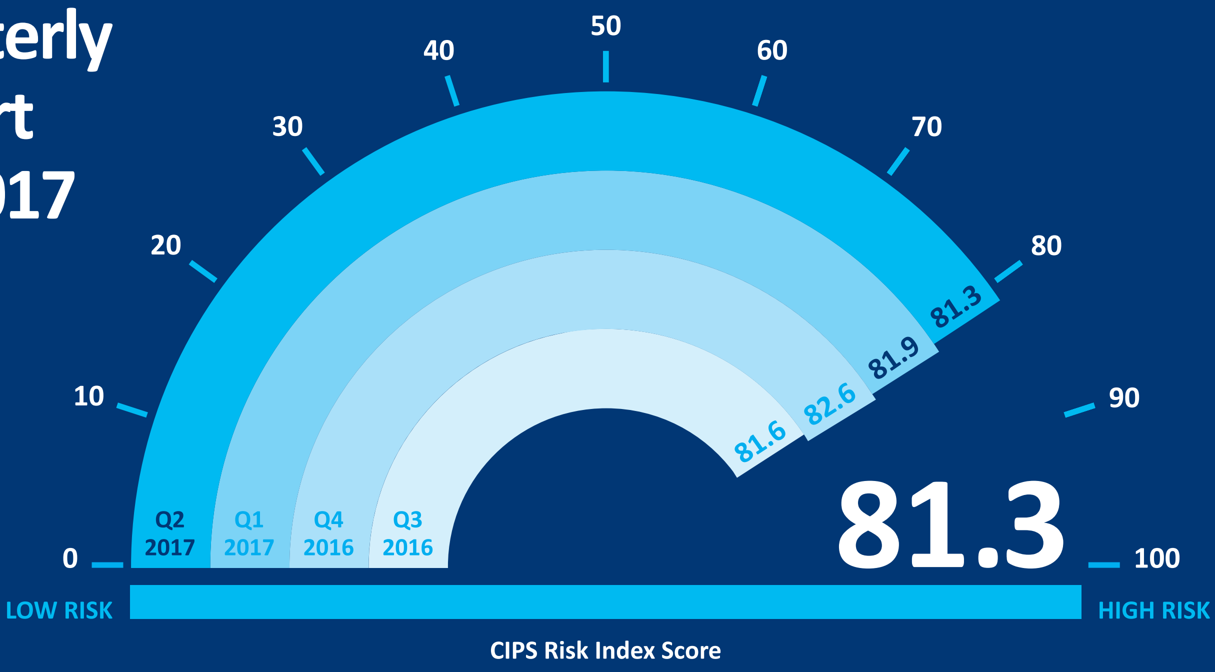
powered by

dun & bradstreet

CIPS
Chartered Institute of Procurement & Supply

CIPS RISK INDEX

Quarterly Report Q2 2017



CIPS RISK INDEX (CRI) KEY POINTS Q2 2017

The CRI score improved modestly for the second straight quarter, signalling a moderation in cross-border supply chain risks. Risks lurk below the surface though, and could disrupt supply chains.

The improvement in the CRI score was driven by lower risk and rating upgrades in heavyweight economies, outweighing downgrades in a handful of less significant countries.

Near-term risks to global supply chains run the gamut, from shifts in global trade policy, to increased threat of disruption from cyber attacks, to ongoing systemic risks like Brexit negotiations.

Six countries were upgraded in Q2 in terms of our operational risk assessments, while seven were downgraded; momentum effects of upgrades/downgrades from Q1 2017 also impacted the CRI.

Our CRI score improves measurably, signalling continued moderation in supply chain risks.

About the CIPS Risk Index

How the CIPS Risk Index works

The CIPS Risk Index is composed of multiple unique assessments undertaken by Dun & Bradstreet's economics team of over 40 in-house economists, data analysts and contributors working in-field across the world. In all, 132 countries (comprising 90+% of global economic activity) are assessed across nine categories, on a monthly basis. The individual country scores are then aggregated to calculate a global supply risk score.

We use weights for each country based on the contribution each country makes to total global exports (in theory, their individual contribution to global supply chains). For consistency, the trade shares were originally anchored to data for 2010, but in 2017 these were rebased to export rates from 2015. The regional scores are done in the same way, aggregating across all countries in the region based on their rebased contribution to total exports.

Country risk scores

Dun & Bradstreet country scores provide a comparative assessment of cross-border risk. The ratings are divided into seven bands ranging from DB1 (lowest risk) to DB7 (highest risk). Each band is subdivided into quartiles (a-d) with an 'a' designation representing slightly less risk than a 'b' and so on. Only the DB7 score is not divided into quartiles and sets a ceiling for the highest risk level.

The Index assesses against nine categories:

CRI CATEGORIES

1. Short-term economic outlook
2. Long-term economic potential
3. Market potential
4. FX risk
5. Transfer risk
6. Business environment quality
7. Business continuity
8. Insecurity/civil disorder risk
9. Expropriation/nationalisation risk

Second straight CRI improvement in 2017

132 country markets assessed for the period Apr – Jun 2017

As overall global growth picked up and beat expectations, supply chain risk also saw an improvement, and our CRI dropped to 81.27 in Q2 2017 from 81.9 in Q1.

Thanks to a broadly based pick-up in global economic activity, operational risks for global businesses declined for the second time in 2017. The CRI score remains just a few points shy of its all-time high though, and, despite the improvement, there are significant risks.

