

Macroeconomic, Country Risk  
and Global Sector Outlook

# Economic Outlook no. 1216 March-April 2015

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and **ignore the noise**

Economic Research



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# Pump up the volume

LUDOVIC SUBRAN

We are almost there! After six years of intense depression, it seems that a weaker euro, lower oil prices and cheap financing costs are doing the trick - the largest economy in the world, Europe, is finally on the mend. It did not come at zero cost for companies and households, but we should rejoice of finally seeing the light at the end of the tunnel. In the meantime, the world has changed dramatically. First, Asia got organized as demonstrated by China's thrive for a different DNA, Japan's fight against deflation, and the organization of smaller South east Asian economies in a smart building block in global value chains. Second, the U.S. has managed to show its resilience to strong headwinds and last, emerging markets have shown they do matter. Yet, economic growth in the BRICs hit a wall: Russia and Brazil are good examples of how politics and policies could harm reputation and endanger private sector growth. Ultimately the world seems to be growing more used to multiple hotspots, but this raises the importance of nurturing other options. There are two remaining questions about the alleged alignment of stars we are revealing in this report: (i) how long will it take for the positive macroeconomic developments to trickle down to companies' balance sheets? and (ii) are we ready for a priceless recovery? Regarding the pass-through, we do see the reduced energy bills pushing up profit margins of many small and medium enterprises, and households are often spending the extra disposable income. It is not happening universally and it has not yet translated in additional

investment decisions. Old habits die hard. But, if you add to this the very low cost of credit in advanced economies, it could take only another couple of quarters for investment to materialize. As for the absence of a price effect, this is a problem. Nominal growth is not picking up as inflation remains low. Indeed, overcapacity has become the norm in many industries, the fall in commodity prices is widespread, interest rates are at record lows and the depreciation of many key currencies do help neither turnover nor trade growth. So volumes will pick up this year, but nominal values may have to wait for another round of structural reforms, reassuring policies and a less messy emerging world. The amusing part of all of this is that a priceless recovery is happening with record liquidity levels, and the ominous formation of bubbles in many countries and sectors, including housing and infrastructure. Will we ever learn? Companies did –or died. The business cycle is not inevitable, corporates can perform better than their peers once they corrected for short-sightedness and stay nimble. This recovery is priceless for two reasons: first, it is invaluable as many companies were close to going bust, but conversely it is coming without a price effect and proper returns on investment. It is not picture perfect but we will manage, as always, because what is the alternative?

## OVERVIEW

# Focus on the signal and ignore the noise

The global recovery remains on track, but the story triggers neither champagne nor real pain

## MACROECONOMIC AND SECTOR RESEARCH TEAM

Real GDP growth, annual change, %

	Weights*	2013	2014	2015f	2016f
<b>WORLD GDP GROWTH</b>	<b>100</b>	<b>2.5</b>	<b>2.5</b>	<b>2.7</b>	<b>3.1</b>
<b>Advanced economies</b>	<b>62</b>	<b>1.4</b>	<b>1.7</b>	<b>2.1</b>	<b>2.3</b>
<b>Emerging economies</b>	<b>38</b>	<b>4.3</b>	<b>3.9</b>	<b>3.7</b>	<b>4.4</b>
<b>North America</b>	<b>25</b>	<b>2.2</b>	<b>2.4</b>	<b>2.9</b>	<b>2.9</b>
United States	22	2.2	2.4	2.9	3.0
Canada	3	2.0	2.5	2.0	2.1
<b>Latin America</b>	<b>8</b>	<b>2.8</b>	<b>0.9</b>	<b>0.5</b>	<b>2.2</b>
Brazil	3	2.5	-0.1	-0.7	1.3
Mexico	2	1.4	2.2	2.9	3.5
<b>Western Europe</b>	<b>23</b>	<b>0.0</b>	<b>1.2</b>	<b>1.5</b>	<b>1.6</b>
United Kingdom	4	1.7	2.6	2.5	2.2
Sweden	1	1.3	2.3	2.4	2.6
<b>Eurozone members</b>	<b>17</b>	<b>-0.4</b>	<b>0.9</b>	<b>1.3</b>	<b>1.5</b>
Germany	5	0.2	1.6	1.7	1.6
France	4	0.4	0.4	1.0	1.4
Italy	3	-1.9	-0.4	0.4	0.9
Spain	2	-1.2	1.4	2.0	2.0
The Netherlands	1	-0.7	0.8	1.3	1.6
Belgium	1	0.3	1.0	1.2	1.5
Greece	0	-4.0	0.7	0.6	1.7
Portugal	0	-1.4	0.9	1.3	1.5
<b>Central and Eastern Europe</b>	<b>6</b>	<b>1.9</b>	<b>1.4</b>	<b>-1.2</b>	<b>-0.1</b>
Russia	3	1.3	0.6	-5.5	-4.0
Turkey	1	4.1	2.9	4.3	4.0
Poland	1	1.7	3.3	3.0	3.2
<b>Asia</b>	<b>29</b>	<b>5.0</b>	<b>4.4</b>	<b>4.8</b>	<b>5.2</b>
China	12	7.7	7.4	7.1	7.0
Japan	8	1.6	-0.1	1.0	1.5
India	3	6.9	7.5	7.7	7.8
<b>Oceania</b>	<b>2</b>	<b>2.1</b>	<b>2.7</b>	<b>2.6</b>	<b>2.9</b>
Australia	2	2.1	2.7	2.6	2.9
<b>Middle East</b>	<b>4</b>	<b>2.4</b>	<b>3.0</b>	<b>3.1</b>	<b>3.1</b>
Saudi Arabia	1	2.7	3.6	2.5	3.5
United Arab Emirates	1	5.0	4.0	3.5	4.5
<b>Africa</b>	<b>3</b>	<b>4.1</b>	<b>3.5</b>	<b>3.8</b>	<b>5.1</b>
South Africa	1	2.2	1.5	2.0	3.0
Morocco	0	4.4	2.7	4.5	4.5

\*Weights in global GDP at market prices, 2014

Sources: National sources, IMF, IHS, Euler Hermes forecasts

## +3.7%

2015 emerging markets' GDP growth, the lowest since 2009

■ Stars finally align for the Eurozone with low interest rates, low oil prices and a weaker euro. The pass-through to corporates is visible (especially in the retail and transport sectors) but not sizeable yet.

■ Uncertainties remain around growth momentum in the U.S., the U.K., China, and Japan.

■ In emerging markets, businesses face serious headwinds as country risk components deteriorate in Brazil, Russia, Ecuador, Saudi Arabia or Ghana. Financing conditions and policies are (especially) volatile.

■ Global insolvencies are expected to decrease by -2% in 2015, but 7 out of 10 countries will experience more insolvencies than in 2007.

■ Increasing sector risk across industries in Russia and neighboring countries, for the machinery and equipment sector for oil-producers, and for exporters in Switzerland.



## Cautious optimism in 2015

Europe benefits from finally taking the QE baton from the US, while Emerging Markets tread water with global trade volumes notably lower.

### Business confidence signals selective happy endings ahead

In Europe, PMI indices were stronger than expected over the first three months of the year. New orders showed significant improvement, notably new export orders. These surveys suggest that GDP growth remains on the moderate recovery path (+0.3% q/q expected in Q1, followed by +0.4% on average by quarter thereafter). In the U.K., activity indicators have slowed but remain at high levels suggesting further expansion. In the U.S., the stronger dollar hampers export prospects as shown by the ISM export orders which in February indicated contraction for the first time in 27 months. In China, business confidence has continued to soften. The March HSBC/Markit Manufacturing PMI registered its sharpest fall in activity in 11 months due to slowdown in output and fall in new orders. In Brazil, the Manufacturing PMI slipped below 50 in February, for the first time since last November, suggesting contracting activity in the coming months.

