
Natural Resources Forum November 2016

Rolling Stones: Moss or Momentum?



The Oxford Analytica Daily Brief®

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Trump win will test US allies and institutions

Wednesday, November 9 2016

Republican presidential candidate Donald Trump defeated Democrat rival Hillary Clinton in the Electoral College, it was announced today, defying her polling lead and nearly all predictive models. With Republicans retaining their House and Senate majorities too, Trump is in a position to take unilateral action via his powers as chief executive, battle with Republican leaders and the Democratic minority to set the legislative agenda, challenge his political adversaries for leadership of the party, and define Washington's global role for the next four years as commander-in-chief. However, investors, foreign capitals, corporates and the US public uncertainly await further clarification of the unorthodox candidate's policy programme after discounting his electoral viability and campaign promises.



U.S. President-elect Donald Trump speaks at his election night rally in New York (Reuters/Carlo Allegri)

What next

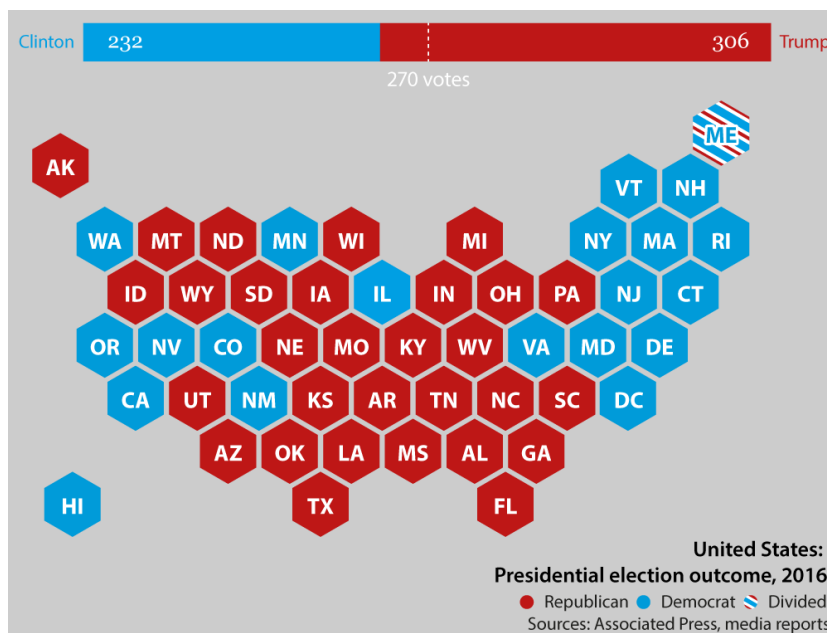
The significant shock to confidence -- both that of investors and US security partners -- is likely to persist at least until Trump takes office in January. Politically, Trump is likely to begin his term with policy changes where he can either act unilaterally under executive authority or enjoy support from congressional Republicans, such as blocking proposed trade deals (instead of unravelling enacted arrangements), cuts to non-defence expenditure, stricter immigration policy and withdrawing US climate commitments.

Analysis

Softer turnout by Democratic-leaning constituencies and a significant uptick in rural white voters without a college education for the Republicans meant that the favourable pre-election polling for Clinton -- combined with assumptions of voter behaviour based on the small data set of previous elections -- did not reflect the actual makeup of the 2016 electorate (see US/INT: Trump highlights election predictive pitfalls - June 21, 2016).

Impact

- Senate Democrats under probable Minority Leader Chuck Schumer are likely to adopt a confrontational stance against the White House.
- Election-related market volatility may further postpone US interest rate rises into next year.
- Further US disengagement from the Syrian civil war is likely, to the benefit of President Bashar al-Assad.
- Puerto Rico Governor-elect Ricky Rossello is unlikely to find allies in Washington for his pro-statehood agenda.



Policy impact

Trump waged an 'insider-outsider' campaign devoted to challenging the political status quo, rallying voters around animus for Clinton, and defying political conventions rather than engaging in discrete policy debates.

Significant uncertainty surrounds Trump's intentions and ability to enact his broad domestic priorities due to several factors, including:

- the willingness and ability of the legislative and judicial branches to defy Trump's more controversial proposals;
- the likely Trump team's relative inexperience in government;
- Trump's fraught relationship with the more moderate and pro-business wing of congressional Republicans, such as Speaker of the House Paul Ryan (see UNITED STATES: Speaker Ryan will not unify Congress - November 2, 2015); and
- the relative lack of policy detail required on the campaign trail compared to making discrete decisions once in office.

Public statements during the transition period and the staffing of key policy positions will be early indicators of Trump's willingness to cooperate with mainstream Republicans.

It is likely that the Trump administration, through legislation and executive action, will oversee reversals of a significant part of his predecessor President Barack Obama's legacy, including:

- the Affordable Care Act ('Obamacare');
- the Clean Power Plan (see UNITED STATES: Prices and policy squeeze coal sector - January 26, 2016);
- ratification of the (COP21) Paris Agreement;
- US rejection of the Keystone XL pipeline;
- US sanctions relief supporting the Iran nuclear deal (see IRAN: Risks to nuclear deal are rising - June 15, 2016); and
- the Consumer Financial Protection Bureau (CFPB) (see UNITED STATES: Low-growth economy will shape politics - October 11, 2016).

Trump's plans for an expansive programme of infrastructure spending, financed by private investment and public borrowing, face a more fraught legislative path with deficit-sceptical congressional Republicans. A more modest programme, financed by cuts to other areas of public expenditure, is a more likely prospect (see UNITED STATES: Infrastructure boom is unlikely - October 28, 2016).

Trade pacts

A Trump administration also means that the Trans-Pacific Partnership (TPP) and Trans-Atlantic Trade and Investment Partnership (TTIP) will probably be blocked by Washington.

Trump is likely to reverse most
of Obama's policy legacy upon
taking office

Trump may threaten swift US withdrawal from the North American Free Trade Agreement (NAFTA). However, the tight integration of the Canadian and Mexican economies with that of the United States and the substantial disruption caused by a unilateral withdrawal means that strong pressure from Washington to renegotiate the pact is likely to be an opening manoeuvre. There is, though, a notable chance of a US withdrawal should talks bog down (see [MEXICO: Weak peso may yet bring trade boost - November 8, 2016](#)).

Trump may push for
renegotiation of NAFTA before
actively threatening
withdrawal

Immigration

Given the central role of immigration in Trump's campaign, it is likely that federal enforcement actions against undocumented immigrants will increase, though a full-scale mass deportation policy would prove highly contentious, face legal challenges and cause economic disruption.

Trump may choose to imbue more gradual measures -- such as increased border security funding, greater restrictions on asylum seekers, and expedited deportation processes -- with symbolic significance as 'tackling' his immigration pledges while promising further action in the future should he run into preliminary resistance (see [MEXICO-US: Wall will divide, whether built or not - September 6, 2016](#)).

Supreme Court

Impending Republican control of the White House also means that the Senate will continue its block on Obama's Supreme Court nominee. Once in office, and with a continued Republican majority in the Senate, Trump will be in the position to set the Court's balance with conservative justices for some time.

Foreign policy

Trump's victory will see US allies seek quick reassurance of Washington's commitments to its security arrangements, international law and participation in multilateral institutions; none of these are likely to be forthcoming from an inward-looking Trump administration (see [INTERNATIONAL: US foreign policy uncertainty abounds - November 9, 2016](#)).

