Managing risk, enabling trade

Economic Update

December 2016

Summary

Global

GDP and trade growth marred by political uncertainty

Following a modest 2.9% expansion in 2015, the global economy is forecast to grow only 2.5% in 2016, mainly due to low commodity prices, weak recoveries in developed markets, economic rebalancing in China and uncertainty surrounding US monetary policy. In 2017 global GDP growth is forecast to just slightly accelerate (up 2.8%). Political uncertainty has significantly increased in advanced markets because of the Brexit decision and the election of Donald Trump in the US. These events could trigger further success of populist movements and parties in Europe (e.g. in Italy where a constitutional referendum is to be held early this month or in the 2017 elections held in the Netherlands, France and Germany). The net effects would be negative for global GDP growth as business investment would be postponed and international trade could slow down further.

International trade has had a difficult year, but trade growth is not as low as originally forecast. Data revisions from the Dutch Bureau for Economic Policy Analysis show that the volume of international trade has actually grown 1% y-o-y in August 2016, as opposed to the 0.3% previously estimated. While this is still a sharp slowdown from the 2% expansion seen in 2015, it is slightly less worrying. Forward-looking indicators, such as export orders, point to a pick-up in trade growth. The Baltic Dry Index – the cost of bulk material, an indicator of the outlook for global trade and economic growth – has sharply increased due to the anticipated boost in demand for raw materials in the US should Mr Trump's large infrastructure investment projects materialise. That said, higher protectionism in major advanced economies could keep trade growth at low levels. Therefore the outlook is highly uncertain, as evidenced by the WTO's 2017 forecast range of 1.8% to 3.1%.

The price of oil has been gradually recovering to levels around USD 50 per barrel. OPEC, as well as Russia, has agreed to cut production which has sent the price above USD 50. The US Energy Information Association (EIA) predicts that the oil price will continue to rise steadily, to USD 56 by the end of 2017.

Oil price

Brent, USD per barrel

Source: IHS

Eurozone

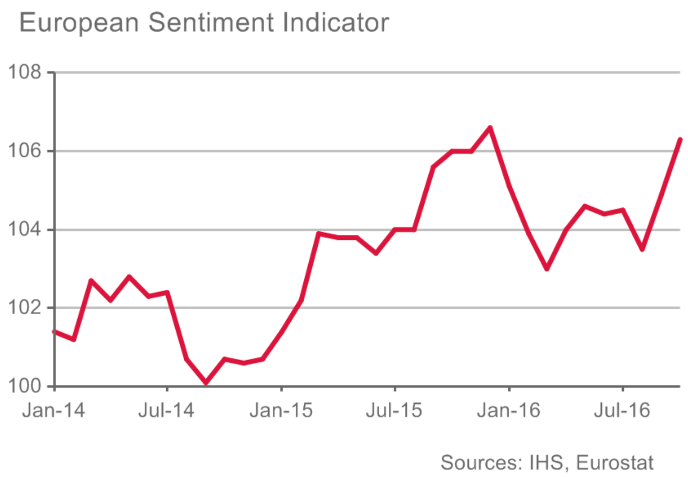
Economic growth forecasts	2016	2017
Austria	1.3	1.2
Belgium	1.4	1.4
Finland	0.9	1.1
France	1.3	1.2
Germany	1.8	1.3
Greece	-0.5	1.1
Ireland	3.8	3.0
Italy	0.8	0.7
Netherlands	1.6	1.5
Portugal	1.0	1.3
Spain	3.1	2.2
Eurozone	1.6	1.3

Source: Consensus Forecasts (Nov 2016)

Eurozone recovery fragile but confidence is strong

The recovery in the eurozone remains fragile. After expanding 1.9% in 2015, the euro area's economy is forecast to grow only 1.6% in 2016 and 1.3% in 2017. The high dependency on exports for economic growth is causing the slowdown since exports no longer receive support from a depreciating euro and external demand remains subdued. At the same time, structural issues persist in the form of a very weak banking sector, debt overhang and low productivity growth. Uncertainty is also rising, particularly related to political developments such as the Brexit negotiations, the referendum in Italy, and the upcoming elections in France and Germany. However, despite those challenges confidence continues to increase as reflected in the European Sentiment Indicator's upward trajectory since August 2016. An improving labour market and ultra-loose monetary policy are also successfully boosting consumer demand.