### Headwinds in Emerging Markets, while Europe finally gets a boost

In an unusual twist we have edged our Eurozone forecasts up, while emerging markets revisions

have been lower, bar India. Firstly the ECB's EUR1.1 trillion quantitative easing programme has seen sentiment in the Eurozone shake off the blues that haunted Q4 2014, with general improvement in consumer sentiment expected to boost domestic demand, while a weaker Euro supports export growth. We maintain our forecasts for the U.S. (+2.9%) and U.K. (+2.5%), with little in indication that their domestic demand driven recoveries will alter their anticipated course. Brazil's 2015 revision, (-0.7% vs. 0.5%), stems from weak domestic consumer demand and lower investment triggering a deeper recession than the 0.1% decline seen in 2014. Russia's outlook is bleak at -5.5%, with -4.0% the following year. We do not expect a sovereign default in 2015, but there is significant pressure across all sectors. China's downward growth revision from +7.3% to +7.1% for 2015 reflects the policy aim of quality growth over quantity, with a focus on boosting domestic demand and lessening overinvestment. India's GDP benefited from a rebasing to utilise market prices and the country's steps to address chronic inflation and address its infrastructure deficit.

### World trade to suffer from the downside pressures on prices

Structurally slower activity and lower or negative trade price inflation means that in nominal terms we look for trade growth in the medium term, 3-5 years out, at around half the +12%

seen between 2001 and 2008. However, the current situation is even more anemic, with nominal international trade growth dire compared to prior levels, at a mere +1.9% in 2014 and forecast to grow by +1.8% and +4.5% in 2015 and 2016, respectively. Similarly, in real terms, world trade (goods and services) increased by an annual average of around +6% between 2001 and 2008. It grew by +3.3% in 2014 and is forecast to increase by +4.0% in 2015 and +4.5% in 2016. To put this in context, between 2012 and 2014 negative price pressure resulted in a loss in nominal trade of USD826bn or +4% of the USD23,590bn worth of nominal trade that Euler Hermes estimates for 2014. However, greater negative price pressure seen in 2015, primarily due to limited growth in demand, lower energy prices and excess capacity will result in USD560bn worth of drag on nominal trade.

## Escaping the crisis: How fast can you go?

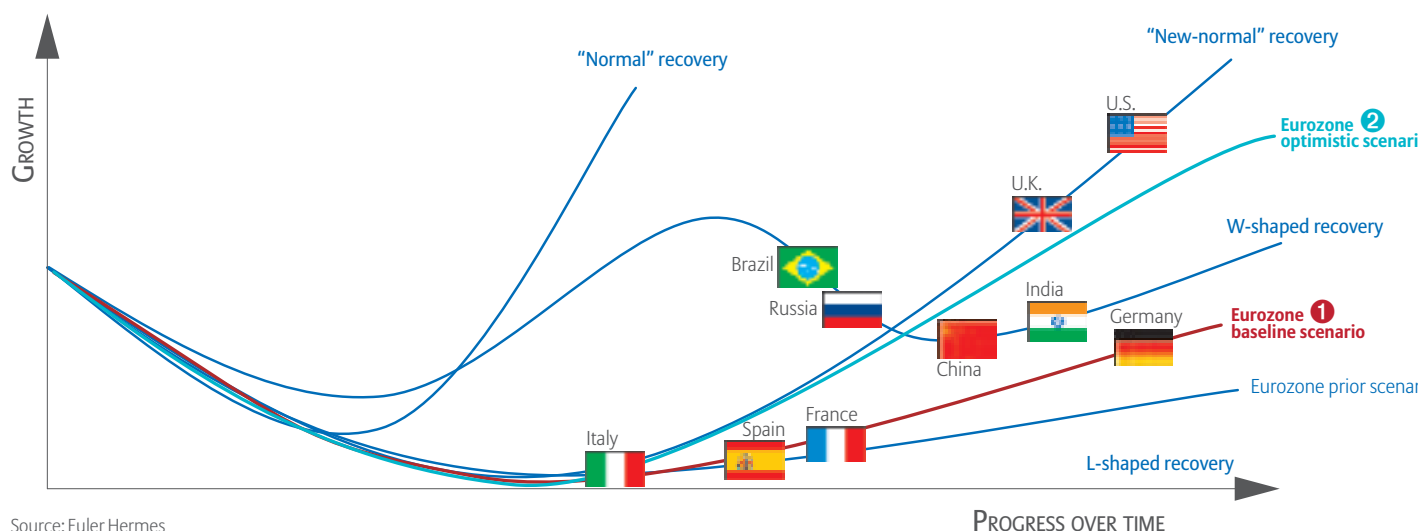
The two speed recovery will continue, with the difference in insolvencies between countries creating a minefield rather than a playing field.

### Two roads to recovery for advanced economies

In a classic recovery, growth rebounds swiftly and proportionally to the peak to trough decline.

**Economic escape velocity:**

Seven years on, where do we stand and where have we been?



Source: Euler Hermes

This time it *really* was different, with two distinctive speeds of recovery in the advanced economies. The U.S. and U.K. saw an elongated U shaped recovery while Germany, France, Spain and Italy saw varying degrees of an L-shaped recovery. U.S. consumption dropped -3.5% from Q3-2008 and Q2-2009, recovering strongly (+13%) in the five and half years since, but employment only returned to its pre-crisis peak in Q3-2015. Conversely U.K. unemployment fell rapidly after peaking at 8.4% in Q4-2011, with the elongated recovery was in consumer spending which fell -5.4%, after the Q4-2007 peak and bottoming in Q2-2009 with the recovery taking five years. These “new-normal” recoveries would typically be disappointing, were they not comparatively strong.

Since the end of 2014 our outlook for Germany, France, Spain and Italy has improved, reflected in our baseline scenario, marginally higher than our prior scenario. Germany’s unemployment rate oscillated around 8.0% between Q4-2007 and Q1-2010 before steadily declining to 6.6% by Q1-2015. But demand has been weak, particularly consumer spending which was between 0 and +0.5 % in 2008-10 and below +1.0% in 2012 and 2013 before “recovering” to +1.2% in 2014. While Germany’s recovery is more advanced it has less slack than the other big three Eurozone economies, which takes time to eliminate but also has the potential for more upside. Employment in France is currently at a similar level to 2006, after negative growth from 2012-14. This has hindered consumption which just returned to Q1-2011 levels. Spanish consumer spending is 8.9% below its Q2-2010 peak, understandable as employment remains 15%

below its Q3-2007 peak. Italy has also suffered, with consumer spending declining significantly from its Q3-2007 peak by -8.4% in Q2-2013 and only recovering 0.8% since. Critically for longer term growth, investment is at Q1-2010 levels in France, Q1-2000 in Spain (-34% below its Q2-2007 peak) and in Italy 31% lower below the Q3-2007 peak.

Investment plans do not change overnight; they require discussion and a shift in sentiment within firms. This is a key reason we shy away from the more optimistic scenario but this could materialise should the Euro and oil stay lower for longer than we anticipate. This would boost confidence and activity on two fronts; in companies due to an improved outlook for Eurozone exports and the consumer benefiting from greater real income. This combination could see upside in the Eurozone surprise in the region of +2.0%.

**Emerging markets facing growing pains**

Emerging Market are facing downward revisions for many different reasons. Brazil’s hawkish central bank faces high inflation and weak demand with chronic underinvestment crippling business sentiment and constraining longer term potential. Brazil will slip into recession this year (-0.7% vs. +0.1% in 2014). Russia’s domestic situation remains dire, with all parts of the economy in decline. The only supportive component (net exports) is due to imports declining even sharper than exports in the face of the halving of the value of the rouble. By comparison our revision to China’s growth from +7.3% to +7.1% is fundamentally driven by a longer term policy focus, centred on removing excess investment capacity and boosting domestic demand. Ac-

commodative monetary and fiscal policy will support this move from “Quantity to Quality” growth. This places the BRICs as various points on a “W” shaped recovery, the one bright spot being India. India, who last year saw growth outstrip China’s for the first time this century, saw significant progress in policy credibility made by the Central Bank and muted inflationary pressures encouraging much needed infrastructure investment. India has progressed in addressing chronic inflation and infrastructure shortcomings but the critical reason behind our forecast adjustments was the rebasing of GDP that lifted growth in FY2013-14 to +6.9% from +5.1%.

