Atradius
Managing risk, enabling trade

Economic Update

June 2017

Summary

Global

Global economy gaining steam

The world economy is in the midst of a broad-based upturn, with global GDP growth expected to pick up to 2.9% in 2017 and 3.0% in 2018. Growth is buoyed by a strong US economy as well as recoveries in large emerging markets, offering better prospects for global demand. Confidence has been increasing across advanced markets since H2 of 2016 and trade momentum has picked up. Global oil prices may find some support towards the end of this year from the OPEC agreement to extend production cuts into 2018.

However, downside risks remain. Political uncertainty, manifesting itself in populist rhetoric across Western democracies, could weigh on growth. It could cause investment to be postponed or cancelled, having a negative effect on global GDP growth.

Atradius forecasts full-year global trade growth to reach 3.2% in 2017, compared to 1.3% in 2016. The momentum of world trade (rolling 3-month percentage change over preceding three months) rose from 0.6% in November 2016 to 2.7% in February 2017. The momentum rate in January and February marked the highest since mid-2010. However, the expected recovery in trade is highly dependent on continued global economic growth and stable policymaking. Therefore policy uncertainty, especially as it relates to protectionism, is a concern for the positive outlook.

In May, OPEC and some non-OPEC countries (including Russia) have agreed to extend production cuts into 2018. The immediate market response was for the Brent oil price to decline to USD 52 per barrel, partly because of disappointment that the cuts had not been deepened or extended even longer. However, over the course of this year production cuts are likely to provide support to oil prices, which are expected to remain within a corridor of USD 50 to USD 60. US shale producers are likely to step up production once the oil price is about to exceed USD 60. The US Energy Information Administration expects an average price of USD 53 in 2017, before rising to USD 57 in 2018.

Oil price remains in USD 50-60 band
Brent crude oil, USD per barrel

Sources: Macrobond, EIA

Eurozone

Economic growth forecasts

	2017	2018
Austria	1.7	1.6
Belgium	1.5	1.6
Finland	1.5	1.4
France	1.4	1.5
Germany	1.6	1.6
Greece	1.2	2.1
Ireland	4.0	2.8
Italy	0.9	0.9
Netherlands	2.2	1.8
Portugal	1.7	1.5
Spain	2.7	2.3
Eurozone	1.7	1.6

Source: Consensus Forecasts (May 2017)

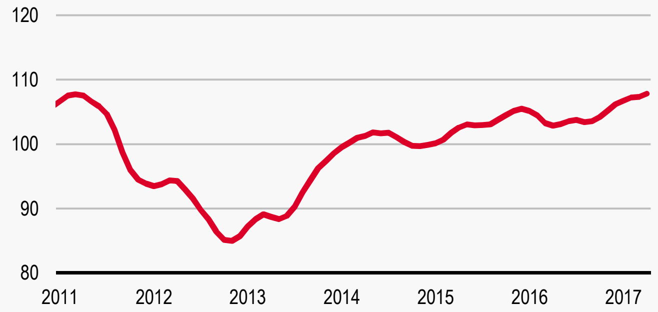
Eurozone outlook improving, but medium-term prospects still weak

The outlook for the eurozone is strengthening, supported by still low oil prices, monetary easing and employment growth. 2017 GDP growth is estimated at 1.7%, which is higher than was expected at the beginning of this year. Emmanuel Macron's election as French president has reduced political risk in the eurozone. However, uncertainty in the external environment remains high. The triggering of Article 50 by the British government, officially starting the EU exit process, and the call of snap elections in the UK could pose a downside risk to the overall European economy. The same is true for possible protectionist policies of the US administration. In 2018, eurozone growth is expected to ease to 1.6%.

Over the next two years the eurozone economy is likely to benefit from higher growth in emerging markets, as commodity prices recover. Monetary policy will remain very supportive, creating a policy divergence with the US. Interest rates are very low, and expected to remain so beyond the end of the asset purchasing programme. The risk of a faster-than-expected US tightening cycle has abated following a more dovish tone from the Fed. Foreign exchange markets are believed to have largely priced in the yield differentials between the US and eurozone, which is supported by a recent bout of EUR strengthening vis-à-vis the USD.

With moderate external tailwinds, eurozone growth will largely have to come from private consumption and investment growth. Confidence indicators are pointing to accelerating economic activity. The European Sentiment Indicator (ESI) has strengthened to 109.6 in April. Consumption growth is expected to remain robust in 2017. While the expected higher inflation rate may dampen consumption growth somewhat, employment and nominal wage growth are likely to remain supportive. Q1 of 2017 results from the ECB Bank Lending Survey point to improved demand for credit among businesses and households. We expect investment to continue to grow at a moderate rate as it remains constrained by both crisis legacy issues and low productivity growth.

