PANORAMA

NOVEMBER 2016

Barometer of sector risks in the world

COFACE ECONOMIC PUBLICATIONS

By Coface Group Economists

Each quarter, Coface conducts a risk analysis on 12 sectors throughout 17 countries in six regions. For this quarter, the result is clearly negative once again, as eight sectors have been downgraded and only one upgraded. The changes concern North America (increased risks in the retail, textile-clothing, paper-wood and transport sectors), Western Europe (downgrade of the agrofood sector) and Central Europe (downgrades for construction and IT & communications, but an upgrade for the transport sector) and Middle East (downgrade for IT & communications).

This contrasting sector momentum confirms that the balance is still precarious, even in regions that have so far been relatively spared from the rise in risks noted on a global scale (23 sector assessment downgrades, compared to just 10 upgrades for 2016 as a whole).

This trend is set to continue in 2017, with global growth likely to remain weak. The continuation of low prices for commodities means that there is no respite for the large number of emerging economies that depend on them. In terms of developed economies, as for the Donald Trump election in the US which beat the odds and is building uncertainties for a few months, the number of risky elections scheduled over the next 12 months in Europe could cause companies to delay their investment decisions. This would undermine the timid recovery noted since 2014. In terms of positive news, for the first time since November 2014, there have been no downgrades noted in Latin America or even in Asia - all regions that have particularly suffered from the emerging markets shock of the past two years.

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coface FOR SAFER TRADE

NOVEMBER 2016

SECTOR SURVEY 4TH QUARTER 2016

Khalid AIT YAHIA
Economist

Paul CHOLLET
Head of sectors and insolvencies

Guillaume RIPPE-LASCOUT
Economist

Table 1: World sector outlook

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

Source: Coface

* Information and communications technologies

Low risk — Medium risk — ↗ The risk has improved
High risk — Very high risk — ↘ The risk has deteriorated

Inset 1

Methodology of world sector survey

Every quarter Coface reviews the assessments of 12 sectors throughout 17 countries in six major regions of the world. In order to best analyse changes in risk, we have implemented a methodology which is based on four main pillars, measuring their impact on each of the sectors analysed.

For companies, this entails changes by country relative to:

- defaults for the four coming quarters *(see inset 2 page 3)*,
- payment time-frames noted for buyers, aggregated by sector,
- financial result forecasts for the coming four quarters, aggregated by sector,
- payment experience noted by Coface, by sector.

Anticipated defaults appear to be a good indicator of overall momentum in the business sectors for forthcoming quarters. These anticipated defaults are calculated using a VAR type model that leverages previous momentum, as well as current and previous momentum in GDP. The delays tested go up to two quarters for each country.

$$Def_t = \alpha_1\, Def_{t-1} + \alpha_2\, Def_{t-2} + \alpha_3\, PIB_t + \alpha_4\, PIB_{t-1} + \alpha_5\, PIB_{t-2} + \varepsilon$$

While payment time-frames for listed companies (1) are only communicated once a year, they are an excellent indicator of intra-sector pressure - and thus the difficulties to come. The behaviour of listed companies in relation to their clients changes when they anticipate a reversal in their business. As such, when buyers step up the pace of their reimbursements, risks tend to increase.

Earnings forecasts for listed companies also help capture changes in future risks. The variables projected over four quarters are profitability (21), net debt (3) and investment (4).

Momentum in payment behaviour is a unique variable recorded by Coface, which helps to improve forecasting of potential risk outbreaks. Numerous econometric models used in Coface's studies (5) have shown that declarations of loss warnings are early variables in the business cycle and in defaults.

Inset 2

Change in insolvencies in developed countries

Insolvencies, YoY	2014	2015	2016 (e)	2017 (f)
Advanced economies	**-12%**	**-8%**	**-2%**	**-1%**
Europe	**-6%**	**-7%**	**-4%**	**-1%**
Euro zone	**-6%**	**-7%**	**-6%**	**-3%**
Belgium	-9%	-9%	-12%	-6%
Denmark	-19%	-1%	65%	33%
Finland	-4%	-13%	-4%	-2%
France	1%	1%	-4%	-1%
Germany	-7%	-4%	-5%	-4%
Iceland	2%	-24%	-18%	-5%
Italy	11%	-7%	-8%	-5%
Netherlands	-21%	-21%	-16%	-4%
Norway	6%	-3%	-4%	-3%
Portugal	-13%	12%	-8%	-3%
Spain	-28%	-24%	-20%	-12%
Sweden	-6%	-11%	-4%	-4%
Switzerland	-10%	-1%	4%	2%
United Kingdom	-8%	-10%	1%	8%
Asia Pacific	**-11%**	**-4%**	**-4%**	**1%**
Australia	-19%	16%	-5%	3%
Japan	-10%	-9%	-4%	0%
Singapore	-11%	-4%	2%	4%
Taiwan	-1%	0%	1%	1%
North America	**-16%**	**-12%**	**-0%**	**1%**
Canada	-2%	-1%	-1%	-4%
USA	-18%	-14%	-3%	1%

Source: Coface

(1) Payment time-frames = payments collected over 12 months/ sales over 12 months * 365 days
(2) Profitability = EBITDA/sales
(3) Net debt = short term and long term debt, adjusted for cash relative to overall assets
(4) Investment = capital expenditure
(5) Coface Panorama "Company insolvencies in Western Europe: slight upturn in 2015", September 2015

In Europe, insolvencies are expected to decline in the majority of countries, thanks to dynamic business. The rare exceptions are Denmark (due to legal developments), Switzerland, France and the UK. The only genuine source of concern is the UK, where the slowdown in business (to 0.9%) prompted by Brexit, means that less well-structured companies will be challenged. Coface forecasts an 8% increase in defaults in 2017, over one year. Sectors for which risks [6] need to be monitored particularly closely are construction, metals, energy and textile-clothing. In France, prospective growth in company insolvencies is primarily due to the transformation of some of the sharp increase in company creations over past years into receiverships. Evolutions in insolvencies in the clothing, agrofood, transport and service sectors need to be monitored.

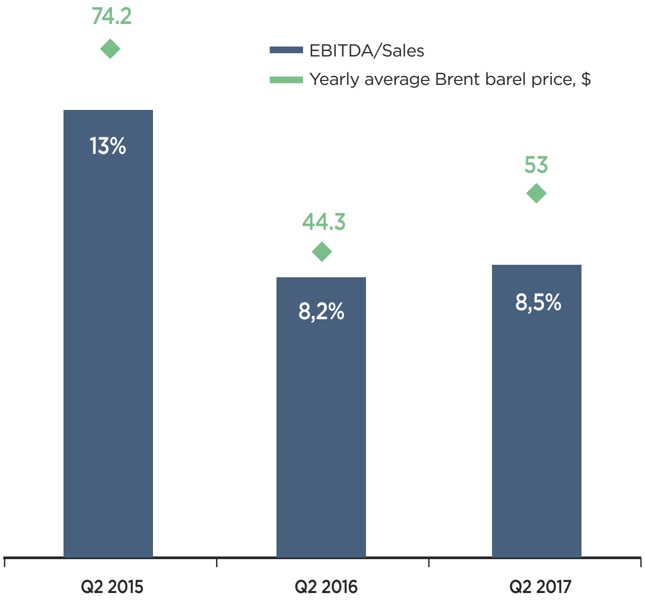
In Asia Pacific, the slowdown in China and the US is affecting companies in the region. Growth in these two economies could further slow in 2017, amplifying this weakness. In Japan, the stronger yen, which is considered a safe-haven, is taking its toll on the country's exporters, who are suffering from fewer outlets. This is especially the case in the textile sector, where price elasticity is higher than in other exported sectors (such as chemicals, metals, mechanical equipment, electronics and transport).

In North America, companies are experiencing an increase in insolvencies associated with lower-than-potential growth for the second year in a row. Sectors linked to consumer spending (textile, clothing and retail in particular) are apparently experiencing increased risk. In the meantime, the continuation of low energy prices is likely to affect regions where the cost of non-conventional oil extraction and production remains high.

