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Sector barometer
Sector risk assessment

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PANORAMA

April 2015

Barometer sector risks in the world

COFACE ECONOMIC PUBLICATIONS

By Coface Group Economists

The changes in our sector assessments reflect the development of the world economy since the end of 2014, marked by the appreciation of the dollar against other currencies, the oil price collapse and gradual recovery in the Eurozone. These trends have had repercussions on most of the sectors we track. So, although the US economy is still robust, we are downgrading our risk assessment for the North American energy sector to medium, because of weakening performance by companies linked to non-conventional oil resources. Conversely, we are upgrading our assessment on European chemicals, which are not only benefiting from falling production costs thanks to cheaper oil and the euro's depreciation against the dollar, but also because of the economic outlook which is improving quarter after quarter. Other sectors are also benefitting from these changes although we have not re-graded them. Costs in the maritime transport sector are also falling due to the lower oil price, but the economic slowdown underway in China is depressing demand. Finally, the automotive sector in Western Europe continues its recovery, symbolised by rising car registrations since April 2014 in Eurozone (+4.2% in February 2015 over one year), although this is not enough to warrant an upgrade.

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APRIL 2015

SECTOR BAROMETER

BY OUR ECONOMISTS

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SECTOR RISK ASSESSMENT			
Sectors	**Emerging Asia**	**North America**	**Western Europe**
Agrofood	Medium risk	Medium risk	Medium risk
Automotives	Low risk	Low risk	High risk
Chemicals	High risk	Low risk	Medium risk
Construction	High risk	Medium risk	High risk
Electronics, IT *	Medium risk	Medium risk	High risk
Energy	Medium risk	Medium risk	Medium risk
Engineering	High risk	Medium risk	Medium risk
Metals	Very high risk	High risk	High risk
Paper-Wood	Medium risk	Medium risk	High risk
Pharmaceuticals	Low risk	Medium risk	High risk
Retail	Low risk	Low risk	Medium risk
Services	Low risk	Medium risk	Medium risk
Textile-clothing	Medium risk	Low risk	Medium risk
Transportation	Medium risk	Low risk	Medium risk

Sources : Datastream, Coface

Low risk · Medium risk · High risk · Very high risk

* Electronics, information technology and telecoms

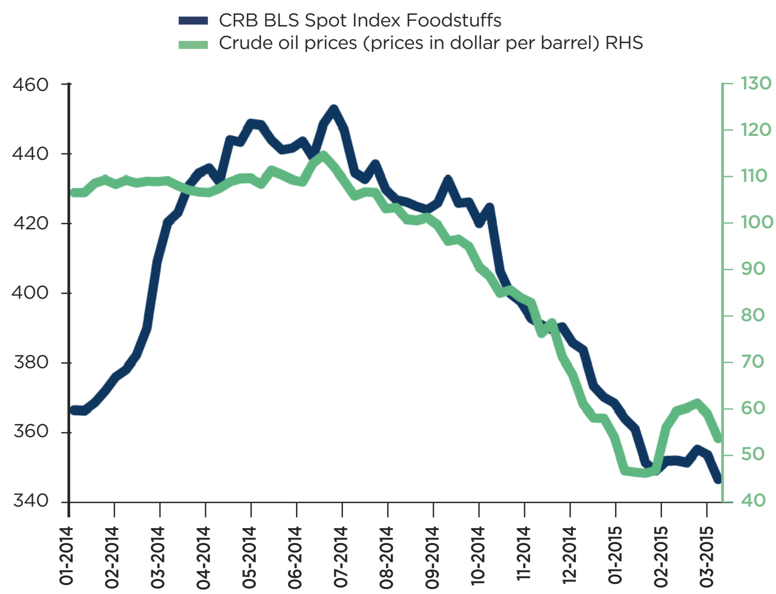
1 AGROFOOD

The fall in energy prices have a positive effect on the sector as a whole. In 2015 the FAO [1] Food Prices Index fell in February 2015 to its lowest level since July 2010 (-1.9% compared to January 2015, and -14% compared to February 2014). Harvests in the Northern hemisphere, particularly in the European Union and the United States, were especially favourable and foodstuffs are in good supply. This has led to a fall in the price of cereals, meat and sugar in February 2015. In contrast, the price of oil remained stable and that of dairy products rallied strongly.