Within the euro area great divergences in economic performances remain. The largest economy, Germany, is losing momentum as lower foreign demand curbs new business investment and output. German GDP is forecast to slow from 1.8% this year to 1.3% in 2017. However, the slowdown is partially offset by increased household consumption thanks to record-high employment, rising real wages and low inflation. In Italy, growth is stagnating as confidence decreases, especially due to banking sector instability and political uncertainty surrounding the upcoming constitutional referendum.



Advanced Markets

US and UK: steady growth, but political uncertainty remains

Economic growth forecasts

	2016	2017
United Kingdom	2.0	1.1
United States	1.5	2.2

Source: Consensus Forecasts (Nov 2016)

The US economy is estimated to grow only 1.5% in 2016, primarily due to lower inventory investments. Fixed investment growth has also been holding back growth, especially in the oil and gas sector, while the strong USD has damaged US exports' competitiveness. That said, economic fundamentals remain strong. The domestic market shows robust private consumption, which accounts for more than two-thirds of the US economy. Unemployment stands at 4.9% and the labour force participation rate is slowly increasing, while inflation has increased to 1.5% y-o-y in September. The tightening labour market and higher inflation are most likely enough evidence to push the Federal Reserve to increase interest rates in its December 2016 policy-setting meeting.

The election of Donald Trump has added a large degree of uncertainty to the economic outlook due to uncertainty around his policy agenda. A potentially large fiscal stimulus in the form of tax cuts and infrastructure investment could boost GDP growth in the short term - as well as inflation. This could prompt the Fed to follow a quicker-than-expected tightening schedule. However, in the longer term growth could be significantly restrained by rising protectionist measures.

So far, the British economy has proven resilient to shocks from the Brexit vote. Immediately after the referendum held in June, 2016 GDP growth forecasts were cut 0.3 percentage points to only 1.6%. However, the UK economy is now forecast to grow 2.0% this year, a tenth of a percentage point higher than pre-Brexit forecasts. This is attributable to a robust H1 and the benefits of weak pound sterling. However, the 2017 outlook is not as bright: at 1.1% the forecast is one percentage point lower than June 2016 forecasts. While this is not a slowdown as severe as initially expected – thanks to a smooth and swift move to a new government and effective monetary policy – the economic performance remains clouded by Brexit-related political and economic uncertainty, which will continue to weigh on business investment.

Source: IHS

Emerging Markets

Emerging markets set to see modest recovery in 2017

Economic growth forecasts

	2016	2017
Asia (excl. Japan)	5.7	5.6
Latin America	-0.4	2.1
Eastern Europe	1.5	2.3

Source: Consensus Forecasts (Nov 2016)

2016 has been a difficult year for many emerging market economies due to low commodity prices, US monetary policy uncertainty and geopolitical risks. While growth figures for Emerging Asia remain robust, fuelled by India in particular, other regions are slowing down. Latin America and Eastern Europe are particularly weighed down by recessions in their key markets Brazil and Russia.

China's economy is forecast to grow 6.7% in 2016 and to slow further in 2017, to 6.4%. A hard landing is still not likely, at least in the short term, as the Chinese authorities have gained credibility in using monetary and fiscal policy to maintain growth within a 6%-6.5% range. However, the credit-fuelled growth does provide a significant risk for the Chinese economy, as it is building on an already enormous base of outstanding debt.

In 2017, modest recoveries are expected for most emerging markets. In Latin America, Brazil and Argentina will exit recession (1.2% and 3.1% GDP growth respectively) thanks to a return to orthodox and market-friendly policies. Unfortunately there still does not seem to be light at the end of the tunnel for Venezuela, whose economy is forecast to contract 10.3% this year and another 3.2% in 2017. Looking at Eastern Europe, Russia is forecast to emerge from recession next year with a modest 1.2% expansion (down0.6% in 2016). GDP growth will be supported by higher commodity prices that will lead to a recovery in consumption and investment. A stronger pick up of growth is held back by sanctions and structural weaknesses, such as weak competition and a declining workforce

A quicker-than-expected monetary policy tightening cycle in the US could hurt emerging markets in 2017 though, particularly those with high external vulnerabilities. Protectionist policies in the US could also weigh on growth in countries that send a large share of their exports to the US (especially in Latin America). At the same time, certain commodity exporters could see a boost to growth triggered by increased demand for products (iron, steel, and cement) that would be used in infrastructure development in the US.