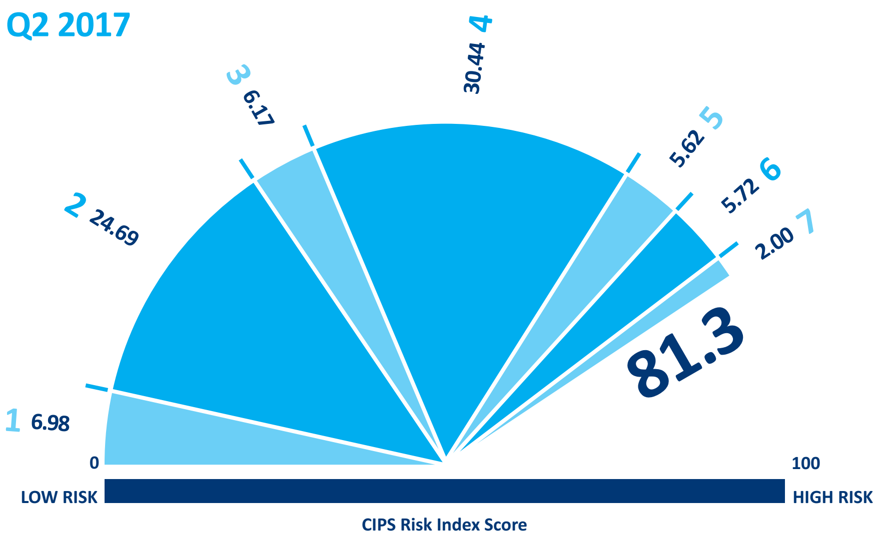
Contribution to global risk by region

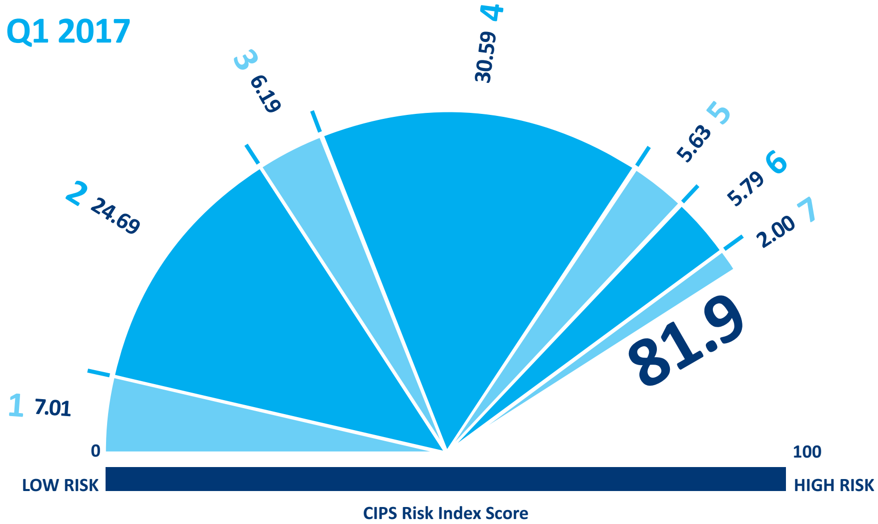
(Q2 2017 vs Q1 2017)

REGIONS

1. NORTH AMERICA
2. WESTERN AND CENTRAL EUROPE
3. EASTERN EUROPE AND CENTRAL ASIA
4. ASIA PACIFIC
5. MIDDLE EAST AND NORTH AFRICA
6. LATIN AMERICA
7. SUB-SAHARAN AFRICA

Charts represent an approximation of regional contribution and reference should always be made to the relevant regional statement for the extent of any actual change.





Regional Risk Summaries

North America

Supply chain risk in North America, as measured by the CIPS Risk Index, powered by Dun & Bradstreet, remained unchanged in Q2 2017, as neither Canada nor the US saw any changes in their country risk scores. The underlying trend in supply chain risk, however, remains upward as the US and Canada embark on revising decades-old trade agreements. Political risk is also on the rise in the US and could spill over into real activity if implementation risks persist.

Dun & Bradstreet has downgraded its near-term growth forecast for the United States economy; we now forecast that real GDP growth will come in at 2.0% in full-year 2017 (down from 2.2% previously), and that growth will accelerate to 2.3% in 2018 (down from 2.6%). Compared with the disappointingly slow 1.6% growth in 2016 - one of the worst years since the Great Recession - even the reduced forecast of 2.0% in 2017 represents a measurable improvement in the economy's performance.

Nevertheless, there are two main factors behind the downgrade. Firstly, our proprietary leading indicator, the Small Business Health Index (SBHI), has been signalling headwinds in the near term for small-business operating conditions, and, by extension, the broader economy. The SBHI measures small-business health as reflected in their payment patterns, failure rates, and utilisation of credit, and is a proven leading indicator of overall economic activity. For example, a period of decline in the SBHI in late 2016 signalled that Q1 2017 GDP would be weak, and this was confirmed by actual data in April. In its latest phase of weakness, the SBHI fell in May, for the third straight month. The drop was sizeable: the index declined by 1.5 points, to 87.4. This is the lowest level of the SBHI since its last trough in September 2014, and signals that the sluggish small-business conditions that we saw in Q1 have spilled over into Q2. In other words, the rebound in Q2 growth will be slower than previously forecast, and will shave off a few basis points from overall growth in 2017.

Secondly, political uncertainty and implementation risks remain high, and could escalate in the near term to weigh on business sentiment and growth prospects. In particular, ongoing deliberations among the Republicans about repealing the Affordable Care Act (ACA) and replacing it with new healthcare legislation imply that major economic policy initiatives of the Trump government, namely tax reform and deregulation, will be delayed. We are already assuming that the stimulus effects of these two policies will be delayed until 2018; even if they pass smoothly, these policies will provide only a small boost to growth. By then the economy will already be at full-employment and operating at its full potential. Hence, policy stimulus will be relatively muted, prompting us to revise the 2018 GDP forecast downward.

Despite a Republican majority in Congress, the Trump government has not had a smooth start, and ongoing political events could undermine the execution of its near term economic agenda. Dun & Bradstreet's Political Environment Outlook indicator, one of the sub-scores that drive the US's overall country risk score of DB2a, is firmly in the red zone, indicating that it is a negative risk to the operating environment and supply chains. Business sentiment, which has been generally upbeat since the November elections, will be one of the first casualties in the event of a significant political gridlock impacting policymaking. US equity markets suffered one of their worst daily losses recently in response to news regarding the former FBI director, James Comey, as investors became concerned that the episode could distract from tax reform and deregulation.