Moscow, in particular, is likely to see opportunities to 'reset' relations with the United States but will exploit Trump's perceived naivete to pressure NATO and Europe and gain ground in Syria (see [RUSSIA: Moscow will exploit Trump's softer line - November 9, 2016](#)). In Beijing, the uncertainty and instability that a Trump victory may bring to regional affairs offsets, for now, at least, any perceived weakening of Washington's international prestige (see [CHINA: Trump victory brings more risks than benefits - November 9, 2016](#)).

Some bilateral relationships may improve as a result of muted US criticism as part of a hands-off Trump foreign policy, particularly with non-democratic US allies, but many traditional US security partners in East Asia and in NATO will probably pursue greater defence expenditure and deepen ties with like-minded neighbours (see [UNITED STATES: Allies will seek reassurance - October 21, 2016](#)).

Party-political impact

Trump's unanticipated win will throw the Democrats into disarray and force introspection by mainstream Republicans as they prepare for a Trump presidency.

Democrats

Clinton's loss and Republican congressional majorities leave the Democratic Party without a high-profile leader possessing a national electoral mandate to rally around in anticipation of future contests.

After winning the Democratic nomination in part due to her ostensible electability, Clinton's loss will embolden the progressive wing of the party to take a harder line on key issues, particularly:

- climate and energy policy;
- financial regulation; and
- opposition to trade liberalisation (see UNITED STATES: Sanders will make exit cost Clinton - May 9, 2016).

When combined with an unfavourable slate of states for Democrats to defend in the Senate races of the 2018 midterms, internal divisions are likely to take priority on the left until stronger national candidates emerge from statehouses and Congress.

Republicans

Ryan, who maintained an arms-length relationship with the Republican candidate through Election Day, is likely to find his speakership -- and calls for a more moderate brand of conservatism -- severely undermined within the party. He could face a leadership challenge tacitly or explicitly backed by Trump (see UNITED STATES: Republicans face splits beyond Trump - March 17, 2016).

Trump-sceptical national security hawks and pro-business conservatives will seek to boost more mainstream advisers into White House circles and push Trump to adopt orthodox policy positions.

However, given Trump's antagonistic relationship with the party elite, calculations of political expedience will guide his interactions with this group, particularly on areas of lesser importance to Trump's platform, such as fiscal policy, where differences of opinion on entitlement reform can be smoothed over by mutual agreement on tax cuts, deregulation and reductions in non-defence spending.

Unrest may undermine East Africa's growth potential

Friday, November 11 2016

Slowing economic growth has muted the 'Africa rising' paradigm. The combined slowdown in the continent's oil economies, discovery of vast natural resources in eastern Africa, and better integration of East African economies has instead led to talk of 'Africa tilting' or other related metaphors of eastern countries' ascendancy. Like its predecessor, this concept needs to be carefully unpacked.



A general view of Nairobi, Kenya
(Reuters/Noor Khamis)

What next

The notion that the continent is tilting in favour of the newly resource-rich East Africa could be undermined by three major weaknesses: a failure to examine the empirical evidence, an inclination to overlook the influence of political factors on the economy and a tendency to assume that contemporary trends that have ambiguous implications will work to improve economic growth. While exploitation of new oil and gas reserves will mean that a greater share of African GDP will be produced in East Africa, this may be accompanied by rising regional instability and inconsistent economic growth.

Analysis

The 'Africa rising' paradigm was a catchy summary of the optimism surrounding economic growth. Yet like most catch phrases, it suffered from deficiencies and ultimately proved to be an unreliable guide.

Most obviously, the notion that the continent was on the rise ignored the fact that many countries were politically unstable. It also neglected that economies were unlikely to experience significant economic growth due to conflict and lack of ports or trade infrastructure networks, most notably with China.

The most fervent advocates of 'Africa rising' failed to disaggregate the continent's economic growth to understand how much of it was due to policy reforms resting on solid economic foundations versus growth driven by Chinese demand for African exports.

At the same time, trends that had ambiguous implications were typically interpreted to be wholly positive: for example, framing the continent's youth bulge and growing population as a great boon (see AFRICA: Youth unemployment will drive migration - October 17, 2016).

The rival (and in some ways more realistic) interpretation that the youth bulge would lead to greater unemployment and hence frustration in younger citizens, increasing the risk of political instability, and that population growth would stretch public services to breaking point, was rarely considered.

Africa tilting

The 'Africa tilting' paradigm rests on equally shaky foundations.

The idea is premised on the notion that while African growth previously relied on oil economies in West Africa and the resource-rich states of Southern Africa, the next decade will belong to the fast-growing economies of East Africa. There are three main pieces of evidence that are typically invoked in support of this argument:

Resources

Impact

- The youth bulge in sub-Saharan Africa will not guarantee a growth in per capita GDP.
- Political unrest and deepening violence could damage regional prospects.
- Conflicts in the region will continue and could undermine confidence, especially if they develop a more regional character.

Recent gas and oil finds could transform East African countries into the continent's most dynamic economies. Modest but significant holdings of oil are currently being exploited in Kenya and Uganda, while Mozambique and Tanzania are set to benefit from some of the largest gas reserves. South Sudan inherited considerable oil reserves at independence.

Infrastructure

The commitment of many East African states to creating stronger regional infrastructure through the construction of major multi-country networks of roads, railways and pipelines, such as the Lamu Port-South Sudan-Ethiopia Transport Corridor Project (LAPSSET), will reduce the cost of exports and promote integration (see KENYA: Slow start for Lamu port sets pace for LAPSSET - March 17, 2015).

Trade

Greater infrastructure and the expansion of customs unions will foster regional trade, creating new markets and jobs. The inaugural Africa Regional Integration Index Report rated the East African Community (EAC) as the best performing on the continent.

Reality check

While it is clear that the overall value of East African economies is set to rise, it is overly simplistic and optimistic to suggest that economic and political power on the continent will 'tilt' in this direction.

Moreover, to suggest that the region resembles South Korea in 1960 is misleading.

Economic health

Of the seven countries comprising East Africa or mentioned in 'Africa tilting' coverage, only Ethiopia and Rwanda are experiencing particularly strong economic growth of over 8%, in part because they start from a low base. Significantly, two of the region's two largest economies -- Kenya and Tanzania -- have tended to lag behind, with growth of between 5-7%.

While the growth in trade within the EAC has been impressive in the regional context, it is important not to overlook the barriers to further integration.

Despite the ambition of a free trade area, each country continues to employ a number of exemptions on goods of particular importance to the domestic economy. Plans for a currency and political union are likely to be frustrated by simmering political tensions between Kenya and Tanzania (see TANZANIA/KENYA: Economic goals will deepen divides - September 19, 2016).

Similarly, some of the most important infrastructure projects, such as LAPSSET, have stalled due to a lack of funding and political disagreements about how they should be conducted. Most recently, Uganda decided to pursue an oil pipeline through Tanzania, disappointing Kenyan hopes that it would choose to join the LAPSSET initiative (see EAST AFRICA: Pipeline may split region into blocs - May 5, 2016).

Resources

High-value natural resources increase the value of a country's currency, rendering other exports uncompetitive (Dutch disease) if unaddressed. As a result, commodity wealth has undermined efforts to diversify economies in countries such as Nigeria and Zambia.