Sectors linked to commodities still showing overcapacity

The slight rebound expected in non-renewable commodity prices during 2017 will not be enough to offer respite to poorly-diversified commodity-dependent economies in the Middle East, sub-Saharan Africa and Latin America. Assessments of the energy and metals sectors have not been upgraded *(see note on energy page 14)* in the regions studied, as their profitability is set to remain weak in 2017 *(see chart 1)*. Coface forecasts average Brent crude prices of $56 in 2017.

Chart 1: Profitability and oil prices



Sources: ICIS Pricing, Reuters, Coface

While this price level should enable a number of US players in non-conventional oil and bitumen extraction to become profitable, the ensuing rise in active wells is likely to hamper a sustainable increase in prices and contribute to limiting the adjustment in stocks seen in 2016. According to the IEA, stocks in OECD countries were up by 175 million at the end of July 2016, over one year, down from 219 million for the previous period. This lower growth was primarily due to the more modest increase in US stocks for the same period (+106 million, compared to +143). As at the end of October 2016, there were 443 oil wells in operation in the US – four times lower than the 1,609 in operation in October 2014. Nevertheless, they increased by 40% between May 2016 and October 2016, in response to the uptrend in prices. This situation has prompted fears of a rapid impact on US and global stocks.

While metal prices are still well below their peak level of 2011 (4,448 points), a low point seems to have been reached in January 2016. The London Metal Exchange Index (LMEX), which synthesises average metal prices, rose from 2,049 points on 12 January, to 2,370 points on 21 October 2016 (+15.7%). China, the leading aluminium producer (with 42.8%, according to the LMEX index), closed a few of its most costly sites in 2016. As such, LME stocks fell by 23% in H1 2016, down to 2.2 million tonnes. Nevertheless, Chinese production is expected to rise again in 2017, provoking fears of a fresh increase in overcapacity. The Australian Department of Industry, Innovation and Sciences (DIIS) estimates that stocks could increase by 23% in 2017, rising from 7.5m to 9.3m tonnes (LME and producers). Prices are thus expected to stagnate at low levels in 2017.

(6) Coface Sector Barometer, July 2016

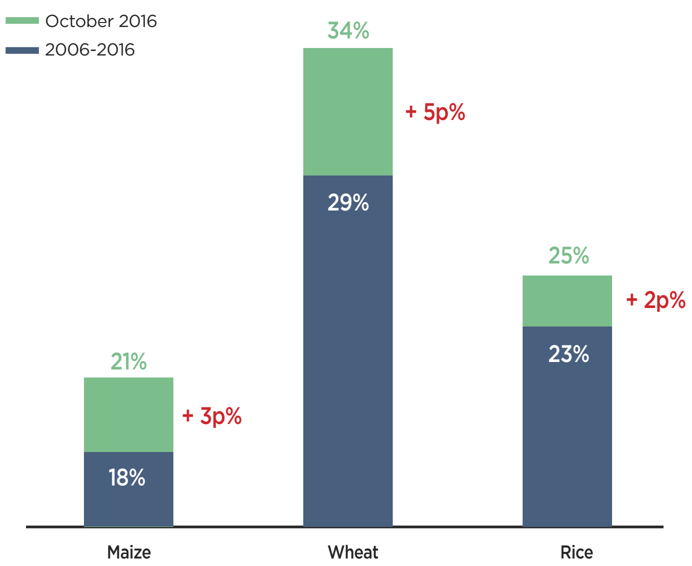
Copper (the second-largest component of the LMEX index, at 31.2%) has seen a similar development. Prices notched up slightly during H1 2016 (by +1%), particularly strengthened by China's construction sector (30% of the sector's global outlets), where building construction increased by 5.6% during the period. However, the rise in global copper production, due to investments and the opening of new mines, particularly in Peru (which has seen a 51% hike in production over one year) and in Kazakhstan (with an increase of 101%), alters the effect of higher consumption on prices. In 2017, refined copper production is set to rise by 2.3%, to reach 24m tonnes. This volume is fairly In line with the level of global consumption (at 23.8m tonnes). Stocks are therefore set to increase by 13.6%, to reach1.5m tonnes. According to the DIIS, this will limit price rises in 2017 to a level of 6%. Among the other components of the LMEX index (zinc, lead, nickel and tin), zinc production changed the most during 2016 – mainly due to the closure of mines in Australia, Canada and Ireland. Stocks of zinc are set to fall by 5% in 2016 and, according to the World Bank, prices could witness a sharp hike of more than 20% in 2017. Overall, metal prices are unlikely to rise by more than 4%.

In terms of farming commodities, the situation is more mixed. In 2017, farm foodstuff prices look likely to record low growth, following a decline of nearly 10% in average crop prices in 2016 due to good harvests of corn in the US and of wheat in Australia, Ukraine and Russia. The US Department of Agriculture (USDA) forecasts that wheat harvests will attain a record level in 2016 (745m metric tonnes), leading to global stocks reaching an all-time high of 120 days of consumption (+4.5%). Although the average level of stocks over the last 10 years has acted as a guarantee against potential climatic or industrial shocks, current crop overcapacity is high (see chart 2). As is the case for France and Germany, Coface has downgraded the sector in Western Europe to high risk. This is because French and German producers, unlike their peers in other regions, are set to suffer from historically low production, within a backdrop of low global prices. French production is predicted to fall by around 30m tonnes (or -25%), while German production will be down by 25m tonnes (or -9%) compared to 2015. This disadvantageous double price and volume effect is likely to increase credit risks.

Corn production has witnessed similar changes to wheat production. Despite increased consumption, global stocks have reached an historically high level. Prices of cotton reached their 26 month peak at the end of October 2016, due to poor harvests that contributed to reducing stocks by 10% over one year. Growth in cotton consumption is low, as demand is uncertain. China holds 60% of global stocks, which it is looking to reduce by imposing import quotas. In addition, competition from synthetic fibres has never been so high, thanks to the continuation of low oil prices.

The decline in global trade is affecting the cargo transport sector, particularly maritime transport, as 80% of globally traded merchandise transits by sea. According to the latest World Trade Organisation (WTO) report, growth in trade is set to stand at just 1.7% in 2016 (the lowest level of growth since 2009), compared to an average of 3.5% between 2012 and 2014. Moreover, the extent of the revised forecast between April and September has prompted fears of hefty consequences for the maritime transport sector, as investments (purchases and construction of cargo ships) are based on forecasts and take several months to materialise. In 2016, global capacity increased by 7%, to reach the equivalent of 19.3bn twenty-foot units (TEU). This was particularly influenced by investments made by the five largest maritime shipping companies (Maersk Line, MSC, CMA CGM, Cosco and Evergreen) which together represent 55% of global supply (and 72% of the top 10). As this increase in supply (7%) far outpaces the growth of trade (1.7%) in 2016, shipping companies are feeling the impact in their balance sheets. As such, South-Korean group Hanjin Shipping (the sector's 10th largest player) went bankrupt in August 2016. French group, CMA CGM, announced $217m in losses for the first half of 2016, with a 14.6% fall in sales compared to H1 2015. Simultaneously, CMA CGM has launched the Bougainville, the world's largest container carrier, capable of transporting 18,000 containers.