Emerging Asia
Turnover for businesses in the agrofood sector in emerging Asia increased again in 2014 (+7% year on year). The sector still benefits from demographic dynamic and private enrichment. India announced the introduction of an export subsidy to boost its sugar exports, contributing at the same time to the fall in world prices. Moreover, there are quality issues with this maize production in China, the world's second largest producer, because of insufficient storage space. The fall in soybean prices is good for China, which is the world's largest soybean consumer and for which demand has been stimulated by the strong growth of aquaculture farms, which represents 62% of world capacity (88% for Asia as a whole, FAO).

The risk remains medium

Food Price Index and crude oil prices variations



Sources : Commodity Research Bureau, U.S. Department of Agriculture

North America
If activity remained sluggish in 2014 (+1% year on year), growth prospects are favourable boosted by household consumption, in turn supported by a fall in unemployment and in the oil price. The United States are the first producer of maize in the world and its production should increase by +3.5% in 2015 (EIU). Demand is supported by ethanol production which represents about 35% of volume produced and 10% of the total US combustible fuel market. Although, the lower maize prices enabled industrial firms to increase their margins, the fall in oil prices should reduce interest for this biofuel. Furthermore, in December 2014, China reconsidered its position regarding American genetically modified maize, of which over one million tonnes were rejected in recent years, so exports can be expected to increase. Finally, forecasts for soybean production growth have remained at a record +18%, thanks, in particular, to Chinese market consumption.

The risk remains medium

Western Europe
The agrofood sector is made up of a few large multinationals but mostly of small firms exposed to contracting margins associated with falling commodity prices. Indeed, the fall in food price (-0.3% in Eurozone in February 2015 over one year) related to the sluggish European demand has particularly affected small producers. Nonetheless, the corresponding drop in the oil price (about -50% between June 2014 and March 2015) helped reduce the cost burden on firms due to price moderation of fertilizers and freight cost. Moreover, the euro depreciation against the dollar benefits exporting companies (-20% approximately since June 2014). In the European Union since 1984, milk quotas have led producers to limit their output to avoid penalties in the case of overrun. But, the market liberalization related to the removal of the milk quota system for the 1st April 2015 should deeply affect the sector. A price decrease is therefore expected in Europe. Furthermore, while in France, fruit and vegetable prices fell respectively by 5.4% and 3.5% in 2014, less favourable weather conditions at the end of the year pushed up the prices of fresh vegetables by 9.1% in February 2015 (year on year).

The risk remains medium

(1) The FAO Food Price Index is a measure of the monthly change in international prices of a basket of food commodities

2 CHEMICALS

One of the sectors gaining most from the fall in oil prices is the chemicals sector. This is because this commodity is both one of its inputs and also provides it with energy. The outlook is improving especially in Western Europe, although the sector remains weakened by the situation in construction where risk remains high. In emerging Asia, we do not see any improvement. Our survey into payment deadlines in China [2] shows that the financial situation of Chinese companies is difficult. In North America, the appreciation of the dollar against other currencies is making American products more expensive. The low oil price is giving European chemical companies a leg up, although US companies still have an undeniable advantage because of the abundance of non-conventional hydrocarbons and robust activity.

Emerging Asia

Our China payment survey published in March 2014 revealed that activity in the chemicals sector deteriorated in 2014. Accordingly, almost a third of companies surveyed in the sector had experienced average payment periods exceeding 90 days. This average was 23% in 2013 and 17% in 2012. The sector is still suffering from the poor state of the real estate and construction sector, one of its main clients. The fall in prices offers only a little bit of good news undermining the value of inventories and eating into margins. But above all, coal occupies a key position in China's energy mix, making the supply from competitors more competitive.

The sector remains high risk

North America

The relatively better health of the European manufacturers is affecting those of the North America. Moreover, the dollar's appreciation is making US exports more expensive and limiting their competitiveness. Nonetheless, the robustness of the automotive sector and a dynamic construction sector are helping sustain activity in the sector. Accordingly, the American Chemistry Council (ACC) activity barometer was up by +3% at 15 March 2015 compared with the same date in 2014.