**Our Global Insolvency Index to moderate**

This multi speed macro-financial context means the global trend of corporate insolvencies will ebb lower but at -2% the rate of decline has slowed and globally is still very uneven. In 2014, our Global Insolvency Index showed a -14% drop with circa 323,000 insolvencies. For 2015, we worsened our forecasts mainly for Brazil and Russia (and to a lesser extent Norway, Finland and Poland), coupled with (i) a rebound in insolvencies in Turkey, Baltics and Switzerland, and (ii) weaker than expected resilience in Greece and Denmark. On the flipside, we increased the declining trend for the U.S., the U.K., Ireland, Spain and the Netherlands, while insolvencies should confirm their drop in Germany, France and Belgium. The global picture for 2015 shows a sixth consecutive year of decrease in insolvencies, with muted tempo (-2%), a lower number of countries posting a decline (-7 countries) and an almost equal number of countries registering an increase.

### 7 out of 10 countries to register a number of insolvencies above 2007 levels

Emerging economy headwinds continue to put firms under multiple stresses and drive a growing number of insolvencies, even though the available statistics often reflect only a fraction of the true reality of bankruptcies in these countries. Business demography, the maturing of many start-ups, is also logically contributing to this trend pushing insolvencies higher. Latin American bankruptcies will rise further, mainly driven by Brazil: our regional insolvency index indicates a +9% increase in 2015 after +2% in 2014 followed by +5% in 2016 to the highest level since 2005. Our Eastern and Central Europe Index should spring higher in 2015 (+15% after -6% in 2014), mainly because of countries exposed to geopolitical risk (Russia), nascent risk (Turkey) or the domino effect via their key trading partners (Baltics). The overall level of insolvencies should remain low in the Asia-Pacific region, but the trend reversal observed last year in China (+2%) will continue in 2015 (+5%) - and spread to Hong-Kong- with the on-going economic and financial changes in the Chinese business model.

The scenario is more favorable for advanced economies as their macro-financial outlook for 2015 and 2016 is conducive to a further decrease in insolvencies. But declines posted in 2014 (-18% for the North America Index and -15% for the Western Europe Index) are unlikely to be repeated in 2015 (-7% expected for both region).

Firstly, most countries that observed the sharpest fall in insolvencies in 2014 (Spain, Portugal, Ireland, Denmark, The Netherlands and to a lesser extent Belgium) are those that suffered the most from the European crises: huge austerity packages and deleveraging measures which have now begun to pay off, but without erasing fully the scarring effect from the past with several sectors still undergoing prolonged difficulties. A second set of countries such as France, Italy or Finland are still struggling to stabilize the number of insolvencies: the lack of cyclical measures and structural reforms is hindering the potential recovery and continue to oblige companies to focus on the preservation of cash by any means. In countries that have already returned to low levels of insolvencies in 2014 such as U.S., the U.K., Germany and Japan, some prior supportive factors have lost momentum. Lastly, few countries will be unable to avoid the radical change in business conditions coming a major domestic sector (see oil and gas machinery and equipment for Norway and Canada) or all sectors (see the currency story for Switzerland).

### Interest rates, oil prices and the euro: How low can they go?

Low inflation means the Fed can stay on hold for longer, the EUR will trade lower (but not at parity) while oil prices will only rise slowly.

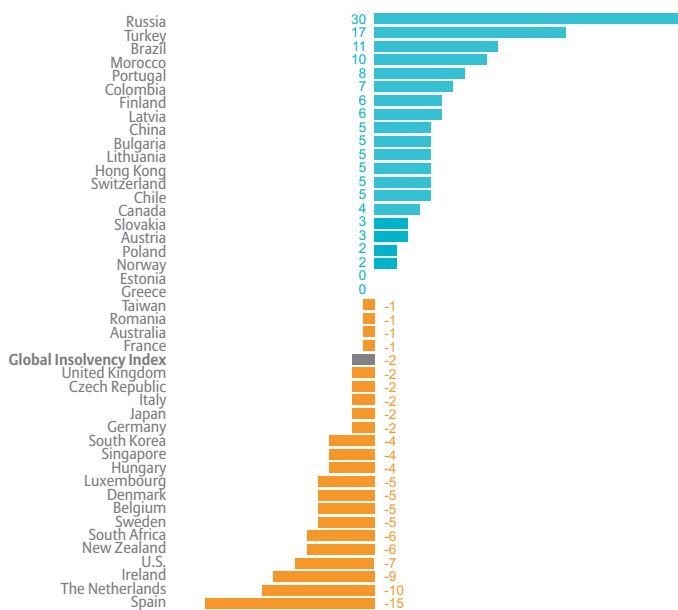
### FED: Low for longer?

Given a rapidly falling unemployment rate and a firming growth rate, market participants had expected the Fed to begin tightening in June 2015. However, March's FOMC meeting saw an evident dovish tone, opening the door for a later rise. We agree and continue to believe that the Fed will be more prudent than generally thought. The reasons are fourfold: (i) at +3.9%, nominal GDP growth remains much below pre-crisis levels (c. 5%). Core PCE, the Fed's favorite measure of inflation, is only rising at a 1.3% clip; (ii) at c. 2%, wage growth is still far from the 3-4% range consistent with Janet Yellen's implicit target. This range is unlikely to be achieved until 2016; (iii) under-employment ('U6'), which includes marginally-attached workers stands elevated at 11%. Although it has trended lower from 12.5% in April 2014, it remains elevated enough to keep wage pressures modest; (iv) recent developments indicate that there is much uncertainty surrounding the equilibrium real interest rate, a key variable in setting the policy rate. In turn, this would militate for keeping rates low for longer. EH anticipates a hike of 25bps in Q4-2015, with the rate of increase to be historically modest.

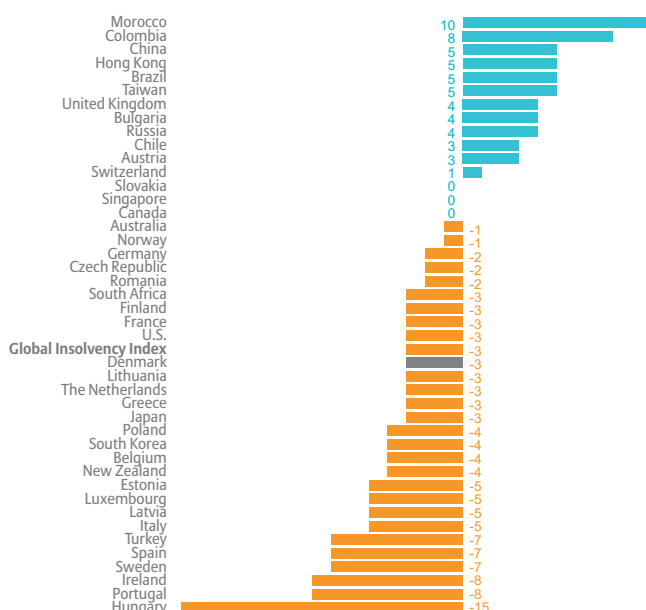
### The euro will not reach parity with the USD!

