Economic Update

August 2017

Summary

Global

Recovery picking up steam

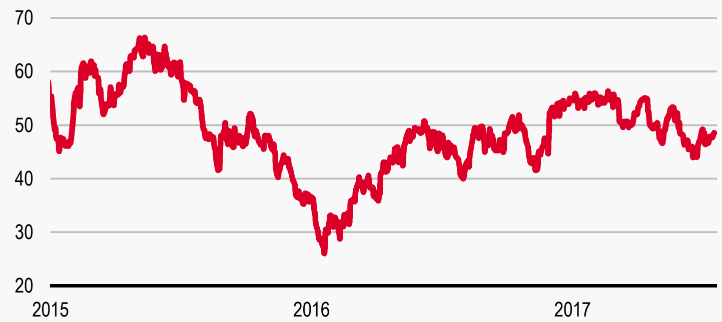
The global economy is continuing to strengthen. Worldwide growth is expected to increase 3.0% in 2017 and 2018. GDP growth is underpinned by a strong US economy, falling unemployment and improving consumer and business confidence across advanced markets. The main challenges to the global outlook – low inflation, negative bond yields, austerity, and low commodity prices – are slowly phasing out. The outlook for emerging markets is brighter than 2016 as well, as Brazil and Russia emerge from recession and access to finance remains favourable. While the global economic outlook is more robust than years past, political risk remains a downside risk to stability.

Not only is global GDP strengthening, but also is global trade growth. After a lacklustre 1.3% expansion in 2016, trade growth (12-month rolling average, y-o-y) has picked up to 2.4% as of April 2017. Despite policy uncertainty, most high-frequency indicators point to sustained growth: the global manufacturing PMI has been above the 50 neutral mark for 17 consecutive months while new export orders also showed 12 months of improvements and are at the highest level in six years. Atradius forecasts full-year global trade growth to reach 3.2% in 2017, compared to 1.3% in 2016. However, policy uncertainty, mainly related to potential protectionism, remains a concern for the positive outlook.

Oil prices remain just below USD 50 per barrel of Brent crude. The persistent weakness is in spite of the OPEC production cut, as supply and inventories in the US have continued to increase. OPEC is expected to maintain its production cut agreement though to end-2018 and to phase it out gradually in order to avoid sharp disruptions. Oil prices are expected to remain muted in the short term: the US Energy Information Administration forecasts a barrel of Brent to average USD 51 in 2017 and USD 52 in 2018.

Supply glut keeps oil price below USD 50 per barrel

Brent crude oil, USD per barrel



Sources: Macrobond, EIA

Eurozone

Economic growth forecasts

	2017	2018
Austria	1.9	1.7
Belgium	1.6	1.6
Finland	2.2	1.6
France	1.5	1.6
Germany	1.7	1.7
Greece	1.1	1.9
Ireland	4.1	3.0
Italy	1.2	1.0
Netherlands	2.3	1.9
Portugal	2.4	1.7
Spain	3.0	2.5
Eurozone	1.9	1.7

Source: Consensus Forecasts (Jul 2017)

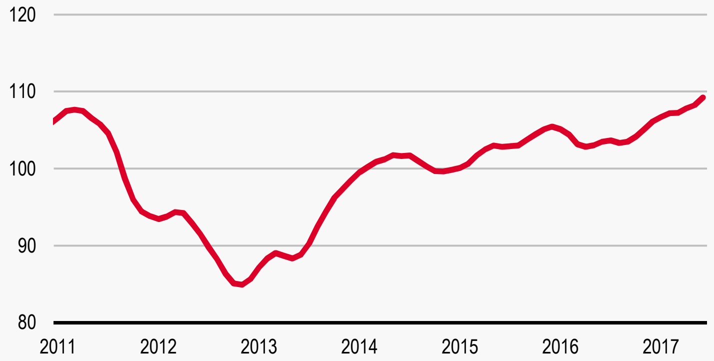
Eurozone growth firming

The eurozone growth rate is firming due to a stronger momentum in domestic demand than previously anticipated. In 2017, GDP growth is estimated at 1.9%, versus 1.4% expected at the beginning of this year. Emmanuel Macron's sweeping victory in both the French presidential and parliamentary elections has reduced political risk. Macron now faces the challenging task of reforming the French economy and reinvigorating the Franco-German axis.