The sector remains low risk

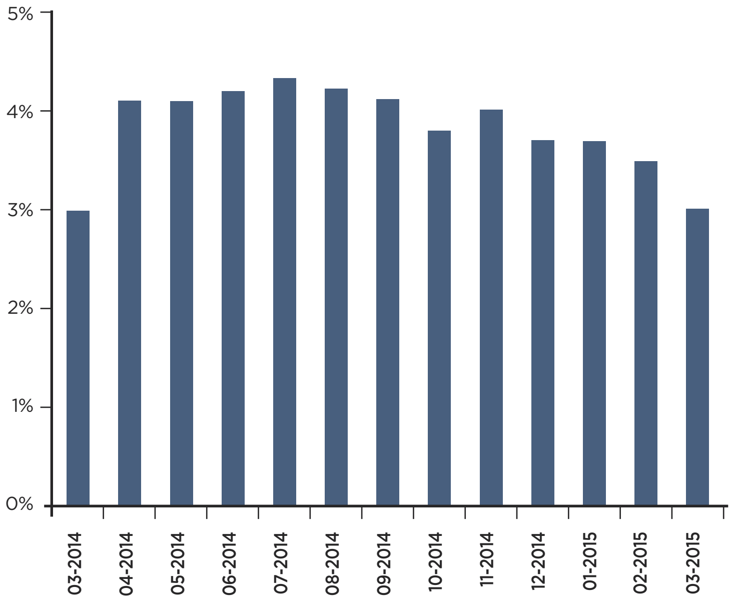
Western Europe

The chemical industry has made quite a comeback: sluggish economic activity, high crude prices, competition from the Middle East and the United States. The European Chemical Industry council (CEFIC) activity indicator points to a rise of only +0.3% in 2014, compared with 2013. The sub-sectors contributing most are the speciality chemicals segment and the consumer products segment. The price of crude, which has halved since summer 2014, has nonetheless enabled them to narrow the competitiveness gap with US firms and restore their margins (after the depreciation of inventory values). Finally, the euro's depreciation has breathed new life into European chemicals exports, reducing slightly further the competitive advantage of their main rivals.

The situation in France has improved significantly, with a 1.9% rise in sales in 2014 according to UIC *(Union des industries chimiques)*, whether due to exports or to the positive contribution of the domestic market.

In view of these positive signals, which are likely to persist in the quarters to come, we are upgrading the sector to medium risk

Annual changes in the chemical sector activity (ACC) in the United States



Source : American Chemistry Council

(2) Panorama Rocky Tung, Coface, "China payment survey", March 2015

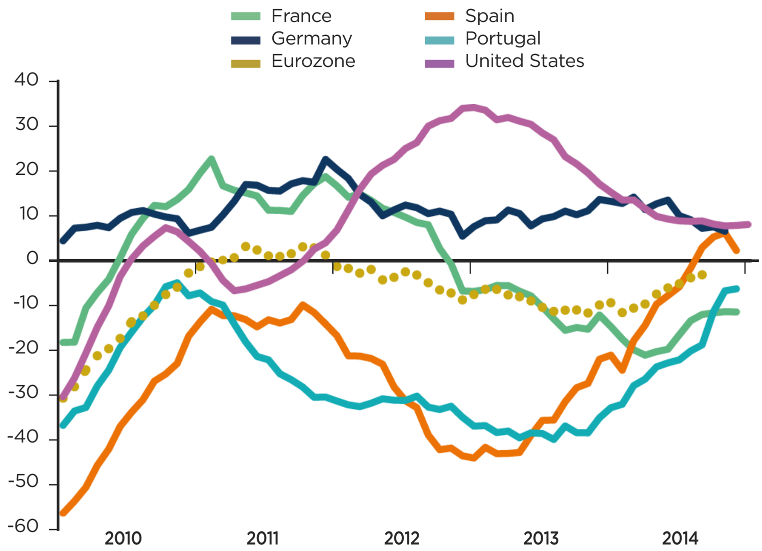
3 CONSTRUCTION

Our assessment of sector risk remains mixed for the different regions studied. In Western Europe, there are signs of improvement after a long period of stagnation, especially in Southern Europe. Nonetheless, structural constraints continue to weigh on construction, mainly in the form of still high unemployment rates and household debt levels. In emerging Asia, negative signals coming out of China persist. Finally, in North America the healthy state of the economy and its dynamism are benefitting the sector for which our assessment remains the most optimistic.