Eurozone economic sentiment in an upswing
seasonally adjsuted, 3-month average



Source: European Commission

Advanced Markets

Economic growth forecasts

	2017	2018
United Kingdom	1.7	1.4
United States	2.1	2.4

Source: Consensus Forecasts (May 2017)

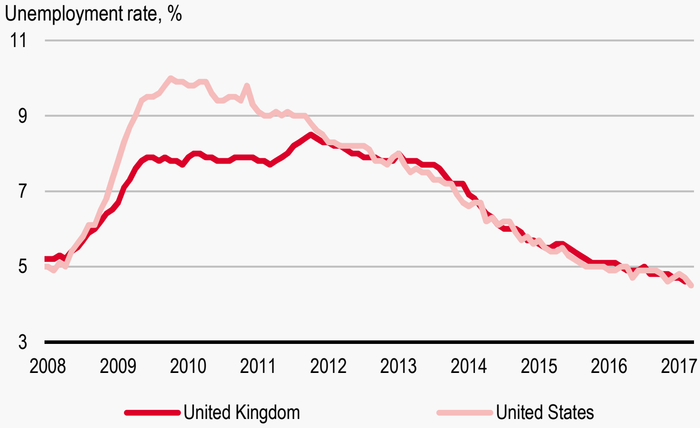
US growth accelerates while UK proves resilient

US economic growth slowed to 1.2% y-o-y in Q1 of 2017, from 2.1% in Q4 of 2016. This was not as low as initially estimated (0.7%) and in line with generally weak first quarter performances in the US. Consumer spending disappointed slightly, growing only 0.6% after a strong performance in 2016. At the same time business investment expanded 11.4% in Q1 of 2017, the strongest growth since Q1 of 2012, thanks to higher confidence and a more stable commodity price outlook. Unemployment has decreased to 4.4%, the lowest figure since May 2007. With better-than-expected Q1 GDP figures and strong labour market data, the Federal Reserve is on course to hike its policy rate another 0.25 points this month, its second increase this year. However wage growth is failing to gain momentum, growing only 2.5% y-o-y in April. Inflation eased slightly in April to 1.7%, but remains close to the Fed's target.

Following a resilient growth rate of 1.8% in 2016, economic momentum is beginning to ease in the UK. GDP grew only 0.2% q-o-q in Q1 of 2017, compared to an average 0.6% growth rate in 2016. The pound, which is about 14% lower relative to the US dollar and the euro compared to June 2016 is increasingly feeding into higher inflation. Consumer prices rose 2.3% y-o-y in Q1 of 2017 while wages grew 2.1%, marking the first quarter of negative real wage growth since mid-2014 (in April, prices were up 2.7% y-o-y). This decreases the purchasing power of UK businesses and consumers and is resulting in slower growth in consumer-oriented sectors. GDP expansion is forecast to slow to 1.7% this year and to decelerate further in 2018, to 1.4%. Uncertainty surrounding the UK's future relationship with the EU is expected to increasingly weigh on growth in the medium term. Prime Minister Theresa May has called a snap election on June 8th with the aim of gaining a broad popular mandate in order to strengthen her Brexit negotiation stance. While it is currently expected that the incumbent administration will gain a larger majority in parliament, there is always the risk that the results do not meet polls' expectations.

US and UK labour markets still strengthening

Unemployment rate, %



Source: Macrobond

Emerging Markets

Economic growth forecasts

	2017	2018
Asia (excl. Japan)	5.7	5.6
Latin America	1.6	2.6
Eastern Europe	2.5	2.7

Source: Consensus Forecasts (May 2017)

Emerging market growth is strengthening in 2017

Growth prospects for emerging markets for 2017 have improved slightly. Several key players (Russia, Brazil and Argentina) are emerging from recessions, while many emerging markets benefit from higher commodity prices. Financing conditions are expected to remain relatively benign, albeit subject to occasional periods of volatility.

Emerging Asia is expected to maintain its high growth rate in 2017 and 2018, particularly driven by India. China is expected to slow only slightly compared to last year, with GDP expanding 6.6% compared to 6.7% in 2016. China's authorities continue to rely on rapidly expanding credit in order to boost economic growth, despite clear evidence of state inefficiencies and property bubbles in some cities. Reform progress is slow, but may pick-up after president Xi Jinping has consolidated his power at a party conference later this year. Chinese GDP growth is expected to slow in the medium-term, as the economy shifts away from credit-driven investment to more domestic consumption-driven growth. While we do not expect a hard landing of the Chinese economy in the short-term, the risks remain considerable.