East African economies will
grow, but political power may
not tilt to the east

While the relatively modest value of the deposits found in Kenya and Uganda may shield them from the worst effects, this will likely prove a significant challenge for Mozambique and Tanzania.

Assessments of the impact of oil and gas also need to consider the political implications of natural resource wealth. To date, Botswana and Ghana are the only African countries in which the exploitation of oil and diamonds has not gone hand-in-hand with democratic backsliding.

Further, none of the continent's major oil exporters (possibly excluding Nigeria) is a democracy; most are highly corrupt authoritarian regimes. One possible reason is that oil insulates governments from domestic and international pressure, allowing them to resist much-needed reform.

The form that management of new resource wealth takes will prove critical to the quality of government and the political environment in Kenya, Tanzania and Uganda, as well as the prospects for long-term growth.

Conflict

Currently, three countries in East Africa -- Burundi, Somalia and South Sudan -- are in a state of either civil war or chronic instability. Ethiopia has just announced a state of emergency due to opposition protests while Mozambique has recently witnessed the re-emergence of the main opposition party, RENAMO, as a rebel force (see ETHIOPIA: Protest risk rises as emergency declared - October 11, 2016).

The capacity of regional actors to manage these challenges is questionable, highlighted by ongoing squabbles over regional peacekeeping contingents in South Sudan and Somalia.

At the same time, the Democratic Republic of Congo, which shares a border with South Sudan, Rwanda and Uganda, appears to be entering into a period of prolonged political crisis that could destabilise its neighbours.

As a result, the region's economic gains risk being undermined by the political challenges confronting many of its states.

3

Number of East African
countries in a state of civil war
or chronic instability

Prospects for the global economy in 2017

Wednesday, November 2 2016

An Oxford Analytica Prospect

The IMF, the OECD and the World Bank see the world economy growing by about 3.0% next year, little changed from its 2012-16 average growth but down from the 5.1% average achieved during 2003-07. Factors influencing the outlook include weak trade and poor productivity along with high debt levels and policy limitations: these feed into each other, creating a downward spiral of growth expectations. Nonetheless, many economies are well placed to cope with this 'new normal'.



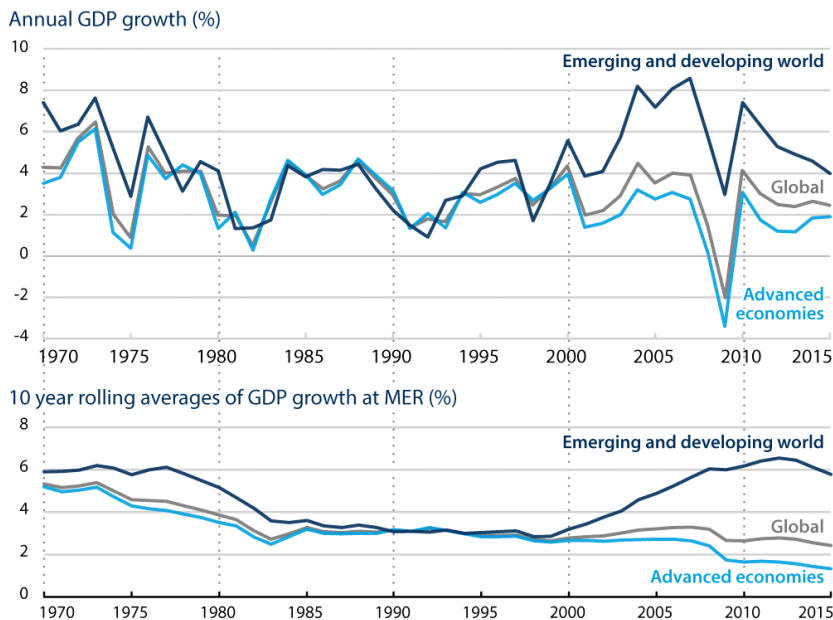
Employees work behind a globe
 (Reuters/Vivek Prakash)

What next

Technical progress could drive stronger global growth if it can be conjured, sustained and diffused, strengthening productivity. Otherwise, against a backdrop of weak trade, debt deleveraging and high geopolitical risks, countries will struggle to implement structural reforms. There are some brighter signs; China will continue to rebalance its economy and reduce debt levels, albeit slowly to meet its growth targets. In India, inflation is on target, allowing monetary policy to support activity and fiscal consolidation to continue. However, global monetary conditions will tighten, strengthening the dollar. Economies dependent on external financing, including the United Kingdom, will be vulnerable.

Analysis

Extraordinary weakness in trade and investment clouds the outlook for the world economy. Furthermore, uncertainty about the prospects for productivity growth and a recovery in commodity markets is growing rather than diminishing.



The long-run cycle in global growth and EM development
 Sources: IMF, WDI for pre-1990 data

Strategic summary

- The euro-area is emerging from austerity, and spending could surprise, but the banking sector is perhaps more likely to surprise on the downside.
- The United States will have a new president, who may bring renewed impetus to public investment and structural reforms, potentially boosting growth.
- In China, the stimulus will unwind next year, helping to curb credit growth, but targeting GDP growth while reducing debts will be a challenge.
- Brazil and Russia should emerge from recession, but any recovery will be fragile while growth-enhancing reforms will be hard to implement.

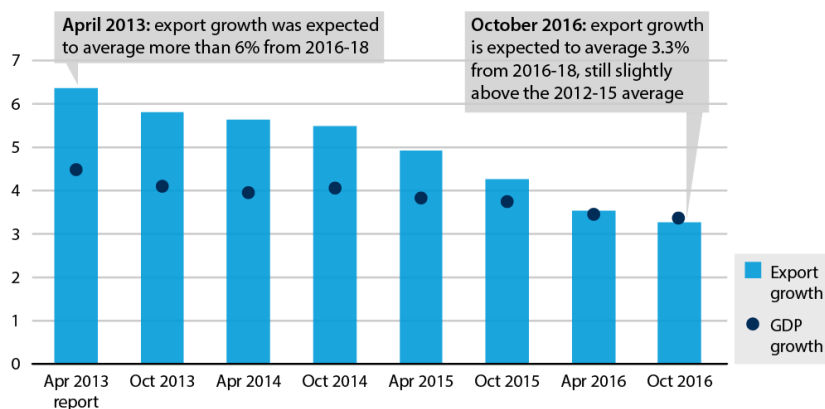
Growth drivers

Against this backdrop, growth expectations have been steadily downgraded:

Contribution from trade

The WTO forecast for world trade has fallen below GDP growth for the first time since the global financial crisis. Moreover, the WTO's 2017 projection of 1.8-3.1% trade growth illustrates the uncertainty surrounding a critical component of global growth.

Greater protectionism is set to persist but the pace of globalisation in the decade to 2008 was unusually intense and the new reality is likely to be slower but more sustainable (see INTERNATIONAL: New trade era will shape world growth - October 18, 2016).



IMF World Economic Outlook: Trade growth projections for 2016-18 (%)
 Source: IMF WEO

Fiscal policy

Calls for policymakers to increase investment, which would be historically cheap to finance, may help some economies but would be unlikely to restore strong trade growth (see INTERNATIONAL: 'Summernomics' offers uneven benefits - September 26, 2016).

There is little chance that efforts to boost growth through 'Summernomics' could add more than 0.2-0.3 percentage points to global growth. Moreover, populism has led governments to prioritise short-term pressures over longer-term planning, reducing the political will for spending (see INTERNATIONAL: Pragmatic protectionism set to persist - October 24, 2016).