Emerging Asia
In this region, the sector remains highly focused on China's residential property market. In a context of tighter shadow banking supervision, investment in property has fallen significantly, dropping from a growth rate in excess of +20% over the past decade to +10% in 2014 [3]. Sales of new houses fell by -17.8% in volume terms year on year during the first two months of 2015. Prices in 66 of the 70 cities surveyed declined in February 2015. This is evidence of the reactivity of promoters forced to drop their prices in order to dispose of their inventories. The Chinese research centre, the CRIC (Chinese Real Estate Information Corp), also reveals that only two cities out of the 23 tracked managed to cut their inventories in December 2014.

The risk remains high

Building permits, annual variations



Source : National statistics institutes

North America
The sector has remained very buoyant since the end of 2011. Building permits continued to grow at an annual rate of +7.4% at the end of January 2015. Note that the drop in unemployment (5.5% in February 2015) and in inflation (+0.2% in February 2015 compared with February 2014) is enabling a rise in real wages. Construction remains sustained by the financial sector. Mortgage loans remain dynamic (+3.9% at end February 2015, year on year, Fed) and non-performing loans moderate (2.3% of total loans in 2014, IMF). At the same time, the tightening of US monetary policy expected by Coface in the third quarter of 2015, will make property loans more expensive, which could hamper the entire sector.

The risk remains medium

Western Europe
The construction sector seems to have bottomed out in Western Europe. The number of building permits has risen in Spain since September 2014 (year on year). On the other hand, the German market has stabilised and the falls are less marked in Portugal, in France and in the whole of the Eurozone (-3% at end October 2014). This is because the lower borrowing rates are benefiting the sector by reinvigorating demand. However, the region's high unemployment, whether in France (10.4% at end February 2015, according to Insee), Spain (23.4%) or Italy (12.6%), as well as a moderate property price correction in the past, are depressing the sector. This context makes it particularly hard for first-time buyers, as the young economically active population is particularly affected by unemployment, with jobseekers' rates at 22.9% for the under 25 in the Eurozone, compared with 11.2% for the whole population at end January 2015. Finally, against a background of public spending cuts, public works enterprises could see a reduction in their business volumes. This is especially true for France, which despite the two-year extension for bringing its public deficit down to 3% of GDP, is expected to make substantial budget cuts.