The ECB has finally started implementing its Quantitative Easing (QE) program in March, thus easing its policy stance, at a time when the Fed is contemplating hiking rates. This divergence is reflected in the spreads between long-term

Corporate insolvency trend in 2015  
Relative to 2014, in %



Corporate insolvency trend in 2016  
Relative to 2015, in %

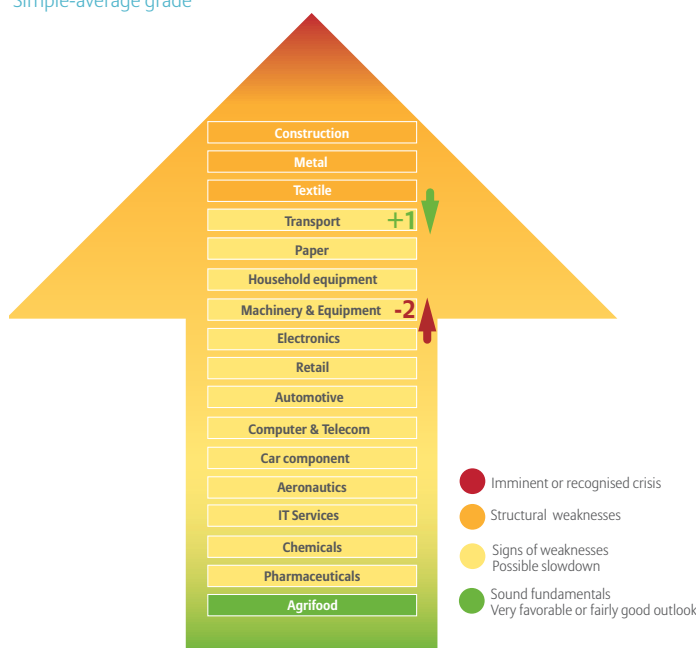


Sources: National figures, Euler Hermes forecasts

Sources: National figures, Euler Hermes forecasts

U.S. and German rates, which are close to all-time highs. More critically, it has led to a sharp fall in the Euro, starting slowly in mid-2014, and accelerating sharply following QE's announcement in January. We continue to believe that the EUR should trend higher over time given that the Eurozone's huge current-account surplus (EUR240bn) and pent up demand from foreign investors for European equities and debt when the Greek "drama" is settled. Indeed, one explanation behind the recent fall in the Euro was not "real money flows" but speculative ones as illustrated by the huge rise in net negative speculative positions on the Euro, to their highest level since 2012. Finally, Purchasing Power Parity theories suggest a long-run equilibrium value of the EURUSD parity around 1.15-1.2. However, should the ECB extend QE beyond September 2016, the Euro could remain below this equilibrium value for a few more years.

### Q1 2015 Sector risk in the world Simple-average grade



Source: Euler Hermes

### Oil: U-shaped scenario?

EH expects a slow rise in the oil price over the course of 2015 up to 73 USD/barrel, leading to an average Brent price of 64 USD/barrel, compared to 100USD on average in 2014. Such a sharp decrease is a large windfall for a few sectors, particularly for oil-intensive ones such as Transport. This is particularly true for airline transport, as roughly a third of their costs are associated with fuel. The IATA expects global airlines to reap additional profits of USD 25bn in 2015 thanks to reduced oil prices. The impact on Chemicals is less straightforward given that industrial sectors as a whole consume 26% of global oil, from which chemicals takes 50% for a total of 13%. Unlike transport, the chemical sector is able to substitute between oil and gas to a degree. As such, Chemicals absorb 25% of worldwide gas consumption.

### Full pass-through takes time

QE has already boosted stockmarkets but will take time to filter into the real economy.

### Recovered household confidence will nurture private consumption

Retail activity at a global scale proved resilient in 2014, backed by revived consumer confidence. Retail and Wholesale gross output worldwide grew by +3.4% in 2014 (worth USD12 300 bn). Global private consumption growth is expected to reach nearly +3% in 2015, hence driving retail revenues upward, with ad-

ditional output of USD400bn, hence reaching USD12 600 bn. This accompanied by cheap oil prices which give further impetus to household confidence. EH calculates that households in the main Western European countries should be able to save up to EUR15bn in 2015 (USD16 bn) on low oil prices, as much purchasing power to be spent in other segments. Therefore, in appearance all conditions are met for boosting activities: retrieved confidence should boost corporates' volume of sales; reduced input costs would contribute to improve their profitability; and less insolvency means less liquidity risk.

### Turnovers will take time to recover

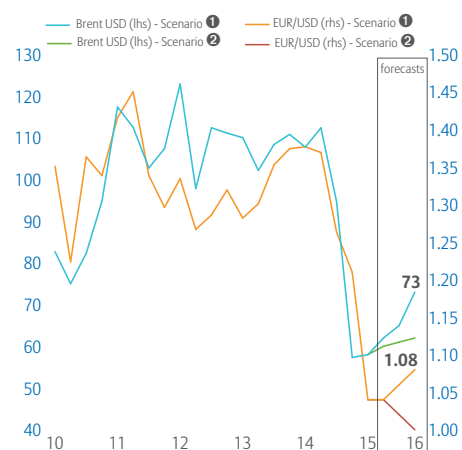
The dullness of the global recovery in 2015 (+2.7%) suggests that worldwide demand still lacks some spark. In Europe more precisely, downside pressures on prices are expected to prevail this year and then to loosen more significantly in 2016, leaving some room of maneuver for companies to better prices their products. Both economic activity (nominal GDP growth) and companies' turnovers fates are tied. As a result, we expect turnover growth to remain weak (around +2% in Germany and the U.K., +1% in the U.S. and France), nil (in Italy) or even negative (-1% in Spain), in 2015.

### Investment remains the missing puzzle piece everywhere

Since the crisis, the fiscal consolidation measures implemented in Europe have triggered strong

falls in public investment. Though total investment has been the primary adjustment variable since 2009. We estimate a cumulative investment deficit of (at least) EUR240bn. Business confidence is on a progressive recovery path, but the financing constraints (expected to correct progressively over the course of this year thanks to the ECB QE) and the weak demand remain significant drags on investment and restrain it from recovering more markedly. Besides, looking at the needs in terms of infrastructure, Europe would need EUR470bn per year, mostly concentrated in energy and transport sectors. The only initiative in Europe is the 3-year investment plan (Juncker plan) of EUR315bn which unfortunately is insufficient to stimulate growth. We therefore expect marginal consequence with +0.5pp of GDP growth cumulative impact be-

### Brent and EURUSD



Sources: Bloomberg, Euler Hermes forecasts



tween 2015-2017. In the United States, leading indicators suggest a slow start to the year in business investment given the expected impact of oil capex cuts. As margins stand at their highest level since the '60s, worries that they could have reached a peak could also dampen business appetite for investment.

### United States: As strong as the dollar?

The U.S. economy is expected to grow at the highest rate since 2005, albeit only around trend,

this is still enough for the Fed to begin to normalise interest rates later in the year. At the same time other major central banks are starting to lean towards easier monetary policy, increasing the value of the U.S. dollar and crimping exports.

#### Consumer leads the recovery

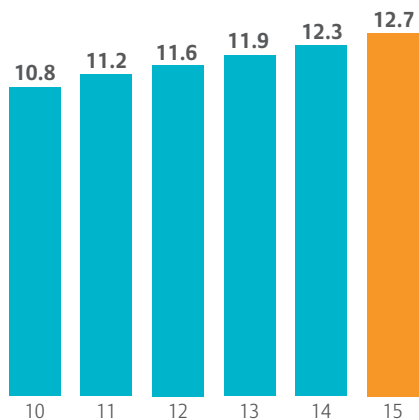
The U.S. recovery is expected to continue in 2015 with GDP growth of +2.9%. It is also expected that the consumer will continue to lead the recovery, as strong job growth over the past year will increase aggregate income while it has already boosted consumer confidence to near

the 100 level associated with a strong economy. Critically, the U.S. consumer has received a substantial benefit from the drop in gasoline prices which have fallen -40% since last June, adding as much as +0.3% to +0.5% to GDP. Wage growth continues to lag however having risen at a real rate of only +0.3% y/y since much of the job creation has come in traditionally lower paying sectors.

