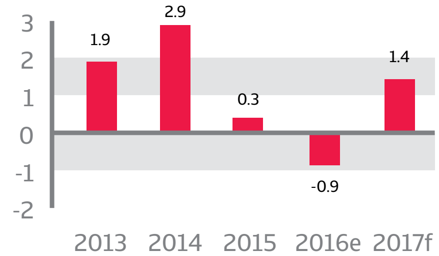
The proportion of working-age Americans, who are economically active reached 62% in September 2015 (the lowest in nearly four decades) and has risen every month since then to 63% as of March 2016. The gradual rebound of the participation rate is further evidence of the US labour market becoming more robust, as it outweighs downward forces such as the retirement of the baby boomer generation.

A downside risk for household consumption growth in 2016 could be greater stock market volatility, given the relatively high exposure to equities through investments and/or retirement savings.

Structural impediments to higher private consumption growth remain

While private consumption has proven the be the main driver of economic growth during the last couple of years, it is still not very strong by historical standards, which is the main reason why yearly GDP growth rates below 3% seem to be the new normal for the US economy. Average wage growth has been modest since 2009. While growth in average hourly earnings has increased from about 2% to around 2.5% since early 2015, this remains sluggish compared to wage growth before the 2008 crisis, which often exceeded 3%. Additionally, a large share of job gains have been in low wage industries or part time jobs. At the same time many households have continued to deleverage, at the expense of additional spending. Household debt as a share of GDP has decreased from almost 100% of GDP in 2007 to 78% of GDP in 2015.

Industrial production (y-on-y, % change)

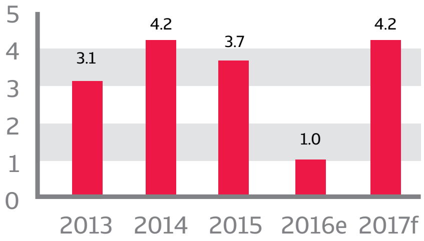


Source: IHS

Decreasing exports and rising imports have hurt the manufacturing sector

For the time being, US companies continue to benefit from low financing costs as the Federal Reserve has, thus far, abstained from raising interest rates in 2016. However, while the strong USD has increased US consumers' purchasing power for foreign goods, it has hurt the international competitiveness of US export businesses, with their profit levels decreasing. Since 2015 US exports have been contracting, with just a small rebound expected in the course of 2017 at the earliest. At the same time increasing (cheaper) imports continue to crowd out some domestic producers. This adverse development mainly affects the manufacturing sector. After feeble growth in 2015 industrial production growth has contracted in 2016, and is expected to record only modest growth of 1.4% in 2017.

Real fixed investment
(y-on-y, % change)



Source: IHS

Investment set to improve

In 2016 business investment remained subdued as the US energy sector adjusts to the low oil prices. Investment in oil rigs has fallen by almost 70% over the past two years. Government spending and private investment have also remained subdued. That said, residential building investment has increased in 2016, and investment by state and local governments is poised to rebound after years of austerity. Therefore, real fixed investment is expected to recover in 2017.

An interest rate increase in late 2016?

So far in 2016, the US Federal Reserve has left the overnight lending between banks in a range of 0.25% to 0.5%, but suggested it would raise them by the end of the year. Despite on-going economic growth and solid gains, this decision to delay an interest increase was motivated by increased uncertainty regarding the global markets and its potential effects on US growth and the inflation rate, which currently is still below the Fed´s 2% target.

Following the burst of a large debt bubble and the drawdown of household debt after the 2008 credit crisis, demand for credit has been low. Despite the effective federal funds rate hovering close to zero since early 2009, lending growth to households has remained subdued. In 2015, household borrowing from banks rose only 2.1% compared to 12% prior to 2007. This suggests that in an environment of deleveraging, the use of monetary policy alone cannot sustain the recovery.

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