In Latin America, Brazil and Argentina are exiting recession in 2017, with a 0.6% and 2.7% growth forecast respectively. However, Brazil's return to orthodox market-friendly policies is under threat due to corruption allegations against president Temer. The Trump presidency in the US is also creating uncertainty in the region, particularly weighing on Mexico's growth expectations for 2017, which have been revised down to 1.8%, from 2.2% in November 2016.

In Eastern Europe, the outlook for Russia has improved along with the modest recovery in oil prices. GDP growth is expected to reach 1.3% in 2017 and to rise to 1.7% in 2018. However, structural weaknesses and the negative impact of sanctions on productivity and investment will continue to weigh on growth.

The Trump administration has backed away from some of its protectionist rhetoric, such as a vow to label China a currency manipulator. It appears that the US administration is taking a more pragmatic approach towards trade. However, in the medium-term considerable downside risks remain from protectionist trade policies and restrictions on immigration. Additionally, US monetary policy tightening could hurt the growth prospects of emerging economies with high external vulnerabilities.

Credit and insolvencies

Insolvency outlook stable, but downside risks on the horizon

Credit standards for corporate loans in the eurozone eased slightly in Q1 of 2017. But banks are expected to tighten credit standards for loans to enterprises in Q2 but lending growth is expected to hold up, supported by very low interest rates set by the ECB which are eroding bank profitability. Thus, credit conditions should support the European business environment in 2017.

The 2017 insolvency outlook for the eurozone is relatively positive. We forecast a 4% decrease in corporate bankruptcies with relatively balanced outlooks for individual countries. Insolvencies are expected to be stable in Germany, Greece and Belgium (within a +2% /- 2% range), while they are forecast to increase in Austria and to improve significantly in the Netherlands and the eurozone periphery (Ireland, Italy, Portugal, and Spain). Political uncertainty remains a downside risk for the insolvency development in the eurozone, but thus far, it appears momentum toward populist policies is easing.

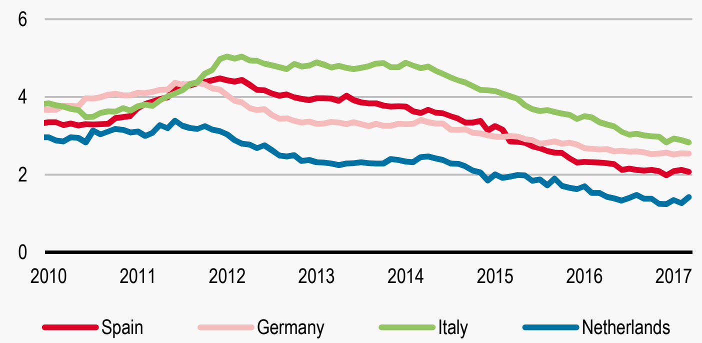
Insolvencies have started to pick up again in the UK, and we expect this trend to continue, with a 6% insolvency increase forecast in 2017, as the weak pound weighs on household purchasing power.

US business insolvencies are forecast to increase 2%, which is within the boundary of a stable outlook. Policy uncertainty could additionally weigh on the business environment, but this is not our baseline scenario for the time being. Business confidence is very high and the new administration's policy proposals are largely business-friendly. Tax cuts should encourage higher capital spending and risk appetite, but the most capital-intensive industries like energy and utilities are also the most debt-riddled, which could prove a downside risk for the insolvency outlook in the coming years.

In emerging markets, credit conditions have continued to worsen in Q4 of 2016, according to the Institute of International Finance's latest EM Bank Lending Conditions Survey. This is driven by heightened political uncertainty and the prospect of a tighter US monetary policy. Therefore, despite the emergence from recession of some key countries, we expect insolvencies in emerging markets to increase again in 2017.