#### Investment will be weak

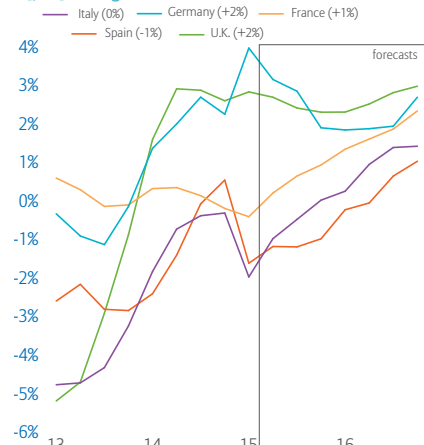
Growth in investment is expected to fall as the decline in oil prices has brought capital invest-

Retail & wholesale distribution  
Gross output, billion real USD



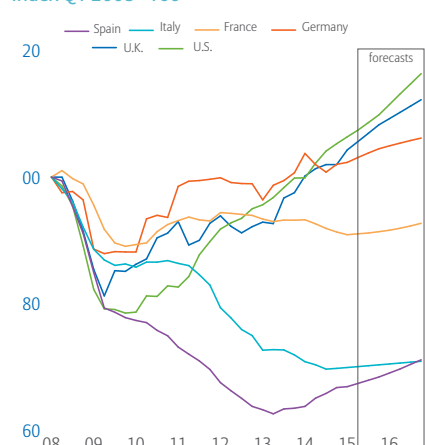
Sources: Oxford Economics, Euler Hermes forecasts

Industry turnovers  
4Q/4Q change



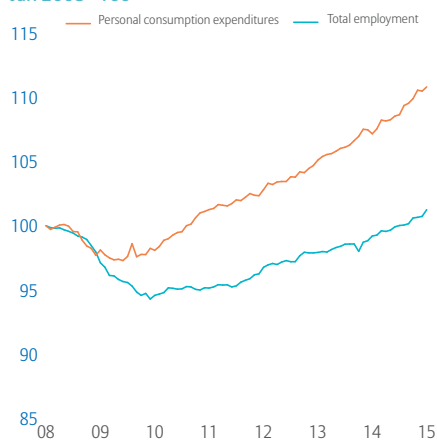
Sources: National accounts, Eurostat, Euler Hermes forecasts

Total investment  
Index Q1 2008=100



Sources: Eurostat, IHS, Euler Hermes forecasts

### U.S. consumer spending vs. employment Jan 2008=100



Sources: IHS, Euler Hermes

ment in the oil industry to a halt. In particular new orders for durable machinery have fallen in five of the past six months and fell at an annualized rate of -18% over the past three months ending in February. Investment is unlikely to pick up unless oil prices rise significantly and show signs of stabilizing. However production from existing U.S. oil fields is still expected to rise +7% in 2015 according to the Energy Information Agency.

#### Challenging credit conditions

Consumer credit rose at an +8.3% y/y rate in January, driven by steep increases in auto and student loans while outstanding credit card debt is still 13% below the pre-recession peak. Meanwhile the housing market is showing only sporadic growth. Lenders are still risk averse and making it very difficult to obtain a mortgage, and as rates rise the housing market will face increased headwinds. The Federal Reserve is expected to start raising rates, but not until Q4 2015. While the Fed is starting to lean towards monetary tightening, the European Central Bank and the Bank of Japan remain committed to aggressively loosening monetary policy via quantitative easing. The divergence between the Fed and the other major central banks has driven the value of the U.S. dollar up +25% versus the Euro and up +17% versus the Japanese Yen in seven months. This sharp increase has driven U.S. merchandise exports down -3.9% y/y, a trend likely to continue through 2015.



### Latin America: Damocles' sword hangs over policy decisions

There are many reasons to be concerned about Latin America: Lower energy prices, tighter U.S. monetary and stagflation.

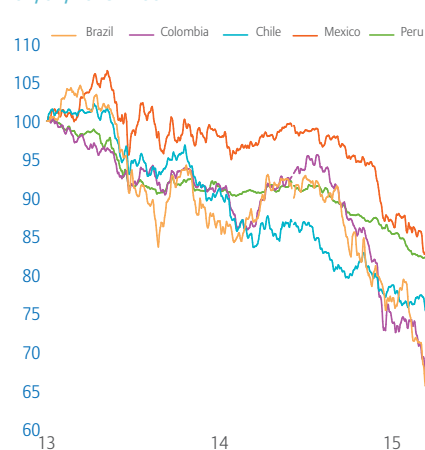
#### After a disappointing 2014, 2015 will be challenging for Latin America

We expect regional growth to fall to +0.5% in 2015, after +0.9% estimated for 2014 due to tighter external conditions, internal challenges (inflation) and social tensions. Notably, lower oil prices will shave -0.4pps from regional growth. The effects vary sharply by country. While net oil importers (Chile, Central America) will benefit from this fall, oil exporters will see varying levels of discomfort. Among them, Mexico and Colombia appear however well prepared to smooth the negative impact thanks to significant reserves accumulated during the boom years. The outlook is more worrying for Ecuador, which strongly relies on oil revenues, funding high public spending. We are particularly concerned about Venezuela, which Euler Hermes expects to see a recession widen of -7.5% in 2015, at least.

#### Low oil prices will be an additional threat to an already dangerous landscape

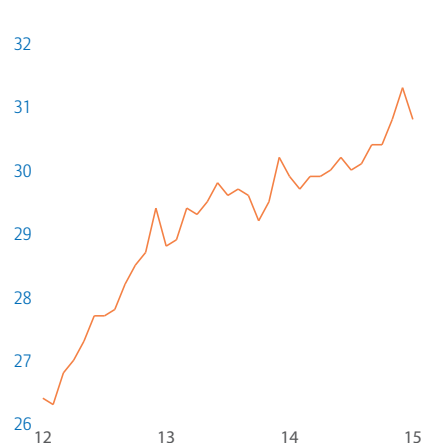
The broad fall in commodity prices and China's slowdown will impact regional exports, especially in those economies dealing with local cur-

### Latin America: Exchange rate vs. USD 01/01/2013=100



Sources: IHS, Euler Hermes

### Brazil: Credit to non-financial corporations % of GDP



Sources: IHS, Banco central do Brasil, Euler Hermes



+1.3%

2015 eurozone GDP growth, the fastest pace since 2011

rency depreciation and increased volatility. These conditions will be hindered further by the Fed’s anticipated tightening and associated tighter financing conditions. This poses a dilemma for monetary policy: while currency depreciation advocates for higher interest rates to limit capital flight, the economic slowdown might need looser policies. Alongside, inflationary pressures are appearing all across the region, and are particularly worrying in Brazil, Argentina and Venezuela. In this context, social discontent is to be monitored closely, especially in countries with strong state interventionism.

**The outlook is particularly challenging for Brazil, which will be in stagflation in 2015**

We expect further increases of the key interest rate as inflation continue to rise, hitting a 12-year high in February, while fiscal consolidation is underway. These restrictive economic policies will weigh on the already weak activity, which will be also heavily impacted by Petrobras’ slashing investment plans (which accounts for 10% of investment). Tighter external and internal financing conditions might also worsen the credit crunch, with capital-intensive sectors such as its upstream oil sector, automotive, construction, metal, and textile, being particularly affected. After stagnating in 2014, we expect GDP to contract by -0.7% and insolvencies to rise by +11% (after +3% on 2014). Coupled with political and social tensions, this triggered a downgrade of Brazil medium-term country risk grade.

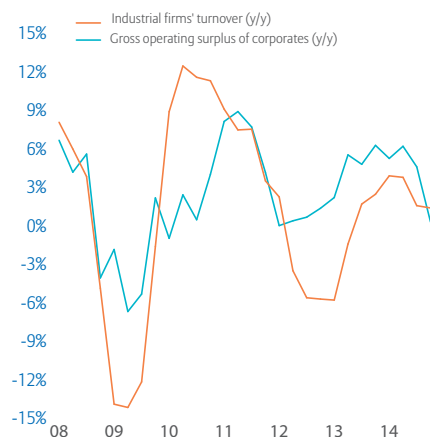
**Europe: On a roll?**

The QE driven Eurozone improvement will take time to truly gather momentum with the U.K. creeping lower and Switzerland wobbling.