The eurozone economy is expected to benefit in 2017 from a pick-up in global activity, driven largely by emerging markets and some advanced markets. Monetary policy in the eurozone remains supportive, creating a policy divergence with the US. Interest rates are very low, and are expected to remain so beyond the end of the asset-purchasing programme. While Mario Draghi remains firmly committed to the current stimulus programme, the stronger economic backdrop has already started speculation when and how the ECB is going to exit its ultra-loose monetary policy. In a speech given in late June he suggested that "deflationary forces" have been replaced by reflationary ones, a first sign that Draghi is getting slightly more hawkish.

Despite the pick-up in global activity, 2017 eurozone growth will largely come from domestic demand. Consumer and business confidence indicators are still very strong. The Eurozone composite PMI dropped from 56.3 in June to 55.8 in July, the lowest in six months. The European Sentiment Indicator (ESI) strengthened from 109.2 in May to 111.1 in June, the highest score since mid-2007. Private consumption growth is expected to remain robust in 2017. While the expected higher inflation rate may dampen household consumption growth somewhat, employment and nominal wage growth are likely to remain supportive. Q2 of 2017 results from the ECB Bank Lending Survey show a strengthening of 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.

Economic Sentiment Indicator
seasonally adjsuted, 3-month average



Source: European Commission

Advanced Markets

Economic growth forecasts

	2017	2018
United Kingdom	1.6	1.4
United States	2.2	2.3

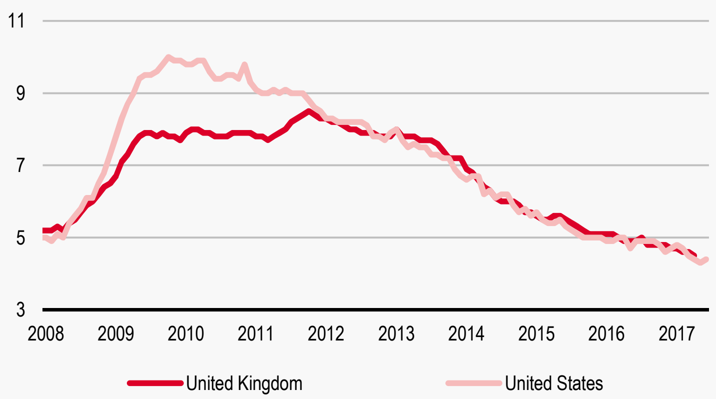
Source: Consensus Forecasts (Jul 2017)

US economy is strong while UK begins to falter

The US economic outlook is steady with 2.2% GDP growth forecast in 2017 and 2.3% in 2018. After a characteristically weak performance in Q1 (1.4% y-o-y growth), growth is expected to accelerate in the remainder of the year driven primarily by consumer spending, supported by low interest rates and the tightening labour market. Job growth surprised to the upside in June and the unemployment rate ticked up to 4.4%, indicating more people are looking for work – a sign of confidence. Inflation (as measured by personal consumption expenditures excluding food and energy) though has continued to ease further to 1.4% y-o-y in May 2017. In its June policy meeting, the Fed increased its main policy rate by 25 basis points for the second time in three months, to a range between 1% to 1.25%. But the pace of tightening will remain gradual, especially as inflation disappoints. The next rate hike is currently expected in December this year followed by two further hikes in 2018.

The UK economy has been resilient in the aftermath of the Brexit vote but GDP growth is beginning to ease. The sterling is still down about 13% against the USD since June 2016 which is feeding into higher inflation. Inflation did ease for the first time in nine months in June to 2.6%, from 2.9% the month before. This is mainly due to lower fuel prices. With wage growth of only 1.8%, UK consumers are still facing pressure on their real disposable incomes. The June 2017 general elections caused the ruling Conservative Party to lose its majority, adding uncertainty ahead of the Brexit negotiations. For now, the political situation is stable with a coalition formed with the Norther Ireland's Democratic Unionist Party. 2017 GDP growth is expected to ease to 1.6% and further to 1.4% in 2018.