Congress is also heading towards the periodic debt ceiling negotiations, and a resolution before Congress heads for recess in August would be ideal to maintain the economy's positive momentum. The US hit the statutory borrowing limit in March, and the Treasury has been using cash-management strategies to pay bills in the meantime. If Congress does not raise the debt ceiling soon, the Treasury could run out of funds by the end of the summer, as the Office of Management and Budget (OMB) warned that tax receipts have fallen short of projections. A lack of unanimous agreement among the Republicans could push discussion beyond that, though. That will damage investor sentiment, both within the US, and among global investors who buy US treasuries.

The labour market remains a key driver of the US economy, adding a stronger-than-consensus 222,000 jobs in June. However, wage growth was lukewarm at 0.2% m/m (implying a flat 2.5% y/y). Despite the addition of more than 200,000 jobs this late in the cycle, this is not translating into higher wages. This points to an underlying productivity weakness. Weaker wage growth should not automatically be interpreted as a sign that the Fed has good reason to pause. The labour market remains very tight, and even 2.5% wage growth will add to inflation. We expect the Fed to stay on track for another rate hike later this year.

**Regional trend against previous quarter. Downward arrow represents reduction in risk.*

North America continued

The changing rules of global geopolitics and hegemony will have a long-term impact on US trade policies. This was evident when the US and Chinese administrations agreed on a bilateral trade deal that signals progress in relations between the two nations on addressing issues in areas including agricultural trade, financial services, investment, and energy. Among other proposals, the agreement will give US producers access to the Chinese markets for beef, electronic payments services, and natural gas. In recent weeks, President Trump has gradually stepped back from his pre-election rhetoric against China, and dropped his campaign promise of labelling China a 'currency manipulator'. In return for this warming of relations between the two nations, and the pledge to expand economic ties, the US government expects to receive more co-operation from the Chinese government on key diplomatic issues such as the volatile North Korean security threat. Meanwhile, China has stepped up to fill the global leadership void created by US withdrawal from large-scale multilateral trade agreements like the Trans Pacific Partnership (TPP). At a Beijing conference, China pledged more than USD100bn in investment to fund its One Belt, One Road initiative, a highly ambitious plan to connect China to Central Asia, Europe and Africa by land and sea.

Overall, economic fundamentals and supply chain risk in Canada are improving. Real GDP during Q1 2017 rose a sequential 3.7% - rising at a faster pace than Q4 2016 (2.7%). Household consumption continues to be supportive of top-line growth, accelerating to an annual pace of 3.1% in Q1 from 2.7% in Q4. In addition, private sector gross fixed capital formation has begun to strongly (and positively) contribute to overall GDP growth. Business investment has lagged for years, weighing negatively on overall growth. This was due in part to the 2014 oil-price shock, but the recovery in oil prices and a general pick-up in demand for machinery and industrial equipment should be interpreted as a very positive development with regards to growth momentum.

Although growth is improving, our short-term economic outlook is not entirely rosy. While the labour market is recording strong growth (185,000 full-time jobs have been added year-to-date), spot oil prices of both Brent and WTI recently fell to near 31-week lows and prices remain mired in a downward trend, suggesting even weaker prices may be in store. Although the magnitude of the recent price downturn is not as large as the 2014 oil-price shock, a drop in oil prices has a material impact on the labour market. Since 2014, at the onset of the oil-price fall, the unemployment rate has remained elevated and growth in total hours worked has been weak. These metrics have recovered recently, in line with the recovery in oil prices. Furthermore, falling oil prices threaten to disrupt the recovery in business investment and could weigh on regional supply chains in the near term. In addition, given recently improved growth, the Bank of Canada has moved towards a more hawkish stance, hiking rates for the first time since June 2010. Higher rates will create greater hardship for households and increase their cost of servicing debt. Historically low interest rates have also driven the interest-only component of the debt service ratio to historical lows. Higher rates will reverse this trend and add to the current burden for households, limiting future consumption.

Trade relations between the US and Canada will come under scrutiny over the near term as the two countries take part in discussions to renegotiate NAFTA. Two days before his 100th day in office, President Trump dropped his hardline stance against the agreement, and announced that the US will renegotiate NAFTA rather than withdraw from it completely. While this removes the risk of a rude shock in the form of a return to pre-NAFTA trade relations between the US and Canada, there is still significant uncertainty for regional supply chains, especially as some contentious industries like dairy and lumber might be more impacted than others. Since the mid-1980s, the US and Canada have had recurring trade disputes regarding softwood lumber, with the US consistently alleging that Canada unfairly subsidises its lumber. More recently, in April, the US fired the latest salvo when the Department of Commerce imposed new anti-subsidy duties averaging 20% on Canadian softwood imports. In response, the Trudeau government has sanctioned a CAD867m federal aid package for the Canadian softwood industry to help it pay the additional duties. The US lumber lobby protested the aid package as just another subsidy, setting the stage for persistent friction between the two countries in the run-up to the NAFTA renegotiations (which could start as early as mid-August).

FURTHER INFORMATION

Country Insight Snapshot Reports

These frequently-updated reports provide a snapshot view of a country's cross-border risk exposure, focussing on the political, commercial and macroeconomic environments.

www.cips.org/dnb-mth

**Regional trend against previous quarter. Downward arrow represents reduction in risk.*

TREND*

Western and Central Europe

Positively, risk levels in Western and Central Europe fell in the second quarter of 2017, with the region seeing five upgrades.

In Iceland, robust economic growth and the formation of a government after inconclusive elections and the successful removal of capital controls (which had been introduced during the financial crisis in 2008-09) has prompted an upgrade of the country's risk rating from DB3d to DB3b. As the macroeconomic outlook is sound, further upgrades over the remainder of the year seem possible. This would bring Iceland back into the DB2 group, where it was ranked before the outbreak of the domestic banking crisis.