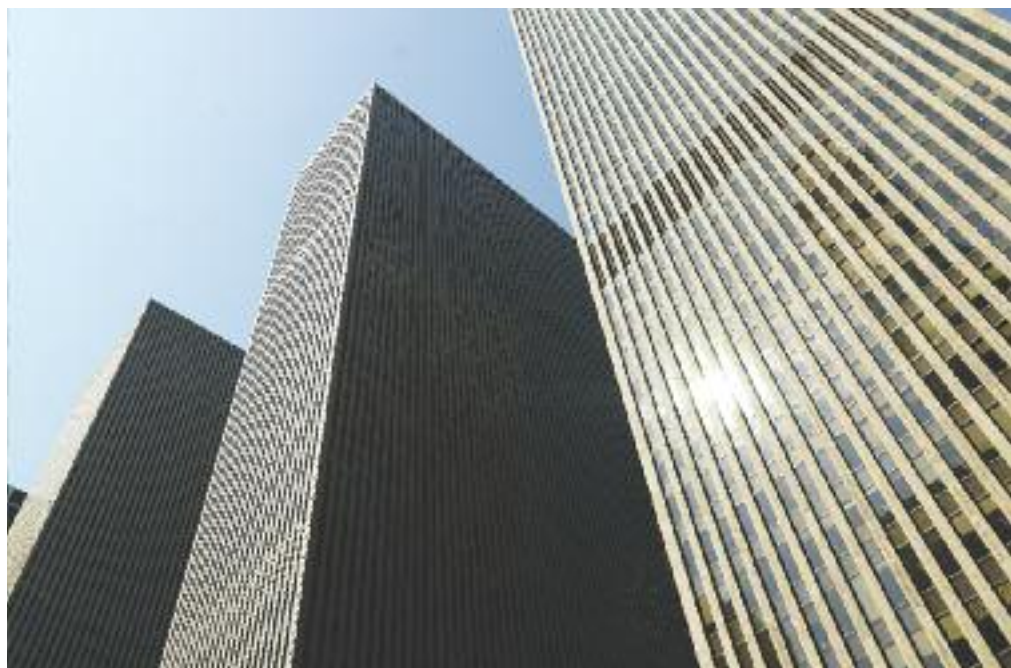
**U.K.: One of the bright spots of the region has peaked**

We expect GDP to rise +2.5% in 2015 and +2.2% in 2016, driven primarily by consumers due to rising employment and real disposable incomes. Lower oil prices provide support (circa EUR4bn additional consumption), but companies should be the main beneficiaries through higher profitability: we expect corporates’ margins to increase by +0.4pp (to 32% of value added) by year-end. The rate of corporation tax has been cut again (-1pp to 20%), the lowest level in the G-20 further stimulating both domestic and foreign investment. But downward pressures on prices are expected to prevail and see a slow-down in turnover growth (+2% in 2015). In 2014, payment terms showed signs of deterioration and we expect this to continue in 2015-16. Business insolvencies are expected to have plateaued after 4 consecutive years of falls (-2% in 2015), we look for an increase of +4% in 2016 due to monetary tightening (expected in late Q1 2016 with a risk of drift into Q2) and the strong birth rate of businesses since 2013.

U.K.: Firms’ turnover and profitability



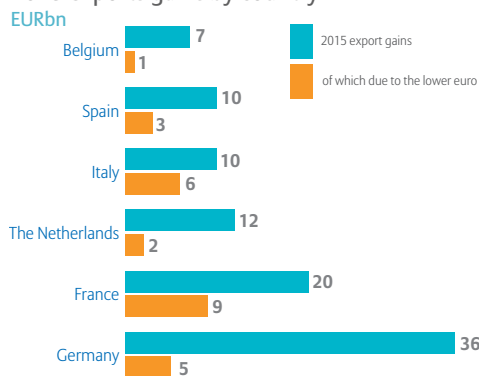
Sources: IHS, ONS, Euler Hermes



# +0.9pp

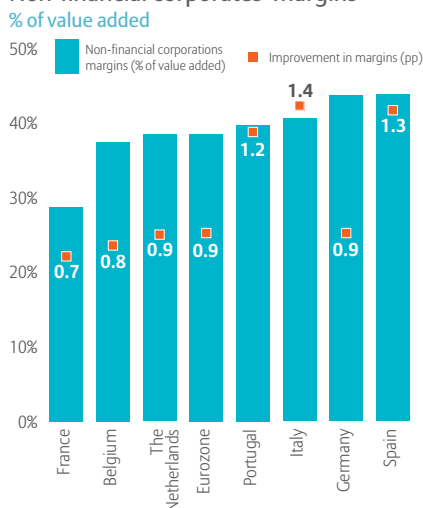
to expected improvement in eurozone firms' margins in 2015

### 2015 exports gains by country



Sources: IHS, Euler Hermes

### Non-financial corporates' margins



Sources: Eurostat, Euler Hermes

### Germany: Consumption first, investment to follow?

Retail sales increased in Germany by +5.3% y/y in January, while the annualized growth rate of the last four months mounts to 19%, the highest rate since 1994. These numbers reflect the bullish German consumer environment and benefit from lower energy prices. The GfK indicator for consumer sentiment increased in March to a 13-year high supported by solid wage growth and a further improving labor market. However private investment remained soft due to (i) uncertainties related to the Eurozone recovery and geopolitical risks; and (ii) minimum wage and pension reforms weigh on margins and increase the skilled labor supply bottleneck. Over the second half of 2015 investments should recover thanks to the lower oil price that are expected to lift corporate margins by 0.9pp on average, giving companies extra cash to invest. Investments may indeed be necessary as the industry production increased in January (by +0.6% m/m) for the fifth month in a row seeing the capacity utilization rate increasing sizably in Q1 2015 which lies now for the third quarter in a row above its long term average.

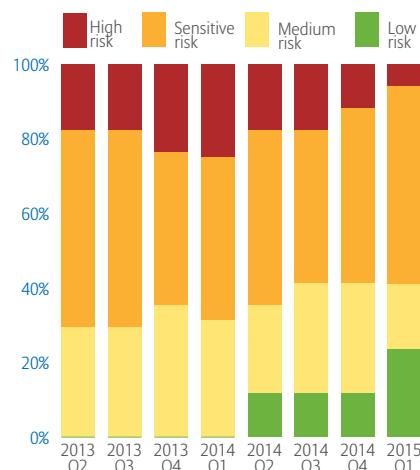
### France: Can the stars finally be aligned?

Against a backdrop of lower oil prices, recent surveys point towards greener pastures for the French economy. Household confidence has risen rapidly over the past few months (+6pts) to levels not seen since mid-2012 whereas business confidence in the Wholesale and Retail trade sector shot up by +7 and +14pts respectively since October. Consumption-related 'hard' data has started to turn up as well, with retail sales growing +2% in 2014 and household consumption (ex-energy) rocketing +6% on an annualized basis over the past three months. Meanwhile, consumption credit growth also finally turned positive on a y/y basis for the first time since end-2011. These simmering signs underpin our positive outlook for consumption growth in 2015. However, it will be far from buoyant, given that unemployment remains a key concern for households.

### Italy: Better days to come, grazie mille ECB!

Finally, after three years of recession we anticipate Italian GDP will rise by +0.4% in 2015 and +0.9% in 2016, still far below the Eurozone average. We foresee three key positive triggers. First, the lower Euro (expected at 1.08 against the USD in Q4 2015) will bring EUR6bn of addi-

### Sector risk distribution in Spain



Source: Euler Hermes

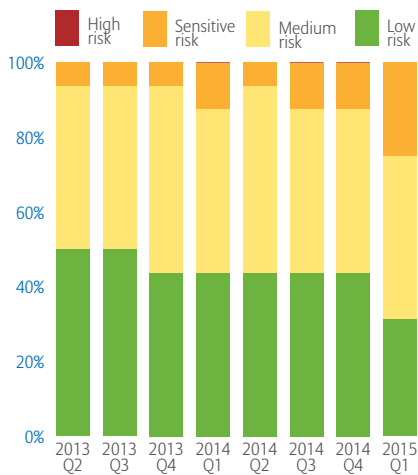
NB: Color represents the number of sectors (as % of 17 sectors monitored by EH) with the corresponding risk grade.

tional exports from a total of EUR10bn of total export gains expected in 2015. Second, financing constraints are expected to ease with both real interest rates on loans to SMEs to steadily declining and credit demand rising thanks to improved sentiment and QE from the ECB. This should give some support to prices and volumes, helping nominal growth to turn slightly positive and turnovers to stabilize in 2015 (and increase by +1% in 2016). Third, lower oil prices should also provide support through additional private consumption (EUR1.8bn) and a lower energy spend. Finally, Investment should stabilize this year, after seven consecutive years of contraction, and more importantly corporates' margins will improve (+1.4pp to 41% of value added).