Monetary policy

The evidence is growing that 'overburdened' monetary policy is losing its efficacy. Ultra-loose policy is also distorting markets. Stock markets are buoyant despite lower growth expectations and corporate profitability as investors search for yield (see INTERNATIONAL: Ultra-loose monetary policy nears limit - September 12, 2016).

Japan's experience raises concerns that as populations age, inflation and demand will remain low, keeping rates depressed. In this 'demographic death spiral' scenario with demand weak, many argue there is no need for higher public investment.

In 2017, monetary policy will continue to diverge. US rates are likely to rise gradually from December 2016. Japanese policy, on the other hand, will remain ultra-loose. The euro-area is expected to taper its quantitative easing programme (QE) slowly while keeping rates low.

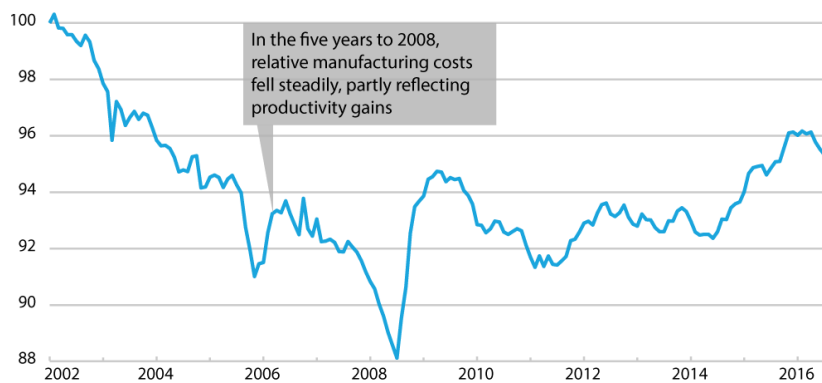
Debt burden

Global monetary conditions are tightening, increasing the cost of interest payments for governments, corporates and households. The US Fed has already started to raise rates. Further tightening should be no surprise. However, the deleveraging needed by firms and consumers may have been underestimated. This may weigh down spending more than expected.

The [IMF Fiscal Monitor](#) released in October 2016 showed that, at 225% of world GDP in 2015, non-financial sector debt reached an all-time high. Furthermore, it is expected to have risen again in 2016, particularly in countries such as China where credit is expanding fast.

Productivity growth

Productivity growth has slowed in the last 15 years despite technological progress and human capital improvements; this has been driven by structural factors including limited diffusion of innovation and skills mismatches, as well as weak demand. Product and labour market reforms will be crucial but harder to achieve against a backdrop of weak trade, low commodity prices and debt deleveraging.



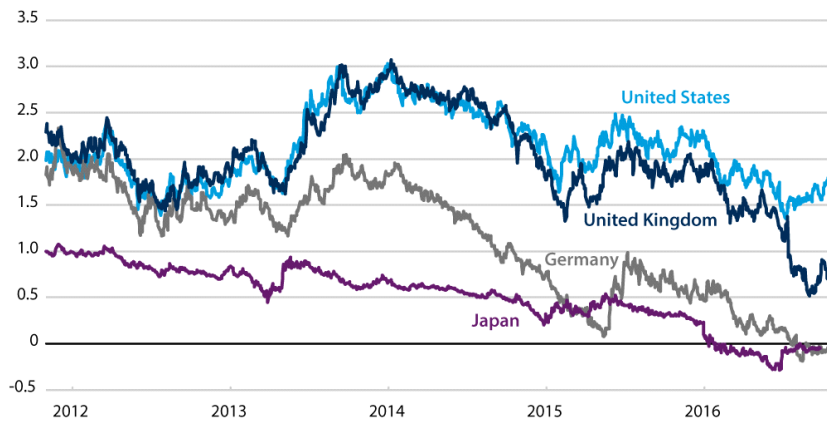
United States: Manufacturing productivity struggling
(Manufacturing prices relative to total producer prices, indexed to Jan 2002=100)
Source: Bureau of Labor Statistics

Financial markets

In late 2016, global yields have edged up as inflation expectations have risen. In September, the Bank of Japan (BoJ) introduced measures to prevent long-term yields from falling below zero, after substantial central banking debate on the costs and benefits of negative rates (see [JAPAN: Monetary policy puts finance first - September 23, 2016](#)).

The upward trend should persist in 2017. Recovery in developed countries and positive base comparison effects on commodity prices early in the year should increase inflation.

225%
World debt as a share of GDP --
an all-time high



Bond yields, 2012-16 (%)

Source: Bloomberg

However, yields may drop again later in the year as flexibility in US supply is likely to cap oil prices, while from mid-year onwards energy-price base effects will also abate, putting inflation under downward pressure. Moreover, UK and EU negotiations will reach a critical stage in the first quarter when Article 50 is expected to be triggered. This may further dampen investor sentiment.

Individual economies

Many countries are well placed for growth. Those that meet all or even some of the following conditions should grow robustly:

- an economy well-diversified and not over-dependent on goods trade and commodities;
- scope and political will to implement product and labour market reforms;
- scope to expand policy without endangering financial stability; and
- manageable debt levels, or a clear and well-supported plan to curb debt.

United States

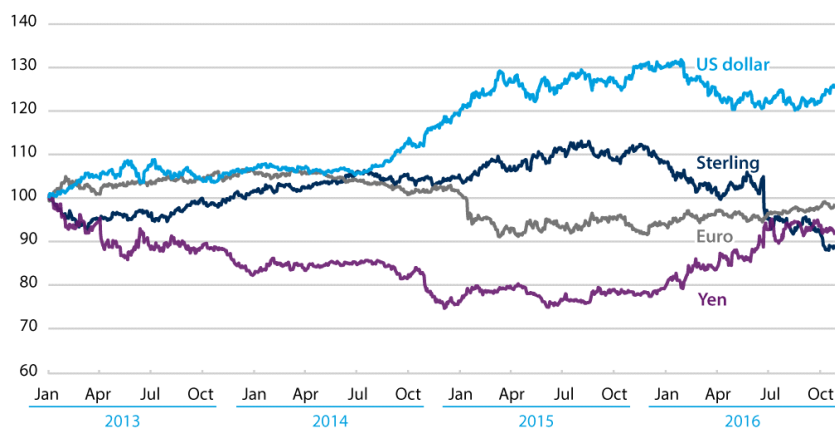
The United States is expected to grow by about 2% next year, a modest improvement on 2016 but this could be too cautious, tempered by the surprise slowdown in 2016.

Employment rose solidly in the months to September, and domestic activity is building momentum.

Inflation rose at the fastest pace in almost a year in September, and a December interest rate increase is likely. However, inflation is outgrowing nominal earnings and will dampen spending if it continues. The Fed is likely to prioritise growth over inflation, slowing the pace of 2017 tightening.

Futures markets have priced in 50 basis points of Fed interest rate increases in the next 24 months, but the market may reprice an increase in term premium into the yield curve.

Ten-year treasury yields may exceed 2% in early 2017, but the pace of increase, and of Fed tightening, will be capped by modest growth and inflation expectations, as well as by dollar strength. The dollar is set for further appreciation in 2017.



Global currency movements (Trade-weighted, indexed to Jan 2, 2013=100)
 Source: Bank of England

Under a new president, fiscal policy should have renewed impetus. Higher spending after years of austerity would raise growth while structural reform could boost productivity.