Similar to the developments in Iceland, the formation of a government in the Former Yugoslavian Republic of Macedonia, following several months of political deadlock in the aftermath of the parliamentary elections, has prompted a risk rating upgrade. The country is now ranked at DB4b (up from DB4c previously) as the change of government could herald a fundamental change in the political regime and launch Macedonia on a path towards liberal democracy, law-bound institutions and Euro-Atlantic integration.

Most importantly for our risk score, given the country's size, we upgraded France's risk rating from DB2d to DB2c, following the victory of pro-EU centrist Emmanuel Macron in the presidential elections in May. We simultaneously upgraded the risk outlook from 'stable' to 'improving'. Macron has vowed to reform the country's heavily-regulated labour market, reduce the notorious levels of red tape, while also supporting free-trade arrangements between the EU and overseas markets. Following his party's victory in the parliamentary elections in June, we remain optimistic and expect changes to France's relatively poor business environment outlook over the coming quarters. That said, labour market reforms will be fiercely opposed by trade unions and, even if they are not watered down, it will take time before the full positive effects are felt.

Also positive for the region's supply environment outlook, the EU has reached agreement with Japan about a free-trade agreement. Tariffs will be phased out in key sectors such as automotive and agriculture and, even more importantly, product standards will be harmonised – which will facilitate future trade. As the US has withdrawn from TTP, it seems very likely that the EU is trying to exploit the vacuum in the Pacific area, and several more free-trade arrangements are already under negotiation.

While the region's outlook continues to improve, downside risks remain clearly visible on the horizon. While Angela Merkel's re-election as chancellor in Germany in September is almost certain, the election outcomes in Austria and Italy (where elections will take place in October and early 2018, respectively) are unclear. The inclusion of anti-EU parties in new governments seems possible, leading to another flare-up of the euro-zone crisis. Furthermore, the number of refugees arriving in Italy from North Africa increased substantially in May and June. As a response, Austrian army units were deployed to control the Austrian-Italian border in the Alps (with no impact on supply chains so far, though). We do not expect the situation to escalate to the level seen in 2015, but recommend monitoring developments closely. Most importantly for supply chain risk in the region, the inconclusive outcome of the snap elections in the UK on 8 June has left the British government with no clear mandate for pursuing a hard Brexit. It remains unclear what post-Brexit UK-EU trade relations will look like, and the impact of Brexit on supply chains involving the EU is thus impossible to quantify at the moment. We advise that until Brexit negotiations progress, a measured approach to managing relationships with suppliers will be essential.

**Regional trend against previous quarter. Downward arrow represents reduction in risk.*

Western and Central Europe continued

In keeping with a gradually improving macroeconomic environment in the euro zone, we have upgraded Cyprus's risk rating from DB4c to DB4b due to strengthening domestic demand conditions. Indeed, the Cypriot economy recorded its fastest yearly growth rate in eight years in Q1. Official data reveals that real GDP expanded by 3.2% y/y (or by 0.6% q/q) in the three months to March as a result of robust private consumption growth (up by 2.6% y/y, or by 0.4% m/m). Furthermore, a number of key economic indicators (such as retail sales) suggest that the economy may have expanded further in Q2. Looking ahead, we expect the economy to expand throughout our two-year forecast period, possibly at a faster rate than the one recorded in 2016. Downside risks to our projections are associated with underlying weaknesses and legacies from the crisis. Cyprus's high dependency on the magnitude of the recovery in the euro zone, and its exposure to the fallout from Brexit, are additional risk factors.

Meanwhile, we have also upgraded Albania's country risk rating to DB4c following a decision by the opposition Democratic Party (PD) to abandon its street protest and boycott of the political institutions and participate in parliamentary elections in June. The crisis ended after mediation by the US persuaded the ruling Socialist Party (PS) to offer PD six positions in a short-lived transitional government and the right to nominate a new head of the Central Election Commission in order, as PD claims, to prevent PS using public funds to finance its electoral campaign. The end of the political crisis has a number of positive consequences. Most importantly, it restores calm to the business environment, allowing firms to resume trade, investment, and recruitment without fear of civil unrest.

**Regional trend against previous quarter. Downward arrow represents reduction in risk.*

TREND*

Eastern Europe and Central Asia

Our risk rating score for Eastern Europe and Central Asia saw a slight worsening in Q2 2017, deteriorating to 5.331 from 5.325 in Q1. Moreover, the score continues to indicate that on average, supply chain risk is greater than in any other global region with the exception of Sub-Saharan Africa.

While no country in the region was downgraded during the quarter, the average score for Q2 was still higher than that for Q1 due to the momentum effect, as Dun & Bradstreet had downgraded Romania's country risk rating by one notch in February. In other words, overall risk in Q2 was higher than in Q1. We had downgraded Romania's risk rating by one quartile to DB4a following events in February when the country was rocked by the largest street protests since the end of the communist era, with up to half a million people having taken to the streets at the government's decision to weaken Romania's anti-corruption laws. While the situation subsequently calmed following parliament's rejection of the controversial measure, recent developments have led to a further deterioration in the political environment, prompting us to once again downgrade Romania's risk rating. Indeed, following the ouster of Prime Minister Sorin Grindeanu in late June (after parliament passed a vote of no confidence tabled by his own party), a large crowd took to the streets of Bucharest a few days later in protest at the appointment of Mihai Tudose as the new premier, auguring a potential return to political instability. As such, Dun & Bradstreet subsequently downgraded Romania by a further quartile (to DB4b) in July; note that this downgrade will not be reflected in the regional risk rating score until Q3.

Across the region as a whole, while GDP growth is gaining traction as economic activity picks up steam following a subdued performance over the past two years, supply chain risk remains elevated. The lower-for-longer oil price environment, banking sector stresses across a number of CIS countries, the rising incidence of cyber threats, domestic political instabilities, and geopolitical tensions all remain contributing factors.