### Spain: The worst is over

2014 saw Spain return to positive growth (+1.4%) and GDP is expected to increase by +2.0% in 2015 and 2016, outperforming Germany, France and Italy. Investment and exports will be boosted by the lower euro, easier financing conditions and improving business confidence. Private consumption will continue to recover progressively, but the remaining 2.7 million unemployed people cap its growth rate. The pass-through to the real economy is evident with fewer sectors in crisis (share of "red" sectors in total sector decreased from 24% in Q1 2014 to 6% in Q1 2015). At the same time the share of sectors in "green" (low risk) stood at 24% in Q1 2015 while there were none in Q1 2014. However, the share of sectors still risky (medium or sensitive risk) remains high, with

### Sector risk distribution in Switzerland



Source: Euler Hermes

NB: Color represents the number of sectors (as % of 17 sectors monitored by EH) with the corresponding risk grade.

71% of sectors in these two categories in Q1 2015, constant since Q1 2014, but 5pp less compared to Q4 2014. However, deflationary pressures remain a significant drag on the strength of the Spanish recovery.

### Greece: No easy road ahead, but a (intermediate) solution is expected

Greece has more time to negotiate the conditions of a new programme (a precautionary credit line, ECCL with a maturity of at least 12 months), which we expect in July accompanied by further debt relief in the form of frozen interest payments on EU and IMF loans, for a limited period of time, and longer loan maturities. However, if the debt relief measures are not immediately agreed by the Troika (and we see this risk edging higher), then another bailout extension is likely, for 4 to 6 months, taking us to December 2015 allowing more time for negotiations. As a reminder, Greece's overall financing gap remains elevated this year, with EUR7bn of bonds maturing in July-August, EUR7.4bn of IMF remaining repayments and around EUR15 bn of maturing bills.

### Switzerland: Adverse macroeconomic developments weigh on economic activity

The end to the exchange rate cap of CHF1.20/EUR, which the SNB announced in January, will impact the real economy in 2015. With an expected appreciation of the CHF by 14% against the EUR, exports to the Eurozone, Switzerland's main export market (45% of ex-

ports) will be affected significantly - as a result EH revised downwards the 2015 GDP growth forecast by -1.0pp to +1.0%. Several export focused sectors face deteriorating prospects. This is notably the case for the automotive suppliers, machinery and the equipment manufacturers (mainly the medium-sized companies) that have factories located in Switzerland. Further, the textile industry will need to make additional efforts in terms of creativity and innovation in order to maintain market shares. Finally, retailers located in the border regions in Switzerland, are likely to be forced to cut their prices in order to remain competitive.

## Central and Eastern Europe: Boom or bust?

Russia's impact has been greatest on itself, while the Eurozone recovery offers some relief to the other countries in the region. However we remain alert to the butterfly effect of the bear.

### Sanctions and oil price drop have hit Russian economy hard

In Russia, the perfect storm of sanctions, capital flight and falling oil prices saw a severe impact on the currency. Since the start of 2014, the RUB has lost about half of its value against the USD, despite heavy central bank FX interventions. Euler Hermes' baseline scenario (70% probability) is a continued balance-of-payments crisis in 2015 with a severe recession (real GDP contraction of -5.5%) and sharply rising insolvencies (+30%). Moreover, the imposition of controls on FX and investment outflows is likely in 2015. However, a sovereign default is unlikely this year as current reserves are still much higher than in 1998.

### What alternative scenario for Russia?

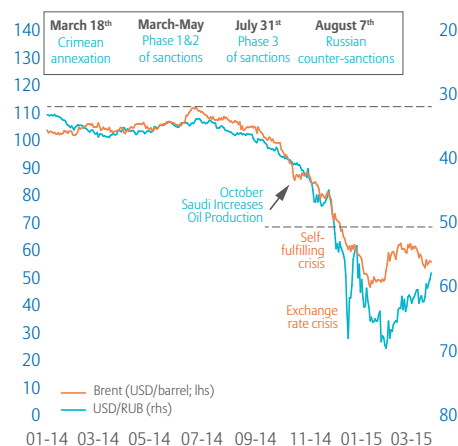
A worst case scenario (25% probability) could be triggered by an escalation of sanctions or full-fledged capital controls or oil prices below USD50/barrel for a sustained period. This would trigger an economic collapse, with real GDP contracting by up to -15% in 2015 and insolvencies rising by up to +80%. The upside risk of a positive outcome with a mild recession (-1%) and a more moderate rise in insolvencies (+10%) is given only a probability of 5%.

### No more low risk sector in Russia

Warning bells began as early as 2013 as the first signs Russian companies' weakening liquidity became evident: Russian DSO (days sales out-



USDRUB and Brent first contract price



Sources: Bloomberg, Euler Hermes

standing) increased by +6 days. In 2014, this resulted in the downgrade of ten out of seventeen sectors assessed by Euler Hermes. Particular attention was paid to Food, with regards to the ban of certain Western agrifood products. Indeed, sanctions coupled with harsh RUB depreciation drove a substantial rise of imported goods prices, negatively affecting Russian companies' profitability. Russia presently has no low risk sectors, even state-protected industries as Chemicals or Machinery proved not immune.

**Spillovers to neighboring countries**

Countries that have strong trade relations with Russia face significant spillovers from the Russian crisis. Both Armenia and Moldova have seen currency depreciation and falling FX reserves and growth is forecast at just +1% in 2015. Belarus, Kazakhstan and Ukraine are also adversely affected, with the latter being in economically crippled. Lithuania's growth is expected to slow to +2.3%, as its high energy dependence on Russia is critical. Latvia's growth forecast was also cut to +2% and three sectors (Automotive manufacturers, Pharmaceuticals, Textiles) downgraded.

**Other Eastern countries resilient despite Russia**

The rest of the CEE countries showed resilience in 2014 thanks to a shift from export-led to domestic demand-driven growth. This momentum should be retained in 2015 due to the European recovery and low oil prices counterbalancing the negative impact by the deepening Russian crisis. Real GDP growth in

Turkey is forecast to rebound to +4.3% in 2015 from +2.9% in 2014 thanks to lower oil prices and monetary easing. However, the pace of monetary easing appears too rapid, leading to exchange rate weakness (USD:TRY down -9% in Q1), and the 2014 slowdown will continue to have some lagged impact on companies, boosting insolvencies (+17% in 2015).

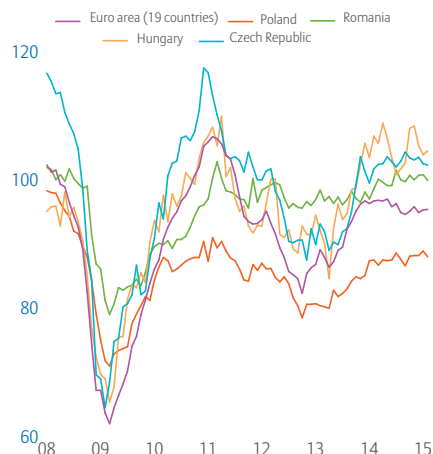
**Middle East & Africa: Blurred lines**

Weaker oil prices: very much a mixed selection bag, so choose carefully.

**Middle East & North Africa: Stumbling but not falling**

The impact of weaker oil prices is not as simple as "bad" for oil exporters and "good" for importers. Growth in major oil/gas producers (including Saudi Arabia) will slow in 2015 but the negative impact of lower oil prices will be muted by public spending supported by large financial assets. For net oil importers and more diversified economies, the impact of lower oil prices is muted by potential disruption to intra-regional flows (from the big oil exporters) of investment, tourism, trade and workers' remittances. Some countries in political transition (Egypt and Tunisia) or attempting to re-engage with the international economy (Iran) could see higher growth but this is because of a bounce back and despite the lower oil prices. The MENA region is unlikely to surpass its long-term average rate of growth (+4.6%) in 2015-16.