The risk remains high

(3) See Panorama R.Tung, Coface, "China: carrot and stick", September 2014

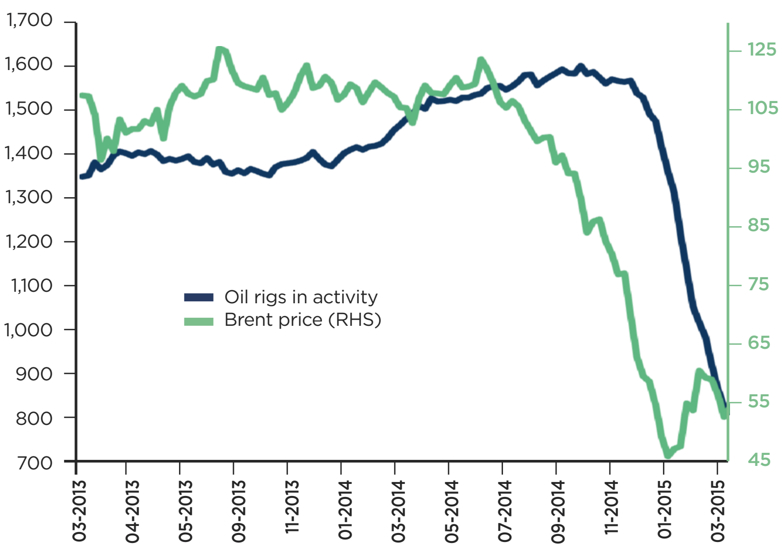
4 ENERGY

Crude oil prices have halved since summer 2014, throwing the oil industry into turmoil. Demand is hardly growing, especially in China where the economy is in a phase of slowdown. On the supply side, the glut of shale oil is likewise affecting prices. Both these trends increase the credit risk for energy sector companies. Nevertheless, this increased risk is not homogenous depending on whether the company is operating upstream or downstream. Geographically, nearly all regions are affected as the crude price determines the margins not only of producers, but also of operators. Accordingly, the major companies have seen profitability fall and are passing the shocks onto their relations with their contractors. The latter have themselves also been affected because they have been hit by cuts in investment by the major companies struggling to obtain returns on their investment.

Emerging Asia
In general, lower oil prices will benefit the emerging Asia particularly China, second largest importer, which is increasing its stocks. Nonetheless, effects on the main oil Asian producers, Malaysia and Indonesia, should be minimized by the low weight of the sector in the economy. It represents 13% and 8% of exports of goods.

The risk remains medium

Number of oil drillings in operation and Brent prices (dollars)



Sources : ICIS Pricing, Baker Hughes Oil Rigs

North America
Shale oil production continues to grow in North America. Between June 2014 and March 2015, crude output in the United States increased by +50%, while prices halved and demand was unable to keep up with the surplus supply. At Cushing in the United States, the biggest facilities are reaching saturation levels (77% at the end of March 2015 according to the International Energy Agency, IEA). Extraction costs for these non-conventional oils are high, varying between $50 and $70 per barrel. As a result, investment expenditure is in decline, affecting the oil industry contractors. Decisions have been taken regarding layoffs and mergers/takeovers in order to release synergies as a means of cutting costs. Moreover, the number of non-conventional oil wells fell by 50% between October 2014 and March 2015.

In the light of this weakness, we have decided to downgrade our assessment of this sector to medium risk

Western Europe
A barrel of Brent was trading at $56 on 27 March 2015, i.e. at 50% below its peak of $114 per barrel in mid-June 2014. The key players in the sector were hit badly and the smaller oil companies are particularly at risk as they do not have sufficient financial strength. The contractors, for their part, have been hit by the sector's economic difficulties in North America. But their geographic exposure allows them to limit risks at this stage. However, an extended period of weak margins in a capital intensive industry increases credit risk. With regard to the refineries, the fall in price is a boon, enabling them to boost margins (€28/t in the second half of 2014, compared with 15 in the first half). Once the inventory depreciations have been digested, margins automatically trend higher if prices remain low and demand holds up.

The risk remains medium

5 METALS

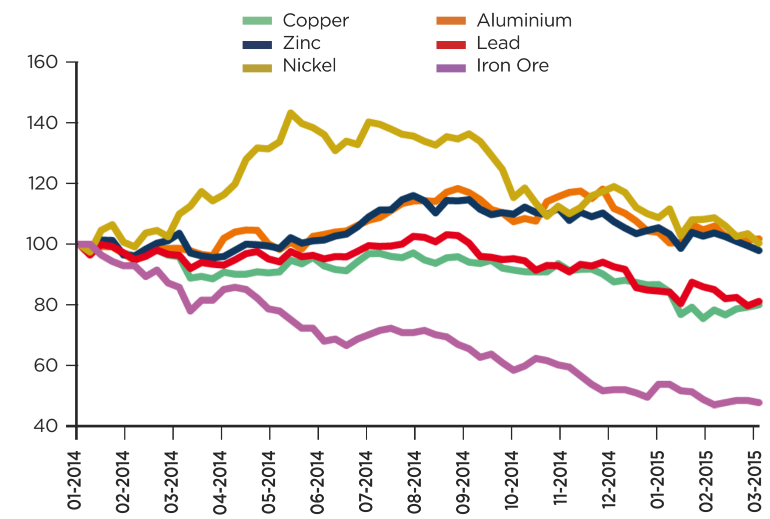
The world economic recovery is still hesitant, even if, according to Coface, it is expected to accelerate in 2015 to reach +3.0% compared with +2.8% in 2014. Against this background of sluggish demand, the main metals have therefore undergone a moderation in their prices and the trend remains bearish overall for 2014-15. This is because the reactivation of capacities put on standby and the clearing of inventories built up in previous years is prompting caution on this sector. World steel production increased slightly in 2014 by +1.1% after climbing +5.8% in 2013 *(World Steel Association)*. China is responsible for most of the supply and demand for steel (49.8% in 2014) and for most of the other metals (copper, aluminium, zinc, lead). The recent negative signals associated with overinvestment in property and weakening growth in its industrial output have considerably depressed metal prices.