Euro-area

The ECB is likely to extend QE in March for six to nine months, but as a compromise to the hawks, the programme may be reduced to 60 billion euros (66.5 billion dollars) from 80 billion euros a month. Ongoing QE should anchor peripheral spreads at 150-200 basis points, even though wide fiscal and growth differences will remain.

The number of eligible QE bonds has fallen this year. The key capital rule states that the ECB cannot hold more than one-third of the debt of any one country or of any new bond issue. Nor can the ECB buy bonds below certain yields.

In March, the ECB is likely to increase the size of the eligible bond market, perhaps by broadening the pool of assets it can buy to include bank bonds, or by raising the share it can buy of a new bond issue. Politically, reversing the key capital rule would be difficult. Germany has already criticised the ECB's ultra-loose policy.

Fed tightening will put downward pressure on the euro moving into 2017, but by the middle of the year the currency should have more support from the QE tapering. However, with elections due in France and Germany and Brexit uncertainty high, downside risks are significant.

The euro-area is expected to grow by around 1.5% next year. Germany should grow in line with the regional average, bolstered by robust private spending. However, financial sector anxiety is high and terrorism risks have risen.

The increase in migration since the expansion of the EU in 2004 has done little to equalise either labour markets or the growth outlook. While the German economy is robust, Italy and Portugal may struggle to grow by 1% in 2017.

In Italy, confidence will be undermined if voters reject Prime Minister Matteo Renzi's proposed reforms. The economy already faces numerous problems including the recapitalisation of two of the three largest banks. Moreover, having been a QE beneficiary, Italy may struggle to generate domestic growth when QE is tapered next year (see ITALY: Referendum 'no' vote could trigger crisis - October 24, 2016).

Italy and Portugal may struggle to 1% growth in 2017

Portugal may also suffer from QE withdrawal. The profitability of Portuguese banks has been squeezed, and a DBRS rating downgrade would exclude Portugal from the ECB's bond-buying programme.

In contrast, both Ireland and Slovakia are expected to grow by 3% or more next year. Brexit may create opportunities for Ireland, but overall the medium-term impact is likely to be negative.

United Kingdom

Rising inflation and uncertainty over Brexit is expected to constrain UK growth to around 1% next year, less than half the average 2012-15 pace. Investment will suffer. Poor understanding of the complexity of WTO negotiations may mean potential losses have been underestimated (see UNITED KINGDOM/WTO: Negotiations may hit growth - September 6, 2016).

Real wages are already under pressure as inflation rises, reducing purchasing power. The pound's weakness is focusing attention on financing the large current account deficit, but emergency rate hikes are unlikely, not least as they could prove counterproductive.

Ten-year yields are likely to rise towards 1.5% in the first half of 2017, as the weak pound will drive inflation back to the 2.0% target and perhaps beyond. Moreover, the triggering of Article 50 in early 2017 and the negotiations with the EU could further dampen sentiment.

However, the market may be exaggerating the impact of the weak pound on prices. Yields may fall back below 1% in later 2017, particularly if weaker demand and modest energy prices cap inflation.

Japan

The BoJ and the Cabinet Office have estimated Japan's potential growth at 0.2-0.3%. Actual growth is likely to struggle to reach 0.5% in 2017, little changed from 2016 estimates.

The real trade-weighted yen fell by almost 30% between late 2012 and September 2015. It has risen by more than 10% since then despite ultra-loose policy, as funds have been sucked into 'safe-havens'. This turnaround has reduced both export competitiveness and policy effectiveness. A renewed fall in the yen will probably have to wait for less global uncertainty.

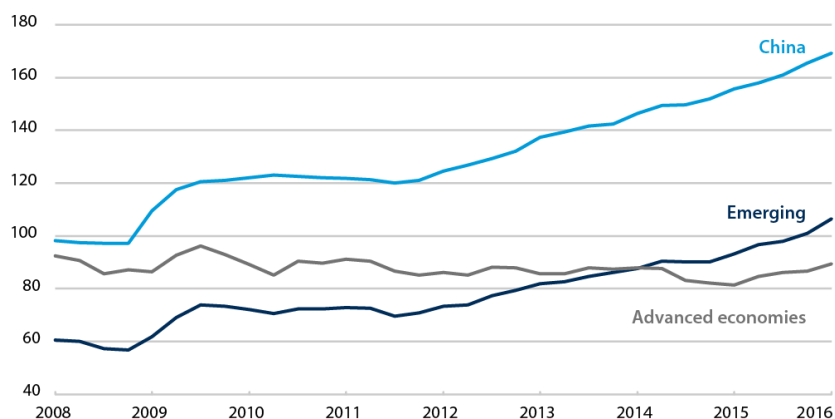
Further monetary easing measures may include more rate cuts and possibly some form of 'helicopter money', pressuring the entire yield curve further downwards.

On November 1, the BoJ reduced its target for core inflation next year from 1.7% to 1.5%. Even this seems unattainable.

China

Growth is in line with the 6.5-7.0% target and modest rebalancing is under way (see CHINA: Curbing debt while lifting GDP will test China - October 21, 2016). However, credit growth has underpinned buoyant housing and car sales, raising concerns that prioritising growth is exacerbating the reliance on credit. Corporate debt is a particular concern.

Japan's inflation target looks
unattainable



Non-financial corporate debt as a share of GDP, 2008-16 (%)

Source: Bank for International Settlements

Stimulus efforts are likely to unwind, which should help curb credit growth. For example, many cities imposed restrictions on housing credit in October, the State Council has issued guidelines for reducing corporate debt and a tax break on car purchases will expire soon.

The larger the gap between credit and GDP growth, and the longer it persists without action, the higher the resolution costs will be.

Rest of Asia

In India, inflation eased to a 13-month low in September and the new Reserve Bank governor cut rates at the October meeting. This should boost the struggling manufacturing sector. Services activity has momentum and exports should improve, supporting growth of around 7.5% in 2017. Stronger activity and looser monetary policy will reduce pressure for more public spending, helping India stick to its fiscal consolidation roadmap.

In South-east Asia, Indonesia, the Philippines and Vietnam are all forecast to grow faster in 2017 than in recent years. However, low political consensus in Indonesia has hindered structural reform implementation, keeping growth close to 5% -- well below President Joko Widodo's aim of 7%.

External risks are high in Malaysia but domestic activity has momentum. The economy is set to expand by more than 4% next year. Thailand, in contrast, may struggle to achieve 3% growth. Vietnam should continue to outperform the region, buoyed by exports and foreign direct investment, particularly in telecommunications.

Latin America

The Brazilian Central Bank expects GDP growth of 1.4% in 2017. Activity indicators have improved. Asset markets have confidence in the orthodox economic stance of the new government.

However, the recovery will be modest. The key reforms sought by the Temer administration would only feed through in the longer term. Implementation is fraught with obstacles.

In Mexico, industrial activity is sluggish. Furthermore, the peso could rally after the US election, reducing competitiveness and constraining the recovery.

Other emerging markets

In China, a crisis is unlikely, but costs will mount without resolution

Russia contracted by 0.7% year-on-year, in the first nine months of 2016. Modest 2017 growth is expected, but trends are vulnerable to fuel prices.

In October, the Turkish Central Bank noted third quarter activity had lost momentum (despite 250 basis points of rate cuts this year). Turkey is vulnerable to capital outflows. Its current account deficit is large and tourism has weakened.