Chart 2: Visible overcapacity in crops, stock/use



Source: USDA

IT and communications, a rapidly expanding but risky sector

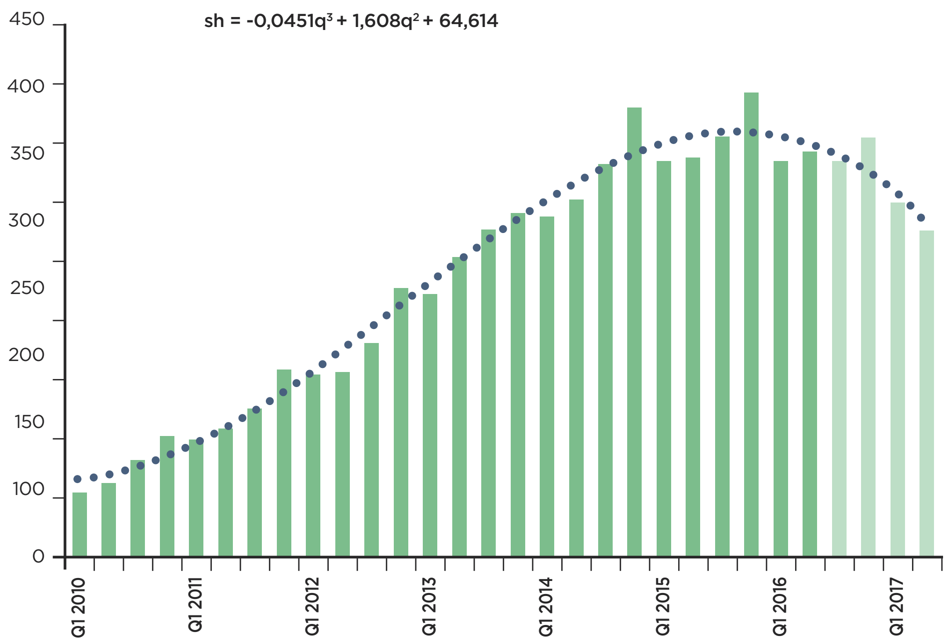
The IT sector is enjoying high growth potential and is fully benefiting from the digitalisation of the economy and exponential growth in connected objects. As an example, according to Deloitte, the virtual reality market exceeded $1bn in 2016. Nevertheless, the lifespan of technologies - and hence the lifecycle of companies in the sector - is short, which generates a high level of credit risk.

According to Gartner, IT represented a market of $3.5trn in 2015. Telecoms services, at $1.4trillion, are currently the main contributor to these revenues – but are expected, as is the rest of the sector, to show virtually zero growth in 2016. The mobile peripherals market (telephones, tablets, computers) is thought to have reached its peak in revenues ($645bn in 2015). Coface forecasts that the global volume of new smartphones shipped in H1 2017 will decline *(see chart 3)*, particularly with the slowdown of the US and Chinese economies. In China, the market is saturated and sales are stagnating (+0.4% in 2016 according to Gartner). Of the 12 largest global telephone manufacturers, eight are Chinese. Their cost cutting and innovative distribution strategies have enabled them to lower prices, but this is generating bankruptcy risks. Lenovo, which was ranked as the fourth largest mobile phone manufacturer in 2015, is thought to have slid down to ninth position in 2016, following a 26% decline in sales (according to IC Insight). In addition, the reconditioned smartphone market is booming, especially in developed countries. Deloitte estimates that 17m used telephones were sold in 2016 - a rise of +50%. These generated 17bn in sales, or 7% of the global market, compared to 4% in 2014. In France for example, one person in 10 has a second-hand mobile telephone

Textile and retail affected by mixed internal momentum

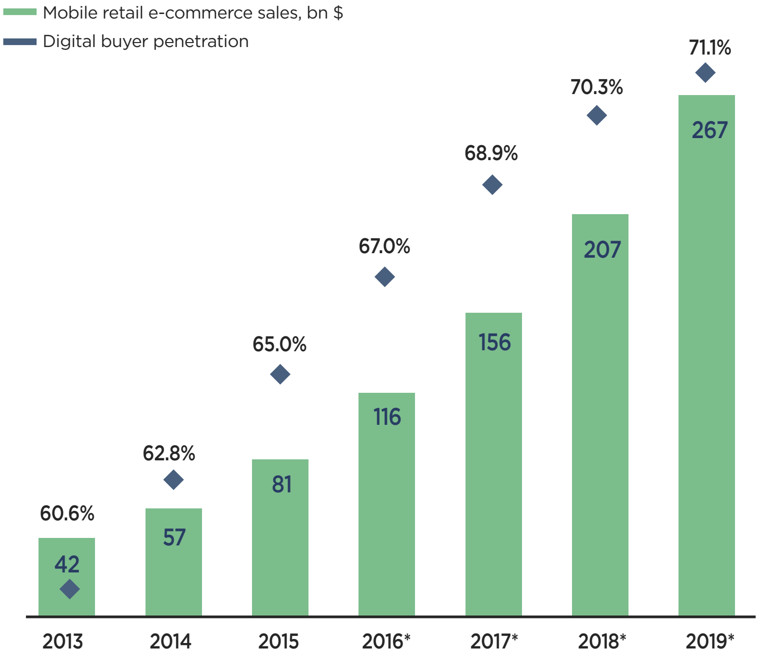
The textile-clothing sector (see note page 20) appears to be one of the riskiest. From Japan to the US and Turkey, the sector is undergoing a transformation, primarily linked to the high penetration of internet sales *(see chart 4 page 7)*. In the US, for example, in 2016, out of 100 articles of clothing sold in retail stores, only 20 were exclusively carried out in the store - compared with 49 in 2011. In addition, the sector's momentum is dependent on domestic demand. In 2017, US growth is set to slow to 1.5%, due to more modest consumer spending. Moreover Donald Trump election adds uncertainties to the confidence side *(see inset 3 page 8)*.

Chart 3: Forecasts for global smartphone shippings, in million units. In our estimates, "sh" represents shipments of telephones and "q" quarters



Sources: IDC, Coface

Chart 4: Rise in purchases on mobile devices in the US



Source: E market

Elsewhere, the polarisation of income and the less well-off middle classes is weakening sectors that depend on their momentum. The IMF estimates that one year of consumer spending (3.5% of GDP) has been lost since 1998, due to this decline in wealth (7). While these factors are structural, they nevertheless cause a rise in risks associated with financing conditions for low-revenue households. The Federal Reserve seems committed to raising its key rate in December 2016, with the ensuing consequence of increasing the cost of credits granted. This will take a further toll on more modest households, who have already reduced their spending. This trend has been observed over the first eight months of 2016, with average growth in retail clothing sales (at 0.9%) well below full-year growth in 2015 (2.1%). North America's textile-clothing and distribution sectors have therefore been downgraded to high risk.

The Central European construction sector has been downgraded to high risk, due to short term threats weighing on the sector in Poland. The country's BTP companies are suffering as infrastructure creation projects have been put on hold until a European decision is given to authorise the transfer of structural funds to Poland. The country may not be able to respect European rules in terms of public deficit (3%) and could thus become the first European country to be sanctioned. This situation is due to the slight slowdown in growth and a new government which is increasing public spending. The first European payment, of €82.5bn (19% of GDP), is scheduled to be made to Poland between 2014 and 2020. While the scenario of a non-transfer is fairly unlikely, the wait is causing concern for players in the sector.

Although our assessment of the automotive sector remains unchanged in this analysis, the sector is still sensitive to the US slowdown and is somewhat dependent on stimulus policies - as is the case for China. Overall, the sector is likely to record an excellent year in 2016, with high sales in numerous countries. Nevertheless, a peak in registrations has been reached in the US (according to Coface's forecast, 17.5m vehicles sold in 2016 – a rise of +0.4% and 17.4m expected for 2017 – a fall of -0.6%) and the impact of the economic slowdown needs to be monitored. The sector has also been downgraded from low risk to average risk in Mexico, as 80% of the country's production is destined for the US market. In Europe, sales are set to return to pre-crisis registration levels in 2017, with Coface forecasting sales of 15.5m in the EU for 2016, compared to 16m vehicles sold in 2007. Germany exceeded pre-crisis sales levels by 10% at the end-2016, and the UK by 12%. France, Spain and Italy are expected to be Europe's most dynamic markets. In Asia, sales in China will be massively dependent on the renewal of stimulus measures for small-cylinder car sales in 2017 - as were implemented in September 2015. Coface's analysis is that this will affect 70% of passenger car sales and prompt sales to rise by 3% in 2017 (around half the pace of +6.5% seen in 2016). Finally, in the Latin American region, Brazil is expected to return to growth, which should lead to an improvement in sales, as from H2 2017. The hoped-for recovery should have a positive impact on the sector's situation in Argentina *(see inset 4 page 9)*.