Emerging Asia

China continues to drive demand in the region and even in the world. Admittedly, this demand remains vigorous but is growing at a slower pace than in previous years while at the same time Chinese output capacity has increased strongly. This context increases the downward pressure on iron ore prices. In contrast, the growth in car ownership (+6.9% in 2014 after rising +14.2% in 2013) is benefitting the lead segment, also sustained by the manufacture of electric bikes, for which China has acquired over 90% market share *(Electric Bikes Worldwide Report)*. Indonesia, the world's leading producer of raw nickel has chosen, since January 2014, to restrict its exports and encourage smelting in the country in order to boost its own economic returns, thus triggering a surge in prices. Demand has turned to other suppliers, notably the Philippines. Finally, in 2015 quotas for the export of rare earths were scrapped by China (87% of world production in 2014) after the quotas imposed since 2009 were challenged by the WTO in March 2014.

The risk remains very high

Movements in metal prices, base 100 = 2014



Source : LME

North America

Steel output rose slightly in 2014 by +1.7% *(World Steel Association)*. It remains sustained by the healthy state of vehicle sales which reached 16.4 million units in 2014, i.e. an increase of 5.7% compared with 2013 (BEA, cars, pickups and light trucks). The use of aluminium for the chassis and bodies rose significantly in 2014 to +6.5% (3rd world consumer). But production is also sustained by the property sector which has continued to grow since the end of 2011 (+9.2% year on year to end January 2015, new residential apartments), which is also driving demand for zinc and nickel. However, utilisation capacities for metals reached 75% in February 2015, below the pre-crisis levels (79.5% between 2005 and 2007), highlighting the existence of overcapacity.

The risk remains high

Western Europe

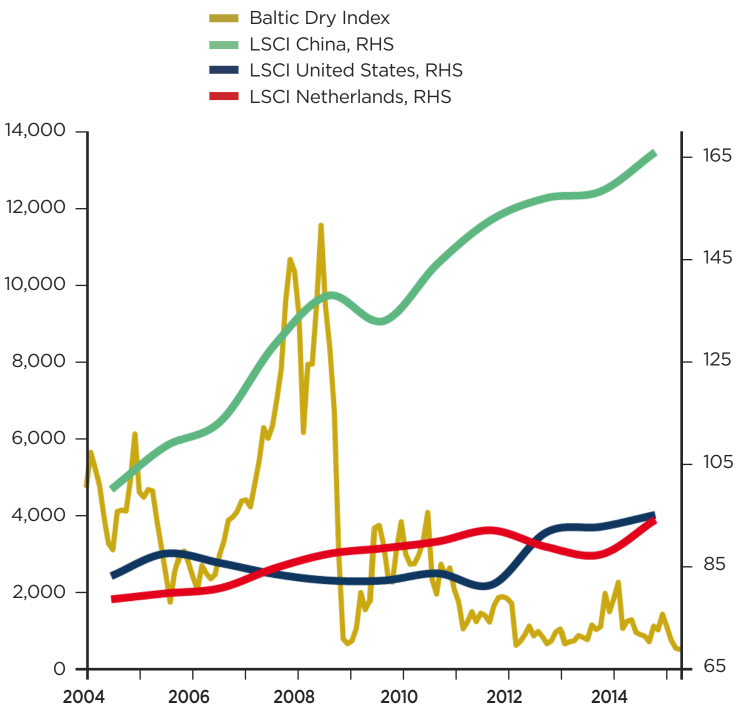
European steel production rose by +1.8% in 2014 after falling by -1.5% in 2013, but is still 15% below its pre-crisis level (2004 to 2006, Eurofer). The nickel segment has profited slightly from these dynamics. Note the growing share of imports, up by 14% in 2014 (Eurofer), in particular from Ukraine, Turkey and China, to the detriment of European output. The more robust property market and above all the recovery of the automotive sector in Europe have sustained demand, with notably a +5.7% increase in registrations in 2014 (EU 27, ACEA), the first rise 2007. In this context, demand for lead, of which 80% is used in the manufacture of batteries, is expected to remain stable, which abundant production at world level has put pressure on the price for this mineral since the end of 2014. At the same time aluminium substitution remained very dynamic in 2014 at world level (+3.5%, EIU), which affected demand for zinc (-2.4% in 2014, ILZSG and EIU). Finally, copper production (1/3 used by the property market) rose strongly in 2014 but also shows an increased tendency to build up stocks after a long period of sluggish demand in Europe.