While we expect oil prices to rise gradually over our five-year forecast horizon, we anticipate that they will remain significantly below the USD108 average level registered during 2011-14. As such, the region's commodity-exporting nations continue to face a painful adjustment process, with governments having to rein in investment spending as they consolidate their fiscal positions to adapt to lower oil revenues. The region's oil importers, meanwhile, continue to contend with the knock-on effects of lower trade, investment and remittance flows from their oil-exporting neighbours. These developments have taken their toll on the region's banking sector. In Azerbaijan for example, the country's largest bank – the state-owned International Bank of Azerbaijan – announced plans in May to restructure USD3.4bn worth of debt. As well as the cost to creditors, the restructuring plan will see the state take on a further USD2.3bn of debt at a time when revenues have already come under pressure due to the subdued oil price. Across the region more generally, already-elevated levels of non-performing loans in a number of states have been rising further as businesses continue to contend with cash-flow difficulties, heightening cross-border payment risks. More positively, however, an ongoing disinflationary trend across much of the region is allowing central banks to continue to bring down headline interest rates in an effort to reduce borrowing costs. In addition, authorities in some oil-exporting nations are stepping up efforts to liberalise their economies, which should improve supply chains over the medium term by generating new opportunities for cross-border investment and trade.

Meanwhile, in line with the wider global trend, private businesses, government institutions, and infrastructure networks across Eastern Europe and Central Asia are facing a rising incidence of cyber threats. Indeed, large international companies and government agencies were crippled by two global ransomware cyber attacks in Q2. In May, a large co-ordinated attack dubbed WannaCry spread to over 150 countries, including Russia, Ukraine, Kazakhstan, and Romania. Just a few weeks after that, in late June, an attack known as Petya was unleashed with similar global ripple effects, hitting large international companies including Rosneft, Merck and Maersk. At a country level, Ukraine was the hardest hit, with government and bank infrastructure, Kiev's airport and metro system, and energy firms Kyivenergo and Ukrenergo all targeted. The virulence of the Petya malware attack, in particular, has stoked fears of a dangerous escalation of the global cyber arms race. A NATO-affiliated cyber-security organisation has stated that Petya was probably created by a state actor. In any case, with cyber threats clearly on the rise and evolving in terms of both scale and scope, it is more crucial than ever that businesses do all that they can to mitigate their risk exposure and ensure that they have adequate response strategies in place.

Finally, geopolitical risks in the region remain elevated, posing an ever-present threat to supply chains and business continuity. Despite hopes of a significant rapprochement in US-Russia relations following the inauguration of Donald Trump as US president, this has so far not materialised, and in fact bilateral relations appear to have deteriorated further over Q2. Indeed, in mid-June, the US Senate approved a bill to impose a new set of sanctions on Russia; if the bill becomes law, it will expand the scope and scale of the current US sanctions regime.

**Regional trend against previous quarter. Downward arrow represents reduction in risk.*

Asia-Pacific

The Asia-Pacific region's risk score remained stable at 3.5664 (on our 1-7 scale, with 7.000 the highest-risk score possible) in Q2, for a second quarter. The lack of change was due to the stability of the region's 23 country risk scores in the quarter, after our downgrade of India's country risk indicator in early Q1 2017. Dun & Bradstreet downgraded India from DB4b to DB4c in January, due to a policy-induced demand shock from demonetisation since the November order to withdraw 86% of cash-in-circulation, which lasted into Q2 2017 and hit cash-based rural northern India, the real estate sector and construction, resulting in a slowdown in credit growth to a record low, as well as forced drops in rural crop prices due to the cash shortages.

As of early Q3 2017, India was braced for further potential disruption from the implementation of Goods and Service Tax (GST), India's first national VAT. With GST in effect since July 2017, numerous smaller warehouses in myriad locations are expected to be consolidated, resulting in operational efficiencies as India gains a truly national internal customs union. GST could also reduce the size of the large informal economy, improving tax collection. However, technical (including IT) demands on small businesses are unprecedented and could prove disruptive in the short term, resulting in another shock less than a year after the Q4 2016 demonetisation order.

The government promised a soft launch to assist companies over two months, but as a precaution due to the uncertainty, Dun & Bradstreet switched India's supply environment outlook, still in the 'amber' zone, from 'improving' to 'stable' trend in June. Anecdotal information from Dun & Bradstreet India's consultations with companies indicate that the GST may create confusion, as companies have not experienced such a tax reform in the past and must adjust their operation and compliance considerably.

There have been no major natural disasters that had any discernible impact on Dun & Bradstreet's proprietary risk scores or economic forecasts since the cyclone season in Australia and New Zealand wound down during April. Cyclone Debbie had hit coal, tourism, and agriculture in Northern Australia, specifically along the coast of Queensland in Q1, as destructive winds and intensive rain caused flooding in some lower-lying and beach areas. However, the impact on Australia's GDP growth in Q2 was likely to be limited and far below that caused by the cyclone of 2011 as four national rail-routes were all up and operational by end-April, and piled-up inventories will have compensated for reduced coal exports. Meanwhile, after riverine flooding affecting eight provinces in Thailand in Q1, we subsequently upgraded our supply environment outlook from 'amber' to 'green'. Disaster resilience has improved since the nationally disastrous floods of 2010.

Nevertheless, due to the logistical delays and business costs incurred when visibility fails during extreme smog episodes in the north China plain, we still recommend that firms with time-critical supply chains in China monitor official alerts about events that could shut traffic routes and factories in areas where their suppliers operate, and go so far as to check pollution levels in real-time (e.g. at http://aqicn.org/map) to monitor for any potential disruption. Chronic and worsening pollution, despite not constituting an urgent risk event, is still a substantial country risk. Peak risks from smog events in China are seasonal, concentrated in the summer and winter months, with air quality, subject to windspeeds, generally improving in the spring and autumn.