US and UK labour markets tightening
Unemployment rate, %



Source: Macrobond

Emerging Markets

Economic growth forecasts

	2017	2018
Asia (excl. Japan)	5.8	5.6
Latin America	1.6	2.4
Eastern Europe	2.8	2.7

Source: Consensus Forecasts (Jul 2017)

Improving prospects for EMEs

Emerging markets' growth prospects continue to improve. Some of the largest markets (Russia, Brazil, and Argentina) are emerging from recession, while many others benefit from the elevated commodity prices. Financial markets' perception of emerging economies is increasingly positive, but countries with high external liabilities remain vulnerable.

Emerging Asia is expected to maintain its high growth rate in 2017 and 2018, particularly driven by India. Chinese growth is expected to slow only slightly compared to last year, with GDP expanding 6.6% (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 authorities increasingly take steps to rein in credit 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 0.4% and 2.7% growth forecast respectively. However, Brazil's return to orthodox market-friendly policies is under threat due to allegations of corruption and conspiracy against President Michel Temer. Mexico's 2017 growth prospects have improved in recent months, amidst receding uncertainty over the potential fallout from the Trump presidency in the US and strong GDP figures in Q1 of 2017.

In Eastern Europe, the outlook for Russia has improved along with the modest recovery in oil prices. GDP growth is expected to reach 1.4% 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.

After the initial negative reaction to the protectionist rhetoric of the Trump administration, financial markets' perception of emerging economies is shifting in a positive direction. 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. The US Supreme Court has permitted a scaled-back version of president Trump's ban on travellers from six Muslim-majority countries. Additionally, emerging economies remain vulnerable to US monetary policy tightening, which could hurt the growth prospects of countries with high external liabilities.

Credit and insolvencies

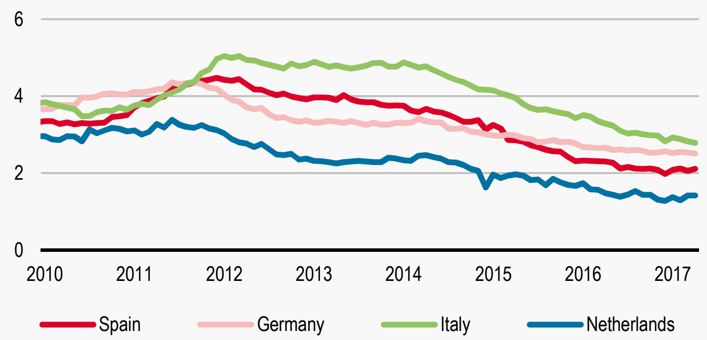
Insolvency outlook stable but uncertainty remains downside risk

Credit conditions in the eurozone are supportive and are expected to remain so in 2017. According to the ECB's Q2 bank lending survey, lending standards for corporate loans in the eurozone eased in Q2 of 2017 despite expectations that they would slightly tighten. The further easing is driven by competitive pressure which is expected to continue in the current quarter. Lending growth is expected to hold up, supported by very low interest rates set by the ECB, which are eroding bank profitability. 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% range), while 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 that momentum toward populist policies is easing.

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. Business confidence is still 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. 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.

In emerging markets credit conditions have continued to tighten in Q1 of 2017, according to the Institute of International Finance's latest EM Bank Lending Conditions Survey. Demand for loans has also decreased. This is driven in part by expectations of rising political risk. Therefore, despite the emergence from recession of some key countries, we expect insolvencies in emerging markets to increase again in 2017.