Global diamonds market will stay oversupplied

Tuesday, August 16 2016

The price of rough diamonds has fallen by nearly 15% since 2011. It hit a record low in February before rebounding to slightly below 150 dollars per carat in line with commodities' overall modest recovery. Stagnant end-user demand means that for middle-market diamantaires it has become cheaper to buy polished stones than to polish rough stones. Meanwhile, Chinese and Indian markets have failed to contribute to consumption growth and weakening local currencies have negatively affected consumer sentiment.

What next

Diamond supply is likely to exceed demand until at least 2020. New mines, excess inventories of rough stones, lacklustre Asian demand and uninterested millennials, constrained finance to the cutting centres and the impact of synthetic stones will all conspire against market recovery. De Beers' 'sights' sales will be closely watched, but the second half of the year tends to be seasonally weaker. Large retailers have provided unexciting guidance for the rest of 2016. Chow Tai Fook, a Hong Kong jeweller largely dependent on the Greater China market, has issued a profit warning.

Analysis

Leading diamond jewellery retailers, including Tiffany, Blue Nile and Luk Fook, are reporting weak end-user demand.

The United States was the mainstay of the market in 2015. It grew its market share to 45% from 42% as Chinese and Indian demand slowed.

Japan, source of 30% of global sales in the 1990s, now accounts for 6%, while the falling purchasing power of customers from the Gulf has led to a 3% drop in demand from the region.

Unless smaller competitors exit the market, gross midstream margins are unlikely to return to 2010-11 levels. Buyers of rough stones are gaining a stronger negotiating position vis-a-vis the miners.

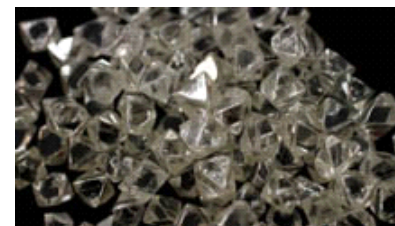
Major producers are responding by being flexible in dealing with customers.

Industry leaders are promoting more transparency; DeBeers is disclosing for the first time sales numbers from each of its sites (see INTERNATIONAL: Diamond market will face liquidity test - March 17, 2015).

Destocking

Because of backlogs in the pipeline, producers built up large inventories towards end-2015. Alrosa and DeBeers are estimated to have held an accumulated 12.6 million carats (mct) of rough diamonds, while the stocks of Dominion Diamond exceeded 200 million dollars in value.

In addition, Chow Tai Fook was said to hold significant inventories of unsold polished stones. The industry leaders were careful to release the stock in a manner that would not disrupt the pricing.



Uncut diamonds from southern Africa and Canada are seen at De Beers headquarters in London
(Reuters/Stefan Wermuth/File Photo)

Impact

- Russia is considering cancelling its 6.5% export duty on diamonds, which would have a positive impact on Alrosa's shipments.
- Lucara Diamond's failure to sell its record-breaking 1,111-carat stone raises doubts over the market for exceptionally priced items.
- Dominion Diamond has approved a 13-year life extension for its mine in Canada, at 647 million dollars in capital expenditure.

Major producers are pursuing more flexibility in dealing with customers

In the first quarter, middle-market restocking appeared seasonally strong, with Alrosa and De Beers selling 4.4 mct of the surplus. This helped replenish depleted inventory levels in the midstream, but sellers' advantage was offset by lower revenue per carat.

Closures

The stress in the rough stone market and poor sales in Asia have led to capacity cuts:

- Chow Tai Fook is closing its stone-cutting operations in South Africa; its sales dropped 13% year-on-year in the first quarter.
- Cutting centres in Botswana have reduced payroll, in some cases by 50%.
- De Beers has sold Kimberley mines, a tailings retreatment operation in South Africa, to Ekapa Mining and Petra Diamonds.
- Rio Tinto is curtailing processing at its Argyle mine in Australia.
- De Beers has suspended production at its Canadian Snap Lake mine, putting it into 'care and maintenance', and will reduce its 2016 output by 5 mct.
- Botswana's diamond mining giant, Debswana, is closing its Damtshaa mine and will scale down production at Orapa for the next three years.

A further output drop is anticipated from the ageing mine of Diavik in Canada.

New mines

However, up to four new mines are being brought to production within this calendar year:

- Gahcho Kue, a long awaited open pit in Canada's Northwest Territories with 61 mct in resources, owned by DeBeers and Mountain Province;
- Renard, the first diamond mine in Quebec, built by junior producer Stornoway, with 23 mct;
- Firestone's Lihobong mine in Lesotho, with 9.5-mct reserves; and
- Diamond Corps' Lace mine in South Africa's Free State province, with 9.4 mct.

Three further small mines are to be opened in Lesotho this year. After 2017, additional production is also expected from two Russian operations:

- Grib mine, owned by Lukoil; and
- Karpinsky, owned by Alrosa.

Around 2018, Rio Tinto's Bunder mine and Shore Gold's Star Orion South are also expected to go into 'steady state' production (the desired output level after the initial ramp-up period following the original mine commissioning that can last 3-18 months depending on the commodity, size and complexity of the operation).

Mid-market financing

Provision of cheap credit to the midstream market participants has long been the lynchpin of the diamond value chain. The sector's total debt burden is estimated at around 12 billion dollars.

\$12bn

Diamond sector's total debt
burden

Since late 2014, radical changes in the financing environment have affected capacity of cutting centres to access working capital, a trend marked by Antwerp Diamond Bank's withdrawal from the market. The trend has been reinforced recently:

Standard Chartered Bank (SCB)

SCB announced that it would be exiting the diamond business. Along with ABN Amro and several Indian banks, SCB has been one of the most dependable sources of short-term credit to the middle market.

The bank has a reported 2 billion dollars in outstanding lines to the sector, about 18% of total.

Reserve Bank of India (RBI)

Outgoing RBI Governor Raghuram Rajan has warned of "deep surgery" to banking balance sheets, suggesting restructuring of 7 billion dollars of total outstanding debt to the diamond sector, which is 55% of the global total.

In the longer term, tightening credit rules may prove salutary to the industry and lead to healthy consolidation. Bloated inventories should become less common, eventually auguring for more pricing stability.

However, the small size of alternative funding vehicles means increased uncertainty in the short term.

Structural threats

The success of diamond marketing in the 1990s can no longer be taken for granted. The retail market has not kept up with changing tastes, demographic shifts and millennials' relative indifference to the product (see INTERNATIONAL: Demographics will underpin productivity - June 9, 2016).

[Market research](#) suggests that a generation of 18-30-year olds has yet to be exposed to generic diamond marketing. In response, De Beers is increasing its downstream marketing investments.

It has reintroduced its "A diamond is forever" campaign in the United States. The company has also launched campaigns to stimulate diamond gifting in India and China.

The industry's main trade group, the Diamond Producers Association, has also launched promotional campaigns aimed at millennials.

Two other developments may cast a longer-term shadow over pricing:

- prospect of diamond recycling; and
- increased attractiveness of man-made diamonds, a lower-cost alternative owing its recent successes to technology allowing for improved quality and product consistency and to marketing prowess of new market entrants.

These developments are worrying for the small polished diamond sector; synthetic diamonds can be 30-40% cheaper than natural ones.