The pharma sector (see note attached) is the most robust, overall, in terms of growth and credit risks in the short term. Organisations ensuring the coverage of health care (especially the reimbursement of medicine costs) are facing the arrival of expensive treatments on the market, while having to control shortfalls caused by demographical changes and challenging economic climates. Nevertheless, the growth of the middle classes in emerging markets, along with the ageing world population, is expected to be a guarantee of solidity for the sector.

(7) A. Alichi, K. Kantenga, and J. Sole, Income Polarization in the United States, FMI, 2016

Inset 3

Donald Trump is the new President of the United States

Donald Trump beat the odds to win the Presidential election in November 2016, leading to a number of uncertainties regarding changes in stock market indices worldwide. The dollar immediately fell against the euro and the yen, emphasising the fears of financial analysts with respect to the first measures to be taken by a President who has no political experience.

Firstly, in the short term, its first acts should be a tax reform that would significantly reduce marginal tax rates for both individuals (collapse the current seven tax brackets into three) and businesses (Reduce the corporate tax rate to 15 percent from 35 in 2016). If this act seems achievable because the Congress and Senate are republicans and should vote lower taxes, their scope should be discussed. The Tax Policy Center estimates the proposal would reduce federal revenue by $9.5 trillion over its first decade and the budget by three points of percentage of GDP in 2017 and four points of percentage in 2018. Moreover, the lower taxes positive effect should be offset by a higher volatility in the financial markets caused by a surge of uncertainties. In the household side, it could cause a decline in value of their savings caused by a drop in the price of their financial assets. At the end of the second quarter they represented 72,330 billion dollars (70% of total assets and 400% of GDP). In the event of a downward trend, distribution, textile and transport could be impacted. The pharmaceutical sector should not be affected by the President arrival in the Oval Office, even if he abolishes the ACA. The latter programme has had little impact on the prices of medicines, over which it is legally prohibited from exercising any control.

A supporter of protectionism, Donald Trump based a part of his campaign on rejecting international trade agreements and announced that he wanted to introduce a 45% and 35% tax on Chinese and Mexican imports. Although he has since denied this, this scenario involving the commercial and physical closure of the American borders would have different consequences on sectors and employment in the short and long term.

Before adapting to it, sectors with a high proportion of foreign imports would suffer from a rise in the prices of imported goods, reducing company margins. On average, according to the OECD [(8)], American added value represents 85% of domestic demand and 67% of the demand for manufactured products. Nevertheless, in several sectors this proportion represents less than 55% of the final demand such as metals (55%), machines and equipment (52%), automotive (47%) and textile (35%). The rise in prices together with the introduction of taxes would also put a strain on household consumption. Corporate tax would have to be reduced in the order to limit these increases.

In the medium term, the promised anti-immigration measures would reduce the labour available on American soil while the unemployment rate is low (4.9%). There would then be strong pressure on wages, which would push company margins downwards. Furthermore, while the segments generating low added value have been relocated, repatriating them to the United States would be extremely costly for companies with regards to investment and jobs. These rises in costs would generate an upward pressure on prices. For example, in the automotive sector, Volkswagen is very present in Mexico, where 370,000 vehicles were produced to be sold in the United States in 2015. Its Puebla plant (built in 1964) generates 70,000 direct and indirect jobs according to Horacio Peredo, the President of the Canacintra Chamber of Commerce. Production of the Tiguan model should begin at the end of 2016 following investments that cost the German company one billion dollars.

(8) Tiva database (2011)

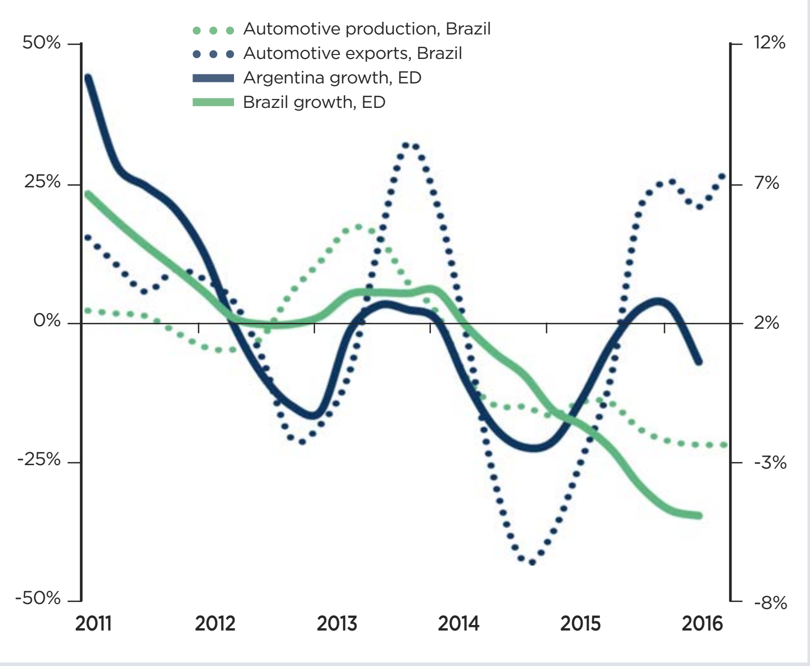
Inset 4

The automotive sector in Argentina is facing high risks but a rebound is possible in 2017

Argentina's automotive sector is very closely tied to neighbouring Brazil, which accounts for 30% of its auto exports. In 2016, the Brazilian recession thus took its toll on vehicle demand Nevertheless, although the sector is struggling in Brazil, its vehicle exports are dynamic (+29% at end-September 2016 over one year, according to Anfeva) and able to compensate for the decline in local sales (-27%). As Argentina is Brazil's main partner, Argentinian producers are finding themselves doubly penalised by this influx of vehicles and by the decline in Brazilian outlets. Over the first eight months of 2016, exports to Brazil plummeted by 43%, compared to the same period in 2015. At the same time, 57% of vehicles registered in Argentina were imported, compared to 54% in 2015. According to Adefa, Argentine vehicle production is set to drop by a hefty 15% in 2016, to around 460,000 vehicles – compared to 544,000 in 2015 and a peak of 829,000 in 2011. Existing capacity utilisation rates stood at 50% in 2016, against. 77% in 2013 and 92% in 2010.

2017 should see a rebound in production, as vehicle demand is bullish in Argentina for 2016 (+8.3% at end-August 2016, over one year). It is expected to be even stronger in 2017, boosted by a growth in sales of 2%, compared to -1.5% in 2016 and, above all, an accommodating tax scheme. Entry-level and midscale vehicles (of up to 350,000 pesos, or around $27,000) should be tax-free, while premium and above models should only be taxed at 10%, compared to the previous 30% for imported vehicles. Furthermore, national banks Banco de la Provencia de Buenos Aires and Banco Nacion, helped by automotive sector associations, are offering car loans with partially subsidised interest rates over four years. On the manufacturing side, tax incentives were introduced in July 2016 to favour the use of car parts made in Argentina. To be eligible for the scheme, the domestic parts used in vehicle manufacturing need to exceed 30%. This incentive scheme resembles Brazil's Inovar-Auto programme. Finally, bilateral rules ratified in June 2016 should help to limit the extent of the trade deficit with Brazil. Each of the two countries will be permitted to export up to 1.5 times the amount imported.