The risk remains high

6 TRANSPORTATION

Developments in maritime traffic, a means of transport which ships 80% of world trade by volume according to UNCTAD (4), reflect the world economic cycle. After the decline recorded after the 2009 crisis, demand for international maritime traffic started to recover from 2010. In March 2015, the *Baltic Dry Index* (5), which measures rates for dry bulk shipping, fell to its lowest level since it was created thirty years ago. This fall is due, in particular, to the Chinese economic slowdown and to China's greater focus on domestic demand. At the same time, there is overcapacity regarding tonnage supply. Prices have contracted sharply due to the large number of vessels in circulation. Finally the increasing size of the vessels and the building of alliances between ship-owners are strengthening cost optimisation strategies.

Changes in the Baltic Dry Index and the Liner Shipping Connectivity Index



Sources : UNCTAD, Baltic Exchange

Emerging Asia

Activity levels across the entire transport sector rose by 4% year on year in 2014 compared with 2013. With regard to maritime transport, China (excluding Hong-Kong) had by far the highest LSCI (7) in 2014 (165.05), placing the country as world leader. The index grew by 4.8% between 2013 and 2014. The world's top four container ports in 2013 include three Chinese ports namely Shanghai (1st with 33.6 million TEU (6)), Singapore (2nd with 32.24 million TEU), Shenzhen (3rd with 23.2 million TEU) and Hong Kong (4th with 22.35 million TEU). Behind China, Malaysia and Vietnam saw a rise in their LSCI of respectively +5.9% and +6.5% between 2013 and 2014. Furthermore, this dynamic benefits to the Chinese shipbuilding sector which accounts for 45% of world orders in 2014 (September 2014, Clarksons Plc) but also to the India ship breaking sector which captured one third of the world market.

The risk remains medium

North America

In North America, activity in the transport sector grew by 11% year on year in 2014 compared with 2013 with an average debt to equity ratio down by 2%. The LSCI maritime transport index rose by an average of 4.8% for the region. Moreover, US transporters benefited from the recovery in world airfreight traffic since April 2014 to reach +6.8% in 2014.

The risk remains low

Western Europe

The general activity level (8) for companies in the transport sector declined sharply (-9% year on year between 2013 and 2014). At the same time, costs for these companies fell by 10%, helping to limit the negative impact of the contraction in activity. These cost reductions are, in particular, linked to the sharp fall in the oil price since June 2014. With regard to maritime freight transport in Western Europe, the Netherlands had the highest LSCI in 2014 (94.15) followed closely by Germany (93.98) and the United Kingdom (87.95). The growth of this Index (+4.7% on average for these three countries between 2013 and 2014) proves that the Eurozone recovery is benefitting the transport sector.

(4) UNCTAD: United Nations Conference on Trade and Development
(5) The index is based on the average price charged on twenty-four world trade routes and includes, in particular, ores, coal, metals and grain
(6) TEU = Twenty-foot equivalent unit (about six meters): unit for measuring containers.
(7) UNCTAD's Liner Shipping Connectivity Index (LSCI), captures how well countries are connected to regular global shipping networks according to several criteria (number of companies, size of vessel used, capacity of vessels, local transport services ...). This index illustrates a country's degree of access to external markets (through its maritime services network)
(8) Figures for all transport sector companies (land, air and road)