Eurozone 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 (% GDP)			Current account balance (% GDP)			Export growth (%)			Political risk Rating[1]
	2016	2017	2018	2016	2017	2018	2016	2017	2018	2016	2017	2018	
Western markets													
Austria	1.5	1.9	1.7	-1.5	-1.1	-0.7	1.7	2.2	2.2	1.4	3.9	3.7	2 POSITIVE
Belgium	1.2	1.6	1.6	-2.6	-2.3	-2.1	-0.4	0.3	1.0	6.0	4.1	3.5	2 STABLE
Finland	1.5	2.2	1.6	-1.9	-1.6	-1.3	-1.1	-0.7	-1.1	1.5	3.6	2.1	2 POSITIVE
France	1.1	1.5	1.6	-3.4	-3.1	-2.9	-0.9	-1.1	-1.2	1.9	3.1	3.3	2 STABLE
Germany	1.9	1.7	1.7	0.8	0.5	0.5	8.4	7.9	7.2	2.5	3.8	3.6	1
Greece	0.0	1.1	1.9	0.7	-1.3	-1.2	-0.6	-1.2	-1.4	-1.7	1.9	2.2	7 POSITIVE
Ireland	5.2	4.1	3.0	-0.6	-0.7	-1.1	4.9	4.6	4.6	2.4	4.4	2.6	3 NEGATIVE
Italy	0.9	1.2	1.0	-2.4	-2.3	-2.1	2.6	2.3	2.3	2.6	3.9	2.2	4 STABLE
Netherlands	2.2	2.3	1.9	0.4	0.7	0.5	8.5	9.6	9.2	4.1	3.8	3.5	1
Portugal	1.4	2.4	1.7	-2.0	-1.8	-1.6	0.8	0.1	-0.2	4.4	8.2	3.0	5 POSITIVE
Spain	3.2	3.0	2.5	-4.5	-3.3	-2.4	2.0	1.6	1.6	4.4	7.0	4.4	4 POSITIVE
Eurozone	1.7	1.9	1.7	-1.5	-1.4	-1.3	3.6	3.5	3.2	2.9	3.6	3.3	-
Australia	2.5	2.1	2.8	-2.0	-1.8	-2.1	-2.6	-1.9	-3.3	7.9	6.0	4.3	1
Canada	1.5	2.7	1.9	-1.9	-2.4	-2.4	-3.3	-3.4	-3.3	1.0	1.9	2.0	1
Denmark	1.7	1.8	1.8	-0.9	-0.6	-0.4	8.1	8.0	8.4	1.7	4.4	2.5	1
Norway	0.8	1.8	1.9	3.1	4.2	3.9	5.0	7.6	6.8	-0.6	2.0	2.4	1
Sweden	3.2	2.7	2.5	0.9	0.3	0.8	4.6	4.8	4.7	3.1	2.5	2.5	1
Switzerland	1.3	1.4	1.7	0.7	0.2	0.3	10.7	9.7	10.9	4.5	2.4	4.2	1
United Kingdom	1.8	1.6	1.4	-3.0	-3.6	-3.5	-4.4	-4.3	-4.1	1.8	3.0	3.0	2 STABLE
United States	1.6	2.2	2.3	-3.2	-3.5	-3.8	-2.4	-2.9	-2.7	0.4	2.1	1.6	1
Central & Eastern Europe													
Czech Republic	2.5	2.9	2.6	0.6	-0.5	-1.0	1.1	0.9	0.4	4.0	4.7	4.3	3 POSITIVE
Hungary	2.0	3.7	3.3	-1.9	-2.5	-2.7	4.9	3.4	2.7	5.8	6.0	5.6	5 POSITIVE
Poland	2.7	3.7	3.4	-2.5	-2.8	-2.7	-0.3	-0.8	-1.2	9.0	8.6	7.1	3 NEGATIVE
Russia	-0.2	1.4	1.7	-3.4	-2.1	-1.3	2.0	3.4	2.4	3.1	5.3	1.9	5 NEGATIVE
Slovakia	3.3	3.2	3.5	-1.7	-1.6	-1.4	-0.7	-0.2	0.7	4.8	5.3	4.7	3 POSITIVE
Turkey	2.9	4.1	3.4	-1.1	-2.3	-2.4	-3.8	-4.2	-4.1	-1.9	4.8	4.4	5 STABLE
Asia													
China	6.7	6.6	6.3	-3.8	-4.1	-4.4	1.7	1.2	1.5	1.1	4.8	2.4	3 STABLE
India	7.1	7.3	7.6	-3.5	-3.2	-3.1	-0.5	-0.9	-1.1	4.4	3.4	3.9	4 NEGATIVE
Japan	1.0	1.4	1.1	-5.2	-5.1	-5.6	3.8	4.0	4.8	1.1	5.0	3.9	3 POSITIVE
Latin America													
Brazil	-3.6	0.4	2.1	-6.4	-7.8	-6.1	-1.3	-1.0	-1.8	1.9	5.5	1.9	5 POSITIVE
Mexico	2.3	2.0	2.2	-2.6	-1.9	-2.3	-2.1	-1.9	-2.3	1.3	3.8	2.9	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, Macrobond, Economist Intelligence Unit, Atradius Economic Research

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