Chart 5: Argentina - a fresh source of growth in Brazilian automotive production (YoY)



Sources: Anfeva, national sources, Coface

APPENDIXES

Table 1: Sector outlook North America

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

* Information and communications technologies

Low risk · Medium risk · High risk · Very high risk · ↗ The risk has improved · ↘ The risk has deteriorated

Table 2: Sector outlook Latin America

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

* Information and communications technologies

Low risk · Medium risk · High risk · Very high risk · ↗ The risk has improved · ↘ The risk has deteriorated

Table 3: Sector outlook Western Europe

SECTOR RISK ASSESSMENT						
Sectors	**Western Europe**	**France**	**Germany**	**Italy**	**United Kingdom**	**Spain**
Agrofood	Medium risk ↘ High risk	High risk	Medium risk ↘ High risk	Medium risk	Medium risk	Medium risk
Automotive	Low risk	Low risk	Low risk	Medium risk	Medium risk	Low risk
Chemical	Medium risk	Medium risk	Low risk	Medium risk	Medium risk	Medium risk
Construction	Medium risk	High risk	Low risk	High risk	High risk	Medium risk
Energy	High risk	High risk	High risk	High risk	High risk	High risk
ICT *	Low risk	Medium risk	Low risk	Medium risk	Medium risk	Medium risk
Metals	High risk	High risk	High risk	Very high risk	Very high risk	High risk
Paper-wood	High risk	High risk	High risk	High risk	High risk	High risk
Pharmaceuticals	Medium risk	Medium risk	Medium risk	Medium risk	Medium risk	Medium risk
Retail	Medium risk	Low risk	Medium risk	Medium risk	Medium risk	Medium risk
Textile-clothing	High risk	High risk	High risk	High risk	High risk	Medium risk
Transportation	Medium risk	Medium risk	Medium risk	Medium risk	Medium risk	Low risk

* Information and communications technologies

Low risk — Medium risk — ↗ The risk has improved
High risk — Very high risk — ↘ The risk has deteriorated

Table 4: Sector outlook Central Europe

SECTOR RISK ASSESSMENT		
Sectors	**Central Europe**	**Poland**
Agrofood	Medium risk	Medium risk
Automotive	Low risk	Low risk
Chemical	Medium risk	Medium risk
Construction	Medium risk ↘ High risk	High risk ↘ Very high risk
Energy	High risk	High risk
ICT *	Low risk ↘ Medium risk	Low risk ↘ Medium risk
Metals	High risk	High risk
Paper-wood	Medium risk	Medium risk
Pharmaceuticals	Medium risk	Low risk
Retail	Medium risk	Medium risk
Textile-clothing	Medium risk	Medium risk
Transportation	High risk ↗ Medium risk	High risk

* Information and communications technologies

Low risk — Medium risk — ↗ The risk has improved
High risk — Very high risk — ↘ The risk has deteriorated

Table 5: Sector outlook Emerging Asia

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

* Information and communications technologies

Low risk · Medium risk · ↗ The risk has improved
High risk · Very high risk · ↘ The risk has deteriorated

Table 6: Sector outlook Middle East + Turkey

SECTOR RISK ASSESSMENT				
Sectors	**Middle East + Turkey**	**UAE**	**Saudi Arabia**	**Turkey**
Agrofood	High risk	High risk	High risk	High risk
Automotive	High risk	High risk	High risk	Medium risk
Chemical	High risk	High risk	High risk	Medium risk ↘ High risk
Construction	High risk	High risk	High risk	Very high risk
Energy	High risk	High risk	High risk	Medium risk
ICT *	Medium risk ↘ High risk	Medium risk ↘ High risk	Medium risk ↘ High risk	Medium risk
Metals	Very high risk	Very high risk	Very high risk	Very high risk
Paper-wood	Medium risk	Medium risk	Medium risk	Medium risk
Pharmaceuticals	Low risk	Low risk	Low risk	Low risk
Retail	High risk	High risk	High risk	Medium risk ↘ High risk
Textile-clothing	High risk	High risk	High risk	High risk
Transportation	Medium risk	Medium risk	Medium risk	Medium risk

* Information and communications technologies

Low risk · Medium risk · ↗ The risk has improved
High risk · Very high risk · ↘ The risk has deteriorated

Table 7: Sector outlook South Africa, Japan and Russia

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

* Information and communications technologies

Low risk | Medium risk | ↗ The risk has improved
High risk | Very high risk | ↘ The risk has deteriorated

SECTOR RISK ANALYSIS – NOVEMBER 2016

ENERGY

ASSESSMENTS BY COFACE

NORTH AMERICA	LATIN AMERICA	EMERGING ASIA	CENTRAL EUROPE	WESTERN EUROPE	M. EAST + TURKEY
VERY HIGH	VERY HIGH	HIGH	HIGH	HIGH	HIGH

RISK ASSESSMENT

HIGHLIGHTS

Brent crude prices reached an average of $51.2/b during October 2016 vs. around $32.2 in February 2016. **Despite this rebound, the outlook for the sector remains** disadvantageous. The freeze on investment projects at major oil groups is an example of this, especially in view of a lack of liquidity due to price changes. **The reduction in spending on exploration-production (E&P) has affected subcontracting companies.** A large number of fields are no longer profitable enough and generate operating losses.

Although **demand** rose by 1.5% in Q2 2016 (95.6mbd vs. 94.2 a year previously), **it was not enough to absorb the supply currently available on the markets,** estimated at around 95.9mb (albeit down by 0.5% over one year). **Stocks are also high. As such, in the US, despite having fallen since May 2016, stock levels are at an all-time high (499mb according to the EIA).**

However, a number of shale oil actors have succeeded in adapting to these low prices by drastically lowering their breakeven point, by roughly 20%. By streamlining their production processes, they have limited the impact of the plunge in prices on their margins. **Nevertheless, a breaking point seems to have been reached in 2015 and the effects of this are still present today.** A study by law firm Haynes and Boone estimates that between early 2015 and end-July 2016, almost 90 companies in the US oil exploration sector went bankrupt. The largest so far are Sandridge Energy ($8.3bn in debt) and Linn Energy ($6.1bn).

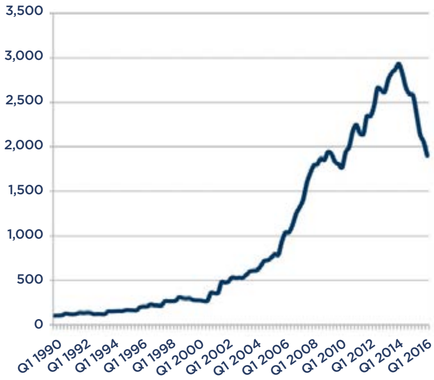
Strengths

- Resilience of diversified sector majors
- Expected growth in demand in 2017
- Oil company efforts to streamline their production
- Likely implementation of an agreement to freeze production

Weaknesses

- **High debt levels especially among shale oil companies**
- **Surplus oil production**
- **High volatility in crude oil prices**
- **Overcapacity among certain oil & gas services companies**

Change in global investments,
base 100 = Q1 1990



Source: Datastream Worldscope

ENERGY

DEMAND

Global demand for oil should reach around 96.7m bpd in 2017, according to the EIA, i.e. a 1.7% rise compared with 2016.

Demand in Europe is likely to fall slightly in 2017, reaching 13.7m bpd on IEA figures. Refineries (NWE Brent cracking) have managed to benefit from the plunge in prices since June 2014 to improve their margins. However, these have stabilised at around $3/b. For 2016, we expect a decline of 5.7% in European refinery production to 11.6m bpd, given the maintenance undertaken in October. The start to 2017 is also set to see less robust output, continuing on the end-2016 trend, with growth in production of 2% reaching 11.4m bpd. One of the unknowns that could have a positive effect on consumer spending is how harsh the winter is, given high energy consumption during the period. Furthermore, changes in industrial activity in Europe should remain a key factor, since this prompted a 130k bpd plunge in consumption of oil products during summer 2016, and the trend is likely to be the same in Q3 2016, with an equivalent plunge in consumption of diesel, petrol and other fuels.