**Regional trend against previous quarter. Downward arrow represents reduction in risk.*

TREND*

Middle East and North Africa

The Middle East and North Africa's (MENA) regional risk score worsened in Q2 2017 to 4.1768, from 4.1603 in the previous quarter. The change in the risk level relates to the base effects in the previous quarter of our one-quartile downgrades of Bahrain (in March) and Jordan (February), and our one-quartile upgrade of Egypt (also in February). In this quarter, we have also applied one-quartile downgrades to Iran and Qatar (both in June). Country risk levels across the region are coming under pressure because of the once-again-weakening oil price, ongoing high levels of insecurity (particularly in Iraq, Libya, Syria and Yemen) and the outbreak of the diplomatic spat between Saudi and its allies and Qatar, which is itself a by-product of Washington's support for Saudi Arabia at the expense of Iran.

The downgrade to Iran's risk rating to DB5b (high risk category) from DB5a follows President Trump's visit to the region, during which he announced closer ties with Saudi Arabia in its 'Islamic cold war' against Tehran. At present, Saudi Arabia and Iran are on opposites sides in the civil wars raging in Syria and Yemen. They also hold divergent positions in relation to Iraq and Lebanon. We expect Washington to start strengthening its sanction regime against Iran in the very short term. In addition, a new security concern has surfaced, with the radical Sunni group, Islamic State (IS), turning its attention to Iran. At present, Iranian militias are actively fighting against IS in both Syria and Iraq. IS's increasing rhetoric in Persian over recent weeks, aimed at Iran's Sunni minority, was backed up by two high-profile attacks (officials claim a further one was foiled) in Tehran on 7 June, which resulted in at least 12 deaths.

Meanwhile, the one-quartile downgrade to Qatar's risk rating to DB3b (with a rapidly deteriorating outlook) follows Saudi Arabia, Bahrain, Egypt, and the UAE's announcement on 5 June of the severing of diplomatic relations with Qatar, cutting all transport links and closing their airspace to Qatari flights; Saudi Arabia shut its land border with the emirate. The three Gulf states also imposed travel restrictions and altered residence conditions for Qatari nationals (the latter conditions have since been eased). The shock move means Qatar is effectively isolated from its neighbours. The economic ramifications are potentially very serious. Some 40% of Qatar's non-oil imports, much of which are perishable, arrive through the Saudi land border. A large proportion of the remaining imports are trans-shipped through Jebel Ali in the UAE. With both routes blocked, Qatar could face shortages if the dispute persists. Crucially, this will impact heavily on Qatar's construction industry, which faces strict deadlines to ensure the infrastructure for the 2022 soccer World Cup is completed on time. Supply chains will be stretched, lead times extended, and prices will inevitably rise – as will export costs. In addition, Qatar will need access to hard currency to pay for its imports, but with the riyal now under pressure, more of the country's reserve assets will be directed to supporting the currency to maintain the dollar peg. Exchange bureaux are already running out of dollars. A weakened riyal will deter investment, and non-resident deposits (many from other Gulf countries) will likely be repatriated; around 45% of deposits are by non-residents. Thus, credit will likely dry up and interest rates rise. The longer the dispute drags on, the more acute these consequences will become.

In the Persian Gulf, supply chains are being realigned because of the Saudi-Qatar dispute that broke out in early June, particularly in relation to oil and gas. Most VLCC-category oil tankers take on crude from several countries (including Qatar) to make up a single load, but the transport ban in theory means that Qatari oil cannot be loaded in this form; however, according to Bloomberg joint loads had actually picked up since the dispute started. Qatari ships usually refuel in the UAE, but the ban also precludes this. This will all add costs to Qatari exports of oil and gas. In addition, Qatar is having to look for new routes for its imports that previously came through the Saudi border and the UAE; it is looking towards Oman and Iran as new trans-shipment points. This realignment of supply chains is being undertaken at a time when the regional supply environment outlook is already being undermined by two main trends: weak oil prices and regional insecurity. Into the longer term, at a global level, fears of disruption to the LNG supplies because of the Saudi-Qatar disruption is liable to see gas-importing countries, especially the likes of Japan and the UK, reconsider their vulnerability to these supplies. This could lead countries to change their energy-production balance, as well as consider alternative sources of gas.

More specifically, in relation to the supply environment outlook for the individual MENA countries, we have downgraded the 'traffic-light' status for Qatar from green to amber, as well as assigning it a rapidly deteriorating outlook, as result of the boycott by regional countries. This leaves just two countries in the region, Israel and the UAE, in the 'green' category. We also downgraded the supply environment outlooks for Iran to deteriorating (from stable) in June and for Tunisia to stable (from improving) in May. In contrast, we upgraded the supply environment outlook for Syria from deteriorating to stable in June.

Regional trend against previous quarter. Downward arrow represents reduction in risk.

TREND*

Latin America

Our Risk Score Index for Latin America's supply chain improved for a second consecutive quarter, having moved to 4.3880 in Q2 from 4.4153 in Q1 as the region's economic recovery, though gradual, gained traction. Dun & Bradstreet is now projecting regional growth of 1.0% in 2017, up from our previous forecast of 0.7% as Latin America emerges from recession. Notably, in Q2 disinflation in Brazil contributed to aggressive monetary loosening and significant declines in borrowing costs, while, conversely, resilient price pressures in Mexico kept production costs elevated. In coming quarters, stronger commodity prices and export demand will boost expenditure on infrastructure projects as several leading governments ramp up spending ahead of key elections in 2017 and 2018. Worryingly, political uncertainty overshadows the commercial environments in some major economies, and most acutely in Venezuela, where violent clashes between security forces and anti-government protesters continue unabated.