Credit and insolvencies

Subdued insolvency outlook

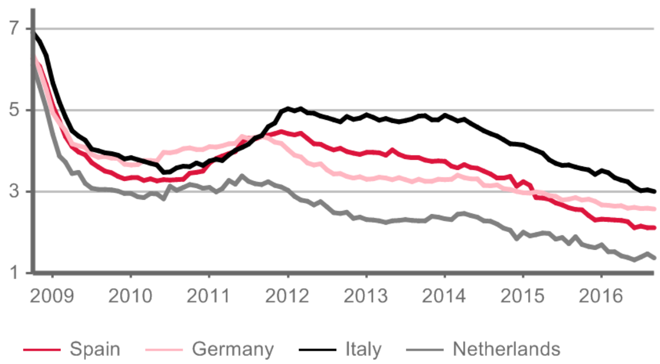
According to the most recent bank lending survey of the ECB, credit standards for loans to enterprises remained unchanged in Q3 of 2016. Very low interest rates on short-term corporate loans t are contributing to increased demand for loans to enterprises. Looking forward, eurozone banks are expected to tighten access to corporate credit for the first time in two and a half years. The ECB's negative deposit rate is eating into European bank profits, and banks are becoming more risk-wary.

Compared to 2015 the corporate insolvency outlook for 2016 has deteriorated. Looking at Western Europe as a whole, insolvencies are forecast to decrease only 1% this year, led by Spain (-12%) and the Netherlands (-10%), but several countries like Finland (+8%), Switzerland (+4%) and Denmark (+4%) are expected to see corporate bankruptcy increases. The business environment in those markets continues to be held back by stronger currencies relative to the euro, hurting their international competitiveness, while external demand remains low.

The 2017 insolvency outlook remains subdued for some major developed markets. Heightened uncertainty, largely related to Brexit, will weigh on investment and particularly affect the United Kingdom (+4%) and Ireland (+2%) in 2017. On the positive side, alongside the gradual recovery in commodity prices, the increasing trend in insolvencies will taper off in economies with large natural resources sectors like the US, Canada and Norway.

In line with weak 2016 GDP expectations, insolvencies are rising this year in many emerging markets. Credit conditions continue to tighten across emerging markets, reflected in the IIF's Q3 bank lending survey, while demand for loans is decreasing due to increasing perceptions of risk and uncertainty. The outlook for 2017 is slightly more positive with Brazil's insolvency level stabilising, but the insolvency environment will likely remain subdued in Russia and China.