According to the IEA, demand for oil products in the US should notch up slightly by 1.1% in 2016 and 0.6% in 2017. The reason most cited for this low growth is the likely increase in oil prices. Coface estimates that Brent prices should average $51.3/b in 2017 vs. $43.6/b in 2016. In addition, the production capacity utilisation rate at end-July 2016 was 91% vs. 94% a year-earlier, according to the IEA. Despite the decline in this rate, margins have all widened, from $9.90/b in July 2016 to $14.26/b at end-August 2016 for WTI Cracking. **Attention should be paid to how harsh the winter is (probably caused by the El Niño climate phenomenon) as well as to industrial activity.**

In Asia, refining margins (Dubai hydrocracking) reached $2.9/b on average in August 2016, down $1.15 since July 2016. Chinese and Korean demand explained this downturn, since this is also narrowing, if not slowing. **Chinese demand is expected to grow very slightly in 2017, to 11.8m bpd from 11.6 million in 2016.** Korean demand is also set to show slow growth in 2017, of around 2.7% to reach 2.6m bpd vs. 2.5m bpd in 2016 on IEA estimates and forecasts. Indian demand looks set to grow by 7.5% in 2017.

SUPPLY

Oil supply is expected to increase by 1% in 2017 according to the IEA, after an increase of 0.2% in 2016, or 97.01m bpd. The IEA estimates that investment spending in exploration and production plummeted 25% in 2015 and 2016, not to mention the sharp reductions in operating costs of more than 35% between 2014 and 2016. The various measures taken should reduce extraction capacity and therefore wipe out growth in crude oil production.

The decline in investment spending should preserve cash piles of exploration-production companies and especially those specialised in shale oil. The number of active wells in the US plunged 27.4% over one year to mid-October 2016. All operators are struggling, although productivity has improved. Law firm Haynes and Boones estimates the number of insolvencies in the sector at 90 between January 2015 and July 2016. These companies have combined debt of $67bn. **This trend is likely to continue until the end of 2016 and afterwards in 2017 given the sharp growth in debt. Nevertheless, a recovery in activity has been noted** since the low point reached in May 2016, with a 40% increase in active wells at end-October 2016. **The election of Donald J. Trump, a strong advocate of deregulation, may help US oil producers by repelling law enacted to protect the environment. But the economics of the oil sector won't change overnight as they are driver by international market trends.**

In Western Europe, financial results for the main E&P companies have continued to plunge: in H1 2016, sales at Total fell 20% over one year, whereas adjusted net debt plummeted 33%. The upstream segment has incurred the deepest decline, whereas the downturn in the refining segment has been less harsh. Investments have followed the same trend with a 33% decline during H1. Meanwhile sales and earnings at Shell plummeted by 23% and 80% respectively. We estimate that the risk is higher for oil services groups as they are directly affected by the fall in investments. **Lower business in exploration, given fields that are difficult to access, have led to significant asset writedowns and disposals.**

Chinese production is set to fall by 3% in 2017, after a 6% decline in the previous year. The major Chinese companies are making the most of low prices to close wells that are expensive to run. The extended weakness in prices has also dragged down profits and cash flows, particularly for public companies. We believe that credit risk is lower in the country since companies in the sector benefit from public support and their vertical integration (presence in refining and distribution of oil products).

Latin America is facing the same problems. Petrobras and Ecopetrol are set to reduce their investments by respectively 24.5% over 2015-2019 and 40% in 2016. In return, oil services companies such as Vallourec are adjusting their production and are not hesitating to produce jointly with Mitsubishi in order to cut costs in a falling market.

SECTOR RISK ANALYSIS – NOVEMBER 2016

PHARMACEUTICALS

ASSESSMENTS BY COFACE

NORTH AMERICA	LATIN AMERICA	EMERGING ASIA	CENTRAL EUROPE	WESTERN EUROPE	M. EAST + TURKEY
					
LOW	MEDIUM	LOW	MEDIUM	MEDIUM	LOW

RISK ASSESSMENT

HIGHLIGHTS

Agencies in charge of health care provision (particularly the reimbursement of drug costs) are faced with the arrival on the market of high-cost treatments, while having to keep deficits prompted by demographic changes and the economic situation under control.

In Western Europe (France, Italy, Spain, Germany and the UK) **spending on prescription drugs** rose by 8.8% in 2015. As such, deficits have widened such as that of the NHS in the UK and Wales (£2.45bn vs. £822m a year earlier). In France, the French Social Security health branch deficit has narrowed slightly but nevertheless remains substantial (€5.8m in 2015 vs. €6.5m in 2014).

In the US, drug prices rose by 2.8% in 2015 on IHS figures, although a number of them **increased extremely sharply.** Pharma groups saw their profits bloated by **3.8% according to the Census Bureau.** The authorities have made numerous proposals to help curb this inflationary spiral before the presidential election. The ramp-up of the Affordable Care Act (Obamacare) has prompted an increase in healthcare spending, as the rate of uninsured adults declined by 2.8 percentage points year-on-year in the last quarter of 2015 (10.5% versus 13.3%).

The transformation of the Chinese growth regime, now giving priority to domestic consumption, **places an increased focus on meeting households' healthcare needs.** However, the development of coverage of healthcare costs (although still partial) means the authorities need to keep a lid on costs, particularly those linked to drugs.

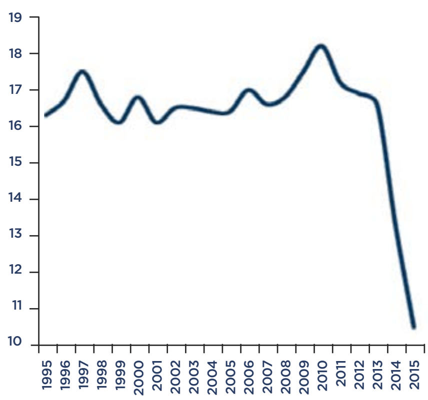
Strengths

- Development of health insurance systems
- Robustness of US demand
- Demographic and lifestyle changes
- Pressure for access to innovation

Weaknesses

- Slowdown in emerging countries
- Quality problems in India and China
- Payers increasingly demanding in terms of costs and the real efficacy of new therapies

Percentage of US adults with no healthcare insurance



Source: CDC

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PHARMACEUTICALS

DEMAND

The cost of new therapies is obliging payers to keep a lid on spending. **In 2017, the price control measures in force in Western Europe will still apply, despite growing demand linked to population ageing and lifestyle changes.** For example in France, the measures taken to reduce spending (set at +2.1% for 2017) should continue to affect pharmaceutical companies, via price cuts, and favour the emphasis placed on generics. **The arrival of expensive speciality drugs that concern smaller populations, mean regulators need to make difficult decisions concerning reimbursement levels.** As such, in the UK, the example of Repatha by Amgen is a good one: the National Institute for Healthcare Excellence (NICE) managed to benefit from an unveiled price discount for the drug in order for it to be reimbursed by the NHS.

In the US, sharp increases in insurance premiums for 2017 (+100% for certain plans) highlight the need to offer US citizens drugs at affordable prices. Indeed, after the numerous scandals that marked 2015 (e.g. the Daraprim/Turing affair), the ramp-up of Obamacare, combined with the need to control healthcare spending (close to 17% of GDP, versus 9-11% in Western Europe), explains the attempts aimed at regulating drug prices. These can be up to three times more expensive in the US than in the UK. According to the Milliman consulting firm, the average annual cost of healthcare spending for a US household was $25,826 in 2016. Its projection for 2017 exceeds $26,900. Close to 42% of this amount is covered by the household versus only 58% by the sponsor (whether a private company, the federal state, or a local authority). **The arrival on the market of a number of speciality drugs in 2016 contributes to increasing the average annual cost of drugs per family. Moreover, the election of Donald J. Trump who wants to repel the ACA could impose a heavy burden on households as they benefitted from subsidized premia. With an Administration and a Congress dominated by the Republican Party, prices won't be capped, as was promised by H. Clinton, resulting in their increase over the next several years.**

In China, since the end of the first half of 2015, drug prices are no longer determined by public authorities, leaving it up to "market forces" to set the price levels. Nevertheless, this opening masks a public determination (which is also enshrined in law) to force the actors in this sector to offer a reasonable price, the result of negotiations with the regulators. **The major changes rocking the sector will continue in 2017, i.e.: tidying up the producers' price setting methodology, regulating prices in order to control the increase in healthcare spending (estimated at more than USD 640 billion in 2014), offering quality products and improving the general health of the population which is rapidly ageing, and which is therefore faced with the same ailments as western populations.** Note, however, that public coverage does not include the most serious diseases, and fundamentally those most expensive to treat.