Mining law would deepen Zimbabwe's economic downturn

Monday, August 15 2016

The raft of assertive economic policy announcements aims to convince the ruling party's domestic constituency that it has a plan to pull Zimbabwe out of its economic and fiscal crisis. Far from spurring local benefits, however, the new measures will discourage investment and exacerbate the downturn, thereby increasing unemployment.

The government on Friday published legislation outlining reforms to the mining sector to increase returns for the local economy. The Mines and Minerals Amendment Bill would require mining companies to list on the Zimbabwe Stock Exchange as a precondition for being granted mineral rights. They would also be required to use local banks and mineral exports would only be allowed with the written permission of the mining minister. Several minerals would only be allowed to be exported in refined form. The amendments follow the imposition of stricter indigenisation requirements and the revocation of all diamond mining licences earlier this year. Last week, the government also revealed programmes to boost investment in agriculture and manufacturing and to promote financial inclusion, which the finance ministry says will accelerate GDP growth to 9.5% in 2017. The IMF predicts 1.4% for 2016.

See ZIMBABWE: Normalising donor relations will take time - December 4, 2015.

CAR will benefit from diamond exports

Tuesday, June 7 2016

Resumption of diamond exports will help Bangui grow exports and provide needed revenue, especially if demand for rough diamonds improves. The security situation remains perilous, and increased diamond trade could provide additional resources for armed groups without sufficient monitoring or controls.

The Central African Republic (CAR) mining minister yesterday announced that the country will gradually restart diamond exports. Diamond mining is an important economic sector that the government is seeking to rebuild. In May 2013, the Kimberly Process (KP) banned CAR's diamonds after discovering that sales were financing the country's conflict. It has since eased restrictions pending compliance with certification requirements. The US Geological Survey in 2012 ranked CAR as the tenth-largest producer of rough diamonds in terms of value in dollars per carat. Prior to 2013, diamonds comprised nearly half of CAR's exports and accounted for 20% of budget receipts. Smuggling reportedly accounted for 30% of diamond exports before the crisis and continued during the KP ban, funding armed groups. Demand appears to be rebounding after prices for rough diamonds fell 18% in the year to November 2015.

See AFRICA: Governance and price woes mar diamond outlook - January 19, 2016.

Global diamond production will be subdued

Wednesday, May 25 2016

The mild recovery in diamond sales is likely to prove insufficient for De Beers and other diamond producers to ramp up production or release greater volumes onto the market, at least in the medium term. Nevertheless, it will help buoy Anglo's prospects.

De Beers sold 630 million dollars of diamonds in its fourth sales cycle for the year, media reported yesterday. This is lower than the previous sale, when it raised 666 million dollars, but a notable increase on January, when only 546 million dollars of diamonds were sold. The second and third sales windows, called 'sights', also saw increases. The firm, of which 85% is owned by Anglo American, holds ten sights per year. These are watched closely given the slump in demand last year: the price for rough diamonds fell 18% in the year to November 2015. However, De Beers, which together with Russian producer Alrosa accounts for over 50% of the global market, has cut output, helping to reflate diamond values. Earlier this month, De Beers announced that it would invest 15.6 million dollars on exploring new diamond fields in Canada's Saskatchewan province.

See INTERNATIONAL: Diamond market will face liquidity test - March 17, 2015.

Global standards would curb conflict mineral trade

Tuesday, May 31 2016

Participants in the Kimberley Process met in Dubai on May 23-26 to discuss progress in regulating the world diamond trade to prevent sales of output from conflict zones. As part of the meeting, the United Arab Emirates (UAE) hosted a joint forum with the OECD to address a key problem facing the diamond industry -- the absence of universal standards, particularly regarding pricing. The meeting comes at a time of considerable activity to tackle the problem of conflict minerals.

What next

Interest in improving the transparency and due diligence of supply chains regarding mining and other products will grow. Unified valuations and common processes on supply chain risk mitigation could reduce illicit trade in conflict minerals. However, agreeing upon common procedures may founder on the question of whether they should be mandatory or voluntary.

Analysis

The term 'conflict minerals' refers to resources -- such as diamonds, gold, tin, tantalum and tungsten -- produced in regions characterised by conflict or other forms of severe political instability. In such areas, armed groups (government or rebel) often control the mines, and use the revenue to fund their activities. Such mines are associated with human rights abuses, including forced labour, and environmental damage.

Efforts to tackle the problem have focused on preventing such resources from reaching the market, targeting the traders, financiers and manufacturers of these resources. NGOs have campaigned for improved reporting systems and due diligence procedures to break the link of financing armed conflict through mining and trading of these resources.

In response, a variety of mechanisms have been devised, including sectoral codes of conduct (such as the Electronic Industry Citizenship Coalition), international certification regimes and legislation.

The Kimberly Process

The Kimberley Process (KP) was a response to diamond mining being used to fund military actions in civil conflicts, mainly in Africa. It sought to cut off the flow of funds from these minerals by restricting their flow to the international diamond market (see AFRICA: Governance and price woes mar diamond outlook - January 19, 2016).

Proposed in 2000 and launched in 2003, the KP is an intergovernmental agreement in which diamond producers, traders, and local and international NGOs participate. Under the process, no rough diamonds should be traded unless they have a government-issued Kimberley certification showing that the diamonds are conflict-free.

KP shortfalls

While the KP has established the machinery for overseeing the diamond trade, many civil society groups argue that it has not been particularly effective in the areas which prompted its creation -- countries affected by conflict diamonds.

Impact

- Notwithstanding efforts to improve governance, the Kimberley Process will face criticism for failing to contain the conflict diamond trade.
- US legislation to tackle conflict mineral trades in the DRC through mandatory standards may face further legal challenges.
- The EU may be able to break the deadlock on its proposed voluntary framework but not before year-end.

NGOs have aimed to expose those involved directly with conflict minerals

Effectively tracking rough diamond movements is difficult, and the KP has not been active enough in monitoring infringements and curtailing the illegal trade, whether in producing or trading countries. In recent years, there have been growing concerns that the KP has become irrelevant and unable to address its internal problems or to tackle issues of human rights in the regions where conflict mineral trade is rife.

These criticisms came to a head last year. The lead NGO in the KP, the Civil Society Coalition (CSC), announced that it would boycott the KP Dubai meeting in protest against the appointment of the UAE to chair the organisation. The CSC argues the country has weak standards, has failed to engage with the coalition and is a main market of illegal trade of diamonds and gold.

Universal benchmark?

Despite the boycott, the UAE government proceeded with the meeting and addressed, jointly with the OECD for the first time, the issue of lack of universal valuation standards for diamonds.

Unlike for other commodities, such as oil or gold, there is no universal benchmark for pricing rough diamonds. Greater price conformity would enhance the income for producing countries and promote responsible supply chains. This would reduce the scope for undervaluations, smuggling and informal trading, which help sustain the conflict diamond business (see INTERNATIONAL: Business to see multipolar regulations - May 19, 2015).

OECD guidelines

The involvement of the OECD reflects its efforts to encourage the private sector to tackle issues of transparency and accountability in their supply chains.

In 2011 the OECD published a [set of guidelines](#), including a simple 'Five Step Framework', to encourage firms and governments to improve their risk management of supply chains for raw and processed materials. Since then, governments adhering to the recommendations have engaged with national groups to raise awareness and training for firms, as well as with third countries. China and the UAE are among those non-OECD countries to put in place mechanisms similar to the OECD's guidance.