European companies dominate container transport market, respectively occupying the top three positions in the world: the Danish operator Maersk with turnover of $47.57 billion (compared with $47.39 billion in 2013), the Swiss operator MSC and the French operator CMA-CGM with turnover of $16.7 billion in 2014 (+5% compared with 2013). Moreover, in order to cost optimisation and search for synergies, two alliances are being formed at the end of 2014. On the one hand, the Ocean three which gathers the Chinese CSCL (7th worldwide), the Kuwaiti UASC (18th worldwide) and the French CMA-CGM (3rd worldwide). On the other hand, the V2 between le Danish Maersk Line (1st worldwide) and the Swiss MSC (2nd worldwide). Moreover, the European Commission extended the special competition regime for liner shipping consortia [9] until 2020.

The risk remains medium

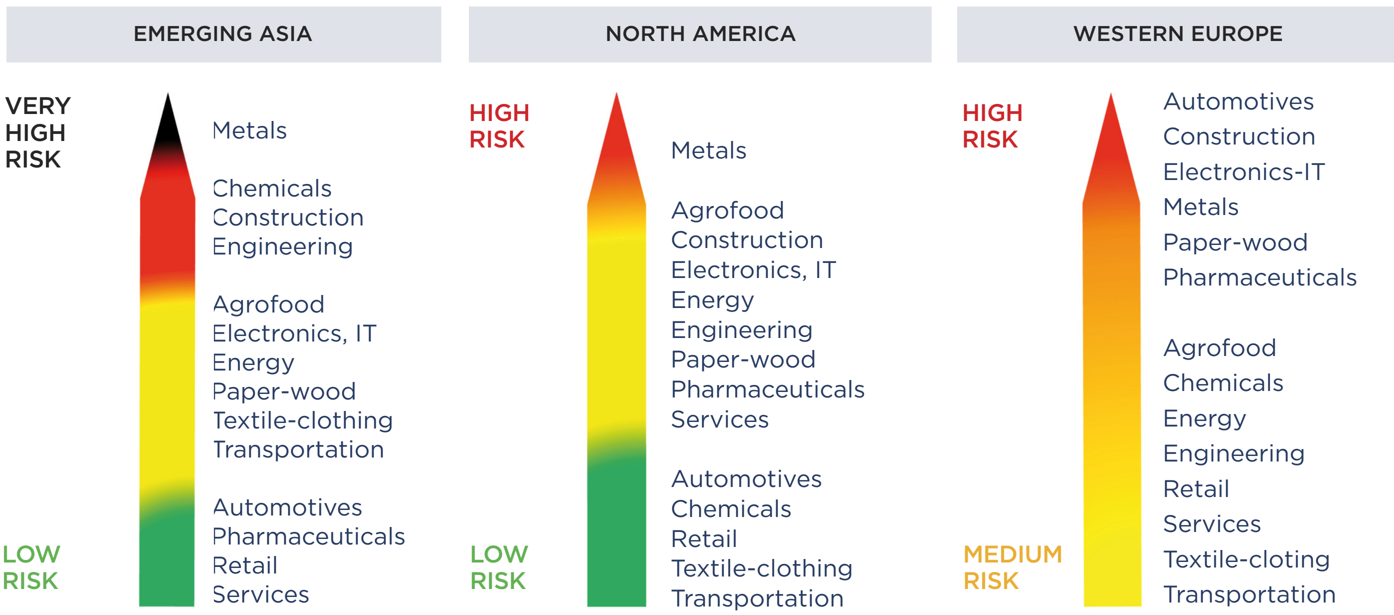
Sectorial risk assessment methodology

Coface's assessments are based on the financial data published by over 6,000 listed companies in three major geographic regions: Emerging Asia, North America and the European Union 15.

Our statistical credit risk indicator simultaneously summarises changes in four financial indicators: turnover, profitability, net indebtedness, and cash flow, completed by the claims recorded through our network.

Sectorial risk assessment

Hierarchy sectors



(9) Consortia: since 1995, ship-owning companies operating regular container transport enjoy an exception to Community competition rules allowing them to enter into co-operation agreements to jointly operate "a maritime transport service which improves the service that would be offered individually in the absence of a consortium". This exemption explicitly excludes tariff agreements.

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