SUPPLY

R&D spending rose by 4.7% on a global level in 2015 and should continue on this trend in coming years, especially in 2016 (+2.6%) and 2017 (3.4%) according to Evaluate Pharma.

The European Medicine Agency (EMA) issued around 45 positive opinions over the first eight months of 2016, vs. 54 over the full-year in 2015 and 43 in 2014. In 2017, **based on information provided by Evaluate Pharma, Coface estimates that spending on prescription drugs is set to grow by 5% for the top five EU countries (Germany, France, the UK, Italy and Spain), reaching almost €104.8m.** This is explained by the increasing presence of specialty drugs (more than a third of total sales), even though payers are reluctant to pay the pharmaceutical companies' list prices.

In the US, the Federal Drug Agency (FDA, in charge of approving new drug registrations among others) is thought to have approved almost 19 new molecular entities (NME) at end-October 2016 compared with 32 in the year-earlier period. The majority of these entities belong to the fields of oncology and orphan diseases, not forgetting treatment of cardiovascular diseases. **Coface estimates that drugs sales, whether associated or not with these new entities, should total $533bn in 2017, i.e. a 10% rise compared with 2016 ($430bn).** Express Scripts, one of the largest Pharmacy Benefit Managers (PBM, which manage claim forms but also negotiate drug prices and volumes on behalf of health insurance companies), estimates that the growth rate for specialty drugs will be 22% in 2016 (the same as in 2015). As in Western Europe, this class accounts for a third of sales and its share is set to increase in coming years as innovative molecules and therapies are adopted for diseases affecting few people.

In relation to the size of its population, Chinese spending on drugs as measured by IMS Health stood at around $115bn in 2015. **Coface estimates that sales should grow by 6% in 2016 and 5% in 2015 to reach $127bn. However, two major risks should be pointed out, i.e. the lack of transparency during public tenders and measures to control health spending in China. Indeed, the health authorities would like to limit prices of imported drugs (which are generally the most innovative), especially in oncology.** Although 96% of the population has public health insurance, this regime does not cover the most expensive treatments very well. In addition, public authorities have heightened their vigilance concerning the practices of pharmaceuticals companies, especially foreign ones.

SECTOR RISK ANALYSIS - NOVEMBER 2016

RETAIL

ASSESSMENTS BY COFACE

NORTH AMERICA	LATIN AMERICA	EMERGING ASIA	CENTRAL EUROPE	WESTERN EUROPE	M. EAST + TURKEY
					
HIGH	HIGH	MEDIUM	MEDIUM	MEDIUM	HIGH

RISK ASSESSMENT

HIGHLIGHTS

Household consumption, which is the driving force in the retail sector, is in a mixed situation from one region to another. While it is continuing to fall in Brazil, its growth remains positive in Asia as well as in the United States, while it is picking up in Europe. In all, global retail sales should grow by more than 3% in 2016 and 2017 *(see chart)*.

This growth should be shaken up by momentum in e-commerce, the share of which in overall global retail sales is rising (10% in 2017 vs 7.4% in 2015) according to Emarketer. The emergence of this new competition is generating pressure on traditional players in the sector and accentuating company defaults. Defaults are primarily high in the textile sector, and more specifically in clothing throughout the world.

Market share of online purchases of mass consumer products (FMCG FDP-SS [(1)]) is set to double over the next 10 years in the most developed markets. These are set to total 30% of the market in South Korea, 15% in China and 10% in the UK and France. In 2025, this type of sale is set to represent 9% of the retail market, or sales of $150bn. As an example, in France which is one of the best positioned players, internet sales growth remained robust in Q2 2016. Over the full-year 2016, online purchases should grow by 10% (after an increase of 14% in 2015).

(1) FMCG-FDP,SS Fast moving consumer goods,fresh dairy products, self-service

Strengths

- Sustained retail sales growth since 2010
- Growth in the Chinese middle class
- Significant urbanisation in Asia and Africa, driving the sector

Weaknesses

- Slowdown in emerging economies
- Fierce competition in the sector

Growth in global retail sales

(as %)

Sources: PwC; Economist Intelligence Unit

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RETAIL

DEMAND

Eurozone growth is set to total 1.6% in 2017 on Coface estimates (vs. 1.7% in 2016). It should remain driven by household consumption, which bodes well for the sector. In 2016, household purchasing power rose, especially since inflation remains low. Unemployment continued to fall slightly at the same time (10.1% of the active population in the eurozone in Q2 2016 vs. 11% in Q2 2015). The level of growth in retail sales remains respectable in the eurozone (2.9% in July 2016 over one year). This growth is partly underpinned by growth in household purchasing power prompted by low interest rates in the eurozone. The ECB's asset purchase programme has helped step up pressure on rates, which has has the automatic effect of increasing loan requests by European households in 2016. Renegotiations, which in France represented 50% of the share of home loans in August 2016 (vs. 29.6% in February 2016), had a very beneficial effect on growth in French purchasing power. In 2017, household purchasing power should continue to benefit from low interest rates.

In North America, and more specifically in the US, the election of Donald Trump entails serious uncertainties about consumption and investment. According to Coface, growth in the United States is expected to fall to 1,5% in 2017 (1.6% in 2016 and 2.4% in 2015). In 2016, household consumption (+ 2.7% year-on-year in Q2 2016) shows signs of slowdown, with retail sales growth (year on year) down by 1 point between July 2015 (3.4%) and July 2016 (2.4%). The retail sector is expected to be even more affected in 2017. The "positive" impact of the elections is on the side of interest rates, which are not likely to increase at the end of 2016. This should be beneficial for consumer credit costs, which are widely used by US households. Trends are more positive in Canada where retail sales have risen since the beginning of the year (3.2% in July 2016, compared with 2.7% in July 2015).

In 2017, the slight rebound in activity in Brazil will not suffice to shake up the sector (+0.6% in 2017 vs. -3.4% in 2016 on Coface estimates). Meanwhile, retail sales growth is still negative year-on-year (-7% in July 2016). This economy must deal with rising unemployment, high inflation (+9% in 2016), and an erosion of real wages.

In 2017, the slowdown in the Chinese economy (+6.1%) will continue to affect the retail sector, even though growth remains robust. Indeed, while household confidence picked up slightly in August (105.6 vs. 100 in March), it remains low. Household disposable income has continued to slow (+8.2% over one year in Q2 2016 vs. +8.8% in Q2 2015). Retail sales growth nevertheless remains higher than 10% over one year (10.6% in August 2016 vs. 12% in August 2015).

SUPPLY

Revenues at companies in the sector are bearing up in Europe as shown by the resilience at Carrefour, the European leader in food retail, which saw its sales grow 2.9% in Q1 2016. The same is true for Leclerc, for which sales are set to rise by 3% in 2016. This momentum is confirmed in France where the banner gained 0.4 points of market share over one year in September 2016, whereas the majority of market shares of other traditional banners have stagnated or fallen. In the UK, like Lidl (+0.4 points to 4.6% market share) and Aldi (+0.6 points to 6.2% market share), discounters continued to win market share in September 2016. In 2017, revenues at groups in the sector should generally be maintained, as shown by Carrefour for which sales are set to rise 3.8%.