The OECD has aimed to curb conflict mineral trade through common supply chain risk management guidelines

The OECD claims that thanks to its guidelines, due diligence programmes are eroding the link between mineral extraction and trade, and the financing of conflicts. Revenues for armed groups from tantalum, tin and tungsten have decreased (though the process has been less effective in breaking the link for trade in gold).

US lead

The government which has gone furthest down the track of binding legislation is the United States (see INTERNATIONAL: US conflict minerals clampdown grows - May 28, 2014). The Dodd-Frank Act included provisions which required listed companies to report on their supply chains for sourcing gold, tin, tungsten and tantalum from the Democratic Republic of Congo (DRC), one of the areas where civil conflict most affected trade in these commodities.

Implementation of these rules has faced challenges from US companies hostile to the compliance costs and defensive of their claimed constitutional rights (see EU: US loophole undercuts 'conflict minerals' controls - April 17, 2014). While those challenges have been partly upheld by the US Courts, the reporting procedure remains in place and companies are still required to report on their supply chains.

The US system is not without critics. In 2015, NGOs analysed the reports submitted by the largest US firms and found that nearly 80% of them failed to meet the standards of due diligence and disclosure in tracing the source of minerals in their supply chain. Despite this, it is an achievement that the system is in operation (May marked the third year in which reports were produced).

EU blockages

By contrast, the EU has failed to agree, let alone implement, rules to address the problem. Legislation was proposed in 2014 but progress has been blocked by differences between the member states and the EU parliament.

The Commission's original proposal set out a voluntary system whereby companies importing gold, tantalum, tin and tungsten would be encouraged to 'self-certify' on their supply chains. Member-states support this position on a voluntary basis, but the European Parliament has proposed amendments which would make the process mandatory (as in the United States). Hopes of compromise before the end of the Dutch Presidency of the Council of the European Union look unlikely to be realised.

Colombia's new emerald investors face major hurdles

Friday, December 18 2015

Increases in global prices have attracted new firms to invest in emerald extraction projects in Colombia. Although the operating environment for such activity is today much improved from the 1980s, when the industry was at the centre of a particularly violent conflict, serious challenges remain. The security situation near many mineral deposits remains somewhat precarious, infrastructure is limited and regulation difficult to navigate.

What next

Continued low levels of global production and new marketing campaigns are expected to drive price rises of around 30-40% for the precious stones during 2016. The already strong interest in the sector will grow further but substantial investments will be required to make mines viable and bring them into line with international standards, protect their output and build positive relationships with local communities.

Analysis

Colombia's emerald production is concentrated in the department of Boyaca, located near the country's capital, Bogota.

Nearly 70% of the 352 concessions granted by the National Mining Agency (ANM) for the precious stones are located in this province.

A controversial monopoly

Emerald mining in Boyaca has had a chequered history.

Violent competition between various illegal armed groups for control of mineral deposits in this region reached its peak in the late 1980s and early 1990s. Up to 6,000 people were killed as a result.

A peace agreement between the competing factions was brokered in 1991, helping to reduce the scale and intensity of violence.

From the mid-1990s, Victor Carranza, also known as the 'emerald tsar', consolidated his control over the industry and came to exercise a near-monopoly over gem extraction.

Foreign firms were deterred from investing in the sector due to the widespread informality of extractive activity, the various assassination attempts against Carranza, and allegations of the magnate's links to paramilitary groups and illicit activity.

New entrants

Since Carranza's death (from natural causes) in 2013, there have been some signs of external interest in commencing emerald excavations in Colombia:

- In 2013, US-based Minería Texas Colombia (MTC) became the first foreign firm to enter Colombia's emerald market when it purchased Carranza's former stake in the Muzo mine in Boyaca.

Impact

- Limited state presence in emerald mining areas will push up private security costs for firms operating in these regions.
- Illegal mining will become increasingly problematic as emerald prices rise.
- Persistent perceptions of criminal involvement in Colombia's emerald trade may foster reputational concerns about engaging in such activity.

- MTC's investment was followed in September this year by Gemfields's 22.5-million-dollar purchase of controlling stakes in two Colombian emerald projects, also both located in Boyaca.

The investments appear to have been motivated by a desire to access new deposits in the context of sustained increases in global emerald prices.

According to an aggregated index compiled by Gemval, a gemstone monitoring body, average emerald prices have doubled since 2013.

This increase is largely a result of contractions in global supply of the gems as existing deposits have been exhausted.

Colombia's production, for example, has decreased from 10 million carats in 2004 to 2 million carats in 2014.

Operational challenges

Higher prices have improved the potential profitability of projects in Colombia and served to increase firms' tolerance of risks associated with such activity.

The eventual earnings and costs associated with these projects remain uncertain as a result of the challenges these firms face on a number of fronts.

Security

Although much improved over earlier periods, Boyaca's mining areas continue to suffer security problems, with invasions and thefts of mines a relatively common occurrence.

In March, three individuals gained unauthorised access to Esmeracol's Itoco project and were subsequently killed when a landslide trapped them in the mine.

Two months later, MTC's mine in the Mata de Fique region was invaded by several hundred locals, following a rumour that a large emerald deposit had been uncovered. The incident saw MTC staff attacked by the invaders and a mining tunnel was destroyed.

Authorities have recently suspended formal mining operations in a number of areas as a result of the unauthorised presence of illegal miners on their concessions.

Infrastructure

A long history of informality means existing emerald mines lack modern infrastructure and equipment.

Transport of heavy machinery and extracted materials is complicated by the extremely poor condition of roads between Boyaca's mineral deposits and Chiquinquirá, the nearest town.

Rectifying such issues can involve significant costs. MTC, after its purchase of the Muzo project, had to suspend extraction activities and invest a further 100 million dollars in order to bring the mine up to international standards.

Community relations

Such improvements to environmental procedures and formalisation of mining operations can generate tensions with local communities.

The average price of emeralds
has doubled since 2013

8mn carats
Decrease in Colombian
emerald production during
2004-14

Many residents have historically sifted through tailings deposits previously dumped by unregulated operators in order to glean small quantities of precious stones contained therein.

Such economic opportunities are removed when formal operations implement strategies to deal with waste products in a more environmentally sound manner. The resulting resentment gives rise to risks of protest and civil unrest.

Regulatory issues

Operational difficulties are compounded by the somewhat uncertain legislative environment for mining activity in Colombia, as well as by long delays in the processing of permit applications (see COLOMBIA: Mining outlook is at a crossroads - August 8, 2013).

Regulatory body ANM currently has a backlog of around 5,000 requests for mining licences and permits.

Firms continue to complain that it can take up to five or six years to gain the necessary approvals to begin operations.

Reinventing the industry

Colombian government agencies and industry bodies have sought to revitalise the sector by attracting new foreign investment in emerald mining.

To this end, the Colombian Emerald Federation (Fedesmeraldas) has engaged in international trade visits, including one to Sri Lanka in May, and hosted the first International Emerald Symposium in mid-October.

Such initiatives have been developed in parallel with efforts to overcome negative associations of the industry with past criminality.

Projects in this line include the Emerald Exporters Association's plans to develop new national branding for Colombian emeralds, as well as an initiative by MTC to launch its own consumer brand, Muzo Emerald Colombia, in 2016.

These efforts are likely to yield moderate results for Colombia's emerald industry over the medium term.

However, ongoing operational constraints for firms in this sector mean that such progress is likely to be achieved only slowly, with any advances hard-won.



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