Interest rate on short-term corporate loans



Source: IHS

Macroeconomic indicators for key markets

	GDP growth (% of GDP)			Budget balance (% of GDP)			Current account balance (% of GDP)			Export growth (%)			Political risk Rating[1]	
	2015	2016	2017	2015	2016	2017	2015	2016	2017	2015	2016	2017		
Western markets														
Austria	1.0	1.3	1.2	-1.1	-1.6	-1.2	1.9	2.7	2.4	2.9	2.2	4.2	2	POSITIVE
Belgium	1.4	1.4	1.4	-2.5	-2.7	-2.5	0.4	0.7	0.4	2.7	2.4	4.1	2	STABLE
Finland	0.2	0.9	1.1	-2.7	-2.4	-2.7	0.2	0.0	0.7	-1.0	2.2	3.6	2	POSITIVE
France	1.2	1.3	1.2	-3.6	-3.3	-3.2	-0.2	-0.9	-1.0	5.5	-0.6	1.9	2	STABLE
Germany	1.7	1.8	1.3	0.7	0.5	0.6	8.5	8.0	8.0	5.7	2.0	3.3	1	
Greece	-0.2	-0.5	1.1	-7.5	-2.6	-2.1	0.1	-0.3	-0.4	-8.5	-8.6	3.3	7	POSITIVE
Ireland	26.3	3.8	3.0	-1.9	-1.1	-0.9	10.2	8.3	9.1	44.4	5.8	6.9	3	NEGATIVE
Italy	0.7	0.8	0.7	-2.6	-2.5	-2.9	2.4	0.7	1.0	3.7	0.8	3.2	4	STABLE
Netherlands	2.0	1.6	1.5	-1.9	-1.1	-1.8	8.7	8.1	10.8	1.9	2.6	7.8	1	
Portugal	1.6	1.0	1.3	-7.7	-2.6	-2.0	0.5	0.2	0.0	4.2	1.7	5.5	5	POSITIVE
Spain	3.2	3.1	2.2	-5.1	-4.7	-3.7	1.4	1.6	0.7	5.8	4.7	4.7	4	POSITIVE
Eurozone	1.9	1.6	1.3	-2.1	-1.8	-1.7	3.9	3.3	3.5	6.2	2.7	2.5		
Australia	2.4	2.9	2.8	-1.4	-1.7	-1.0	-5.1	-3.1	-3.1	-3.2	2.0	6.6	1	
Canada	1.1	1.2	1.9	-1.3	-1.9	-1.4	-3.2	-3.3	-2.3	0.1	-0.5	4.4	1	
Denmark	1.0	1.0	1.6	-1.4	-1.4	-1.4	7.1	8.7	8.2	2.3	2.4	9.8	1	
Norway	1.1	0.8	1.7	5.7	2.5	3.9	8.0	5.6	7.4	-4.2	-6.2	6.7	1	
Sweden	4.1	3.3	2.3	0.2	-0.2	-0.5	5.3	4.5	4.6	7.2	-1.2	3.0	1	
Switzerland	0.8	1.5	1.5	1.1	0.5	0.2	11.2	11.1	14.1	-2.1	3.6	3.0	1	
United Kingdom	2.2	2.0	1.1	-4.3	-3.7	-3.7	-5.4	-5.4	-4.1	-0.3	2.5	6.0	2	STABLE
USA	2.6	1.5	2.2	-3.5	-4.0	-3.7	-2.6	-2.6	-2.2	-4.7	-1.9	5.2	1	
Central and Eastern Europe														
Czech Republic	4.6	2.5	2.4	-0.6	-0.6	-1.2	0.9	1.2	0.3	6.3	3.7	4.6	3	POSITIVE
Hungary	2.9	2.0	2.6	-1.6	-2.0	-2.5	4.4	4.6	3.9	8.1	9.1	10.1	5	POSITIVE
Poland	3.6	3.0	3.2	-2.6	-3.0	-3.2	-0.6	-1.0	-1.3	8.3	9.4	4.6	3	NEGATIVE
Russia	-3.7	-0.6	1.2	-3.7	-3.9	-3.5	5.2	1.4	2.0	11.5	-4.0	15.5	5	POSITIVE
Slovakia	3.6	3.4	3.1	-2.7	-2.1	-2.0	0.2	-0.3	0.3	5.5	4.0	4.9	3	POSITIVE
Turkey	4.0	3.0	3.0	-1.2	-2.4	-3.3	-4.5	-4.7	-4.8	11.7	5.3	15.8	5	STABLE
Asia														
China	6.9	6.7	6.4	-3.5	-4.2	-4.2	3.1	3.4	4.9	0.3	5.1	8.4	3	STABLE
India	7.6	7.6	7.6	-7.2	-6.5	-6.1	-1.1	-0.9	-1.3	-5.4	12.9	8.6	4	NEGATIVE
Japan	0.6	0.6	0.9	-5.3	-6.3	-6.5	3.3	3.7	3.3	3.5	-10.5	1.9	3	POSITIVE
Latin America														
Brazil	-3.8	-3.3	1.2	-10.3	-9.8	-9.5	-3.3	-2.0	-3.2	20.3	11.5	8.6	5	POSITIVE
Mexico	2.5	2.0	1.9	-3.5	-3.3	-2.6	-2.9	-2.5	-0.7	15.0	10.6	-1.1	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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