In the US, sales at the leading global retail group, Walmart, are set to stagnate in the end in 2016 (+0.5%). This figure is fairly reassuring given that the strength of the dollar is weighing on its revenues. Similarly, despite changes in its wage policy, which increased by 1.2 million employees ($10 per hour vs. $9 previously) in January 2016, in Q2 the group generated a net profit up 8.6% for Q2 of its 2016/2017 split financial year. **Increasingly exposed to pressure from Amazon, Walmart has stated its aim to develop its own e-commerce business,** which is why in August, the group acquired (for $3bn) the US online retailer Jet.com. This operation proved beneficial, with growth of 11.8% noted in its online sales in this last quarter. In October 2016, Walmart also doubled its stake in the capital of Chinese online sales site JD.com. The family-owned group now has a 10.8% stake. The US group has therefore become one of the major shareholders in the Chinese group, which is considered to be the main rival to Alibaba, the Chinese no. 1 in e-commerce.

In Latin America, companies in the sector are suffering from the economic slowdown. In Brazil, the decline in activity has led US retailer Walmart to close 10% of its stores in 2016. In contrast, Carrefour, which has been present in Brazil for 40 years, remains an exception as it managed to maintain sales growth in Latin America at 17.9% in H1 2016.

Companies in the retail sector are likely to suffer from the economic slowdown in China in 2017. Carrefour's sales in the country have continued to decline, dropping 5.3% in H1 2016. Financial situations at certain Chinese suppliers could therefore become strained. However, a number of heavyweight groups are resisting, such as **Alibaba** (n° 2 global e-commerce website), whose **sales in the segment rocketed 49% over one year in H1 2016. While 75% of the group's revenues stem from e-commerce in 2016, the giant is increasingly diversifying its business (sport, media, online finance etc.), given the local economic slowdown.**

SECTOR RISK ANALYSIS – NOVEMBER 2016

TEXTILE-CLOTHING

ASSESSMENTS BY COFACE

NORTH AMERICA	LATIN AMERICA	EMERGING ASIA	CENTRAL EUROPE	WESTERN EUROPE	M. EAST + TURKEY
HIGH	HIGH	HIGH	MEDIUM	HIGH	HIGH

RISK ASSESSMENT

HIGHLIGHTS

Textile sales remain sluggish in North America and Western Europe. Company defaults have increased in the traditional textile segments in Western Europe. In all developed countries, traditional distribution channels are victims of the development of online sales. In emerging Asia, textile production remains hampered by China's decision to limit duty-free cotton imports since 2013. **However, Chinese industrialists have been sourcing quality cotton from outside the country, which is driving up production costs.**

The textile-clothing sector is marked by the **increasing replacement of cotton with synthetic fibres (polyester, acrylic, viscose).** Globally, cotton accounted for only one-third of textile consumption in 2015 versus one-half in 1994. Less costly, easy to mix with other fibres and with a limited impact on the environment compared with cotton, synthetic fibres concentrate technological progress in the textile-clothing. **Furthermore, prices of polyethylene terephthalate (PET) and oil, from which it stems (chart), are correlated.** In October 2016, whereas the decline in oil prices and PET stood at -0.5% ($46.7/b) and -1.2% ($845/t) over one year, cotton prices increased by 34.7% (60.9 per pound), **accentuating even further the competitiveness of synthetic fibres relative to cotton.**

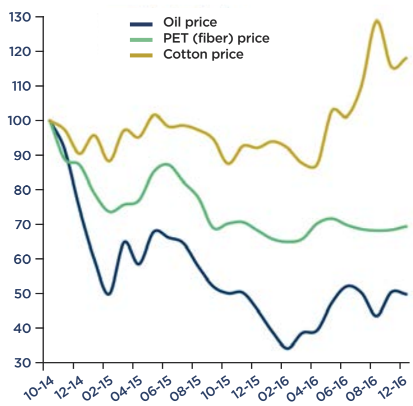
Strengths

- Growing middle class in emerging countries
- Fall in prices of cotton and synthetic fibres

Weaknesses

- **Substantial cotton stocks in China, where destocking is hampering demand on the global market**
- **High demand elasticity product**
- **Sales threatened by e-commerce**

Change in oil, PET and cotton prices (100 = October 2014)



Sources: EIA, ICIS Pricing, Thomson Reuters

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TEXTILE-CLOTHING

DEMAND

Global cotton consumption is set to notch up by just 0.6% in 2016/17 (August/July) and by 1.2% in 2017/18. Consumption volumes remain far lower than the levels noted before the global financial crisis in 2008 (24m tonnes in 2015/2016 vs. 65.2m tonnes in 2007/2008).

In North America, textile consumption is expected to be affected by the slowdown in growth in the United States. (+1.6% in 2016 and +1% in 2017 according to Coface, compared with 2.4% in 2015). The election of Donald Trump also causes serious uncertainties about consumption and investment in US. The decline is likely to be similar to that seen in the first eight months of 2016, when average growth in retail clothing sales (0.9%) was far lower than average growth over the year in 2015 (2.1%). This decline in in-store clothing demand is also affected by the sharp growth in demand for internet sales. In 2016 in the US, out of 100 clothing articles sold in the retail network, only 20 were actually made in a physical stores (14 directly by internet and 66 in a physical store but influenced by internet). In 2011, almost half (49%) of clothing sales were exclusively sold in stores, according to Forrester Research.

The general situation seems to be even less favourable in the eurozone where 10.1% of the active population was unemployed in Q2 2016. In 2017, an upturn in this figure should enable slightly better sales growth. Over the first seven months of 2016, the level was slightly better than the average in 2015 at +1.2% in volume terms vs. 1%. However, while young consumers allocate more resources to textile, 22% of them were still unemployed in Q2 2016 (15-24 years).

In China, the world's leading consumer of cotton (30% of global consumption), consumption is set to fall 1% in 2016/2017. While this country is by far the market where growth in clothing sales is the most dynamic, the pace has slowed, falling from 7.6% in 2015 to less than 6% in 2016 according to the national statistics bureau. This trend should amplify in 2017, given the forecast for a plunge in GDP growth in 2017 (6.1% vs. 6.5% in 2016 according to Coface).

SUPPLY

Global cotton production is set to fall sharply in 2015/2016 (-18.8%), for the fourth year in a row. Stocks are expected to fall 12% in 2016 but should nevertheless represent 93% of annual production. **In 2016/2017, a slight recovery in global cotton production is hoped for (+5.9% according to the EIU), given notably more beneficial weather conditions (El Nino is not expected).**

The impact on cotton prices is mixed for 2016. Between January and March, these reached a low point of $1.48/kg since 2009, given the uncertainty caused by cotton auction sales by the Chinese authorities. These auctions finally took place in May 2016, and Q2 prices then reached a peak of $1.88/kg (a two-year record) in August. The main cause stemmed firstly from very optimistic projections by investors for US exports and secondly, uncertainty on the weight and the quality of Chinese stocks. **However, in view of sluggish global growth, persistently mammoth global cotton stocks (nine months of consumption in 2016/2017), this increase in prices should be both temporary and measured between now and the end of the year (+2.2% in 2016) as well as in 2017 (+2.4%), especially since production should increase further (+23%) in the US (n° 3 global producer).**

In China, the government has reduced its duty-free import levels for raw cotton, given the massive amount of stocks. Combined with the increase in labour costs and production costs as a whole, Chinese cotton plants are also less and less competitive. With prospective growth of 19% in 2016/2017, clothing production in Bangladesh should benefit from Indian and Chinese relocations thanks to hourly wage rates that are among the lowest in the region. Pakistan (world no. 4 producer) remains affected by volatility in its electricity production due to an infrastructure shortfall.

Like Vivarte (la Halle, Naf Naf, Kookaï...) where a fourth CEO in two years was nominated in October 2016, the textile-clothing segment positioned in the mid-range is suffering extensively in Europe.

The increase in cotton prices (+34% over one year) in October 2016 has deteriorated its competitiveness relative to synthetic materials which have fallen 1.2% over the same period. 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 decline in cotton prices and the increase in demand for food are driving farms to switch to more profitable crops.

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COFACE SA
1, place Costes et Bellonte
92270 Bois-Colombes
France
www.coface.com

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