Interest rates continue to decline

Interest rate on short-term corporate loan, %



Sources: Macrobond, IMF

Macroeconomic indicators for key markets

	GDP growth (% of GDP)			Budget balance (% of GDP)			Current account balance (% of GDP)			Export growth (%)			Political risk Rating[1]	
	2016	2017	2018	2016	2017	2018	2016	2017	2018	2016	2017	2018		
Western markets														
Austria	1.5	1.7	1.6	-0.8	-1.0	-0.6	2.7	2.6	3.1	1.6	3.2	4.6	2	POSITIVE
Belgium	1.2	1.5	1.6	-2.7	-2.4	-2.2	-0.4	0.3	0.4	4.2	5.4	4.5	2	STABLE
Finland	1.4	1.5	1.4	-1.9	-2.4	-2.7	-1.1	-0.1	-0.2	-0.5	12.4	8.9	2	POSITIVE
France	1.1	1.4	1.5	-3.4	-3.0	-2.9	-1.1	-1.3	-1.2	0.0	9.1	3.0	2	STABLE
Germany	1.9	1.6	1.6	0.7	0.6	0.5	8.9	8.3	8.4	1.5	4.5	4.4	1	
Greece	0.0	1.2	2.1	-2.6	-1.6	-0.8	-1.0	-1.3	-1.4	-6.5	3.7	4.3	7	POSITIVE
Ireland	5.2	4.0	2.8	-1.5	-0.6	0.2	4.5	11.5	9.0	-0.8	12.6	6.9	3	NEGATIVE
Italy	0.9	0.9	0.9	-2.4	-3.7	-2.6	2.8	1.7	1.7	1.6	4.0	4.0	4	STABLE
Netherlands	2.2	2.2	1.8	-0.3	-1.1	-0.8	8.1	11.8	16.5	0.1	6.3	4.8	1	
Portugal	1.4	1.7	1.5	-2.5	-1.7	-1.4	0.9	0.5	0.3	2.0	3.7	3.7	5	POSITIVE
Spain	3.2	2.7	2.3	-4.5	-3.5	-3.1	2.3	0.9	0.9	2.6	6.4	5.9	4	POSITIVE
Eurozone	1.7	1.7	1.6	-1.7	-1.7	-1.5	3.9	3.5	3.8	2.7	3.2	3.0		
Australia	2.5	2.5	2.8	-1.6	-1.1	-0.6	-2.7	-2.1	-3.1	2.8	9.7	4.8	1	
Canada	1.4	2.4	1.9	-1.9	-1.9	-1.5	-3.3	-2.5	-2.8	0.0	7.3	3.0	1	
Denmark	1.3	1.6	1.6	-1.5	0.3	-0.2	8.1	7.3	6.4	-1.4	9.6	7.1	1	
Norway	0.8	1.6	1.9	2.7	4.4	5.8	4.0	3.0	2.0	-10.0	5.8	8.7	1	
Sweden	3.3	2.8	2.3	0.2	-0.4	-0.3	4.6	5.8	5.2	0.8	4.4	5.8	1	
Switzerland	1.3	1.5	1.7	0.8	0.3	0.2	9.8	8.0	7.2	2.5	3.3	4.4	1	
United Kingdom	1.8	1.7	1.4	-2.9	-2.8	-2.6	-4.4	-3.3	-2.9	4.1	6.7	4.3	2	STABLE
United States	1.6	2.1	2.4	-4.2	-3.6	-3.8	-2.6	-2.3	-2.1	-1.4	4.9	3.4	1	#N/A
Central and Eastern Europe														
Czech Republic	2.3	2.5	2.6	0.6	-0.6	-0.4	1.0	0.5	-1.1	0.7	8.2	5.4	3	POSITIVE
Hungary	2.0	3.3	3.2	-1.7	-2.5	-2.8	4.9	2.4	1.8	5.2	7.5	7.8	5	POSITIVE
Poland	2.7	3.4	3.2	-2.5	-3.1	-2.9	-0.5	-0.6	-0.5	8.5	4.2	5.7	3	NEGATIVE
Russia	-0.2	1.3	1.7	-3.8	-3.0	-1.4	1.9	4.3	2.4	-8.1	16.4	-0.9	5	POSITIVE
Slovakia	3.3	3.2	3.4	-2.2	-1.5	-0.9	-0.7	0.3	1.5	2.8	4.6	7.5	3	POSITIVE
Turkey	2.9	3.1	3.2	-2.1	-2.3	-2.2	-3.6	-4.8	-5.2	0.8	12.2	15.0	5	STABLE
Asia														
China	6.7	6.6	6.2	-4.2	-4.2	-4.0	1.8	3.0	2.8	6.2	8.8	8.9	3	STABLE
India	7.0	7.3	7.6	-6.7	-4.9	-4.9	-0.6	-1.2	-1.9	9.0	12.6	18.0	4	NEGATIVE
Japan	1.0	1.4	1.1	-3.6	-3.1	-3.2	3.8	4.3	4.1	-7.5	7.7	7.3	3	POSITIVE
Latin America														
Brazil	-3.6	0.6	2.5	-8.9	-7.6	-5.7	-1.3	-1.4	-1.9	3.3	-4.1	13.2	5	POSITIVE
Mexico	2.3	1.8	2.2	-3.3	-2.2	-1.8	-2.7	-1.5	-1.4	13.1	5.4	3.3	4	POSITIVE

[1] Note: STAR is Atradius' in-house political risk rating. The STAR rating runs on a scale from 1 to 10, where 1 represents the lowest risk and 10 the highest risk. In addition to the 10-point scale there are rating modifiers associated with each scale step: 'Positive', 'Stable', and 'Negative'. These rating modifiers allow further granularity and differentiate more finely between countries in terms of risk.

Sources: Consensus Economics, IHS, National accounts, Atradius Economic Research

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