Our more sanguine outlook for the region is partly attributable to Argentina's improved performance in Q2, underpinned by improved business expectations in response to government's business-friendly reform programme and stronger commodity prices. In May, industrial production grew by 3.1% y/y seasonally-adjusted, led by the automotive and chemicals & plastics sectors, which expanded by 14.0% y/y and 8.2% y/y respectively, while the mining and food sectors grew weaker at 3.8% y/y and 0.4% y/y respectively. The rise in industrial output in May was Argentina's largest monthly expansion since April 2015 and the first positive monthly growth for 2017. In the lead-up to October's legislative elections, higher public spending will boost economic activity further. Positively, investor confidence continues to improve, as evidenced by the government's sale of USD2.75bn of a 100-year bond with a yield of 7.9% in June; an additional USD2.6bn in foreign-currency bonds are expected to be issued by year-end. The economy grew by 4% y/y in May following faster-than-expected Q1 growth of 1.1% q/q (0.3% y/y seasonally adjusted). We now project real GDP growth of 2.4% in 2017 but caution that contingencies for business disruption due to workers' strikes are crucial for the next two quarters.

Meanwhile, in Brazil the commercial sphere remains heavily clouded by rising political turmoil that threatens to jeopardise the government's pro-market reform agenda and complicates near-term business planning. In Q2 political risks escalated as President Michel Temer became the first sitting president to face criminal charges. Accused of corruption by Attorney General Rodrigo Janot, Temer was charged following an investigation into secret recordings made by executives of the JBS meat-packing company in which the president allegedly condoned bribery of powerful politicians, including jailed ex-House Speaker, Eduardo Cunha. Janot also accused Aécio Neves, president of the PSDB (part of the ruling coalition) of conspiring with Temer to obstruct the probe. The pair have also been accused of manipulating the political appointment process and laws to disrupt the Lava Jato corruption case that has engulfed around 1,000 politicians on all sides of the political divide. Consequently, the most imminent risk to supply chains, at the time of writing, stems from business disruptions due to expected public protests against government reforms and corruption and in support of the removal of Temer from office.

In a similar vein, extremely high political instability is a key risk factor for supply chains in Venezuela. By end-June 75 persons had been killed in nearly three months of deadly clashes between anti-government protesters, with over 1,000 injuries, 2,700 arrests and 350 properties burnt or looted across the country. Protesters are demanding President Nicolas Maduro's ouster and early elections; constitutionally, the presidential election is due in 2018. Despite drawing condemnation at home and abroad, Maduro continued plans to rewrite the constitution which has provoked violent demonstrations. The president announced that a 'super-assembly' will be created in July to replace the democratically-elected, opposition-led National Assembly. The new assembly will be charged with the responsibility of rewriting the constitution, in a move widely seen as the president's push to subvert democracy and tighten his grip on power. We continue to advise clients of the extremely high risk of expropriation and nationalisation in the rapidly-declining socio-economic and political climate in Venezuela.

**Regional trend against previous quarter. Downward arrow represents reduction in risk.*

TREND*

Sub-Saharan Africa

In the three months to June, supply chain risk remained unchanged in sub-Saharan Africa as none of the regional countries were upgraded or downgraded. But underlying risks point to headwinds for supply chains in the near term, with better growth expected in the medium term. With commodity prices expected to remain well below their cyclical highs, regional members will be challenged to find alternative sources of growth in 2017. The region had the weakest growth since the recession in 2016, but we forecast a modest acceleration in 2017. As the US Federal Reserve continues to raise rates in 2017, and global financial conditions tighten, regional economies may suffer from periods of capital outflow and weaker currencies. Political risk has increased, and sporadic episodes of civil disorder could hamper the region's return to faster growth.

South Africa, the region's largest economy, continues to highlight the risk of political upheaval spilling over into the real economy and posing challenges to supply chains. The international sovereign credit rating agency Moody's decided to downgrade South African sovereign debt to one notch above sub-investment grade in June, while maintaining a negative rating outlook. This move follows on from sovereign debt rating downgrades to sub-investment grade by the other two main rating agencies, S&P and Fitch, in April. Ratings agencies are concerned about the effects of political instability on the economy, a weakened institutional framework, generally subdued economic growth, and the rising public debt burden. The downgrades have raised South Africa's borrowing costs on international capital markets at a time when national finances are stretched and the economy is struggling to gain momentum following two periods of q/q contraction in Q4 2016 and Q1 2017. Currently, we expect the economy to grow by just 0.8% in 2017, and at the slightly faster (but still low) rate of 1.8% in 2018.

The Nigerian government is pinning its hopes on infrastructure investment to revive the economy in the short term. Real GDP suffered its fifth consecutive quarter of contraction in Q1 2017 as low oil prices, disrupted oil production, political instability and security concerns continued to depress the economy. In May, the finance minister, Kemi Adeosun, expressed her hope that plans to invest heavily in upgrading the country's transport and power infrastructure, as well as efforts to boost agricultural output, would help revive the economy and drag it out of recession in 2017. The government has earmarked around USD7bn for infrastructure projects in 2017/18, particularly large-scale projects in the power and transport sectors. The government is seeking approval to secure around USD6bn in project finance from the Export-Import Bank of China, specifically to modernise its railway connections, which will have positive spillover for regional supply chains in West Africa. Investment in the Lagos-Kano, Calabar-Lagos, Ajaokuta-Itakpe Warri and Kaduna-Abuja railways to raise freight capacity and reduce lengthy transit times are top policy priorities for 2017-18.

On the brighter side, Ethiopia is among the fastest growing economies in Africa, and international firms continue to take up positions to gain a foothold in one of the continent's most promising markets and production bases. The government continues to invest heavily in transport and power infrastructure, and export-oriented industrial parks, which include special economic zones and export processing zones that offer favourable trade and investment conditions for firms setting up operations in the parks. Various industrial parks are scheduled to open in 2017-19, which will focus on attracting investment in areas such as pharmaceuticals, food and beverages, machinery equipment, textiles and apparels, and logistics services. The Kenyan economy is also growing fairly quickly and the government is pursuing pro-business and investment-targeting policies. Kenya and the five other member states (namely Burundi, Rwanda, South Sudan, Tanzania, and Uganda) of the East African Community (EAC), are attempting to promote local textile, clothing and footwear production and boost formal supply chains. To help achieve this, EAC members are considering tax waivers for locally-based textiles, clothing, and footwear manufacturers, which include a three-year waiver on customs duties and VAT for raw materials and manufacturing equipment not available locally. Also, the EAC may impose a revised common external tariff structure for the import of cotton, textiles, clothing, and footwear. These factors also bode well for supply chains in the region, although faster growth beyond 2017 will be necessary to benefit all countries in the region.

Regional trend against previous quarter. Downward arrow represents reduction in risk.

Commentary

Andrew Coulcher
Group Membership & Knowledge Director
Chartered Institute of Procurement & Supply

Though the score has flatlined, which means that overall risk has improved, there are still a number of hazards lurking in the shadows.

The Index is still at one of its highest levels for a quarter of a century as supply chain professionals navigate the stormy times that global business is experiencing. With continuing pressures such as commodity and currency fluctuations and possible dangers ahead such as the fallout from Brexit negotiations and any resulting tariffs and red tape to slow down global trade, risk may not stay static for long.

Though Brexit is still in progress any further fallout in Europe has stabilised for now, supported by Macron's election in France and his promise of not only reducing the amount of red tape in business transactions but also reforming burdensome labour regulation. France and another four countries were upgraded in the region, buoyed up by the new EU agreement with Japan on free trade, renewing confidence in the continuity of global and European trade.

Some possible unsettling events loom on the horizon with the Austrian and Italian general elections later this year and early next. Anti-EU candidates threaten another derailment in the value of globalisation and a move closer to protectionism and a curb on the free movement of people.

Trade talks and negotiations are still ongoing however, and it's anyone's guess how the dice may fall.

FURTHER INFORMATION

CIPS has developed a knowledge partnership with Dun & Bradstreet to allow CIPS members access to insight and information to help identify and mitigate supply chain risk.

www.cips.org/dunandbradstreet

**Regional trend against previous quarter. Downward arrow represents reduction in risk.*

BODHI GANGULI

Global Leader and Leading Economist
Dun & Bradstreet

Dun & Bradstreet's Global Risk Index score improved for the second straight quarter, and dropped from 81.90 in Q1 2017 to 81.27 in Q2. While the improvement in the CRI is definitely encouraging, the index remains in high risk territory. The Q2 reading is only slightly below the CRI's all-time high of 82.64 in Q4 2016. To put this in perspective, the average CRI score over the last four quarters was 81.85, while the average for the ten years 2006-15, which included the Great Recession, was 62.25.

The reduction in supply chain risk in Q2 was driven mainly by two factors. Global economic growth was decent during the quarter, and growth forecasts for the near term are brighter than they were at this time last year. Secondly, political risk has declined in recent months, particularly in Europe. Nevertheless, potential changes to global trade agreements remain a major risk to cross-border supply chains, as NAFTA renegotiations could start as early as late August, and Brexit continues to unfold. Q2 also saw major instances of cyber risk, a serious and evolving threat that has moved to the top of the operational risks we are monitoring.

FURTHER INFORMATION

Country Heatmap

Use the Country Heatmap to quickly locate the countries which are relevant to your supply base. If they are at a threshold of, or beyond your risk appetite, you can find out more from detailed Dun & Bradstreet country reports.

www.cips.org/risk-index

**Regional trend against previous quarter. Downward arrow represents reduction in risk.*

powered by

dun & bradstreet

CIPS
Chartered Institute of Procurement & Supply

ABOUT CIPS

The Chartered Institute of Procurement & Supply (CIPS) is the world's largest procurement and supply professional organisation. It is the worldwide centre of excellence on purchasing and supply management issues.

CIPS has a global community of 115,000 in 150 different countries, including senior business people, high-ranking civil servants and leading academics. The activities of purchasing and supply chain professionals have a major impact on the profitability and efficiency of all types of organisation and CIPS offers corporate solutions packages to improve business profitability.

ABOUT DUN & BRADSTREET

Dun & Bradstreet grows the most valuable relationships in business. By uncovering truth and meaning from data, we connect customers with the prospects, suppliers, clients and partners that matter most, and have since 1841. Nearly ninety percent of the Fortune 500, and companies of every size around the world, rely on our data, insights and analytics.

Our platform's foundation is the world's largest commercial database, with over 280 million company records we derive from 30,000 data sources, Trade data from more than 1 billion accounts receivable records and update 5 million times per day. We integrate this insight into your core systems, workflows and cloud-based apps in ways that enhance their impact, and we also integrate with your existing data and third-party data sources. Our DUNSRight® process gives us the unmatched ability to turn an enormous stream of data into the high-quality information you need to grow your most valuable relationships.

www.dnb.co.uk/contact

CIPS Group Easton House, Easton on the Hill, Stamford, Lincolnshire, PE9 3NZ, United Kingdom
T +44 (0)1780 756777 F +44 (0)1780 751610 E info@cips.org

CIPS Africa Ground Floor, Building B, 48 Sovereign Drive, Route 21 Corporate Park, Irene X30, Centurion, Pretoria, South Africa
T +27 (0)12 345 6177 F +27 (0)12 345 3309 E southafrica@cips.org

CIPS Asia Pacific 1 Wallich Street, Guoco Tower, Level 14-01, Singapore, 078881
T +65 6403 3940 E infosg@cips.org

CIPS Australasia Level 2, 520 Collins Street, Melbourne, Victoria 3000, Australia
T 1300 765 142/+61 (0)3 9629 6000 F 1300 765 143/+61 (0)3 9620 5488 E info@cipsa.com.au

CIPS MENA Office 1704, The Fairmont Hotel, Sheikh Zayed Road, PO Box 119774, Dubai, United Arab Emirates
T +971 (0)4 311 6505 F +971 (0)4 332 8810 E mena.enquiries@cips.org

www.cips.org