**Economic sentiment index**

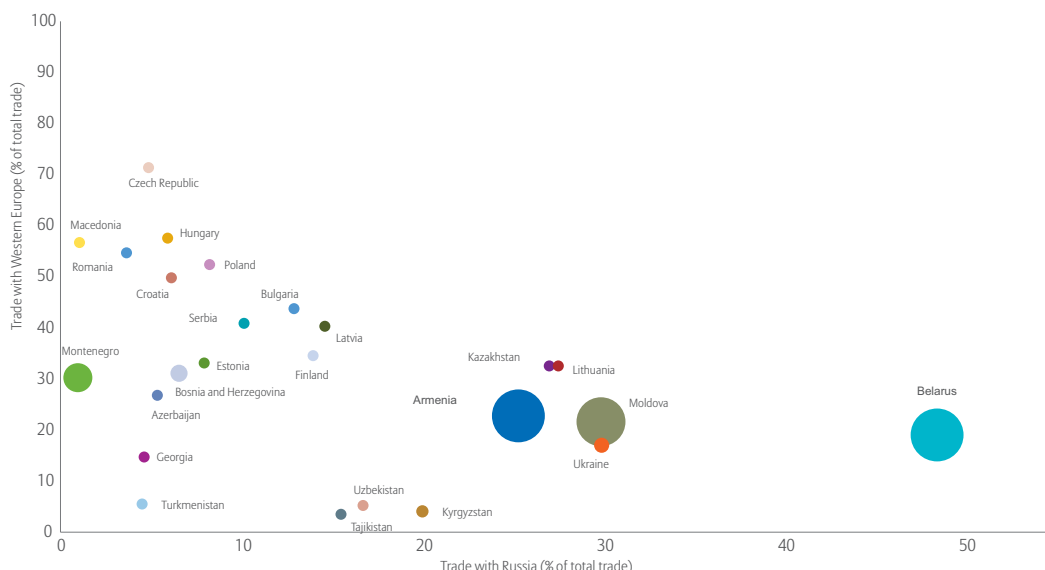


Sources: Eurostat, Euler Hermes

**Sub-Saharan Africa: Just changing down a gear**

Growth in major oil and gas producers is set to slow in 2015, partly reflecting economic imbalances (Angola) or political/stability factors (Nigeria), or both (Sudan). Net oil importers should get a boost but some have economic imbalances (we downgraded Ghana to B2 from B1) and some have structural impediments to higher growth (South Africa). More regional economies will benefit than not from lower oil prices and the region includes some of the world's fastest growing economies (including Côte d'Ivoire, Ethiopia, Mozambique, Rwanda and Tanzania). Sub-Saharan Africa is unlikely to surpass its long-term average rate of growth (+4.5%) in 2015, but will do so in 2016 (+5.1%).

**Trade and investment flows with Russia vs. Western Europe**



NB: The size of the bubble equals investment flows (inflows and outflows) with Russia (in % of total investment flows) Sources: IHS, Euler Hermes



## Asia-Pacific: Policy makers to focus on growth

China's move to Quality from Quantity growth remains on track, Japan's needs further change to boost nominal GDP and India must turn positive sentiment into action.

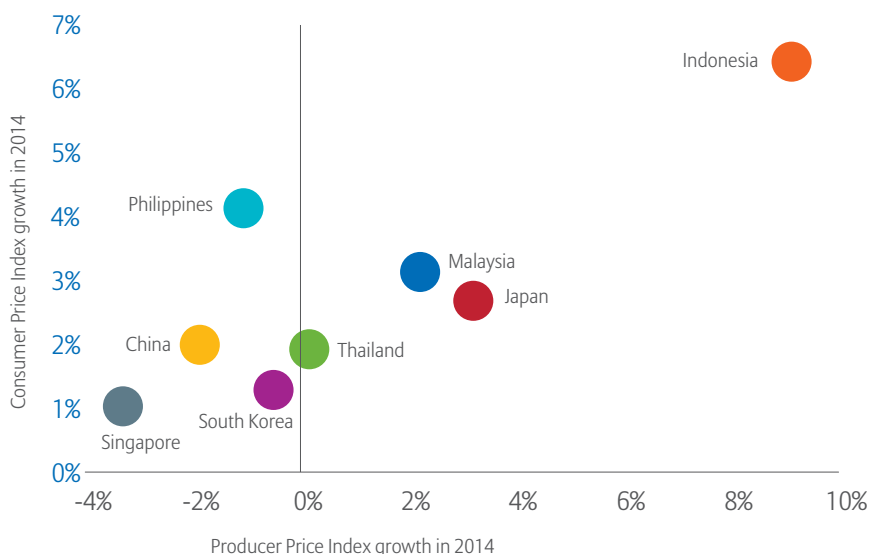
### China: Favorable policy mix to support growth

China's growth will likely slow to a record low in 2015 (+7.1%). Economic activity decelerated in Q1 with industrial production and retail sales losing further pace. Deflationary pressures remain evident with producer prices growth contracting for the 36<sup>th</sup> straight month in February. In Q2, we expect domestic demand to remain tepid, dampened by a decrease in business sentiment and a slowdown in credit. Against this background, authorities will likely adopt a more accommodative stance with at least one interest rate cut of -25 bps likely, coupled with more supportive fiscal policy through higher infrastructure expenditures.

The steel industry will remain the most fragile sector in 2015, as demand decelerates in line with the slowdown in construction and automobile production. Accordingly, the local production of steel collapsed to +1.8% in 2014 (compared to +11% in 2013) and we expect +1% growth in 2015. Infrastructure, in particular an expansion of the railroad network, will likely contribute to the +3% rise in steel production in 2016.



### Producer prices and consumer prices



Sources: IHS, Euler Hermes

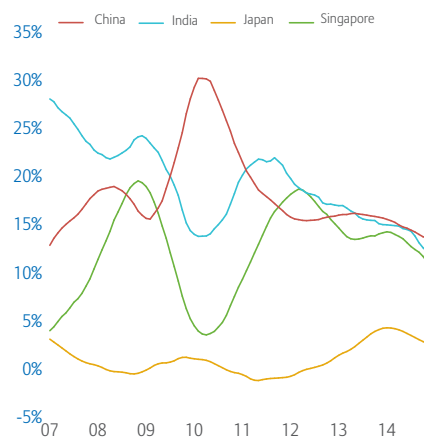
### Japan: A stimulus led recovery again

Japan's economy is projected to grow by +1.0% in 2015 (from -0.1% in 2014). Monetary policy will ease further to bring inflation close to +1% in 2015 and foster credit creation. On the fiscal side, an extra-budget package (+0.5% GDP) was unveiled in Q1, while not approved yet, the budget focuses on social transfers and public works. Private consumption is set to gather pace in line with rising consumer confidence. However, without structural reforms (cuts in corporate tax, increased flexibility in the labor markets, increasing immigration) domestic drivers will remain anemic with limited additional investment (+0.6% in 2015) and slow household nominal income growth (+1.1%).

### India: A positive surprise this year

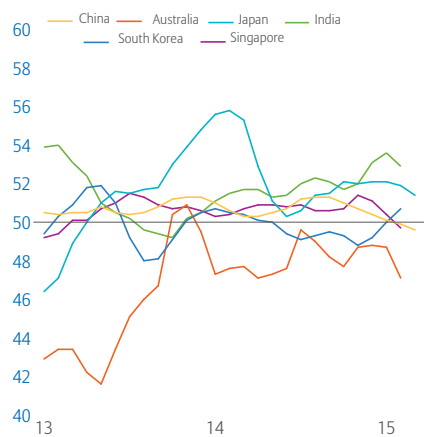
In India, GDP growth is set to pick up speed in FY2015-16 (+7.7% after +7.5% in FY2014-15), a pace faster than China (+7.1% in 2015). Lower inflation has already allowed the Central Bank to ease its monetary policy and credit growth is set to accelerate. Public expenditures are set to increase with further spending in infrastructure vital to facilitate much needed structural improvements. Net exports will support growth as India will benefit from the increase in U.S. and Eurozone demand. 2015 outlook is well oriented for the industrial sectors, with steel production expected at +8% in 2015 and automobile production at +7%.

### Bank lending to private sector 12m/12m change



Sources: IMF-IFS, Euler Hermes

### Manufacturing PMI 3 months rolling average, 50= no growth threshold



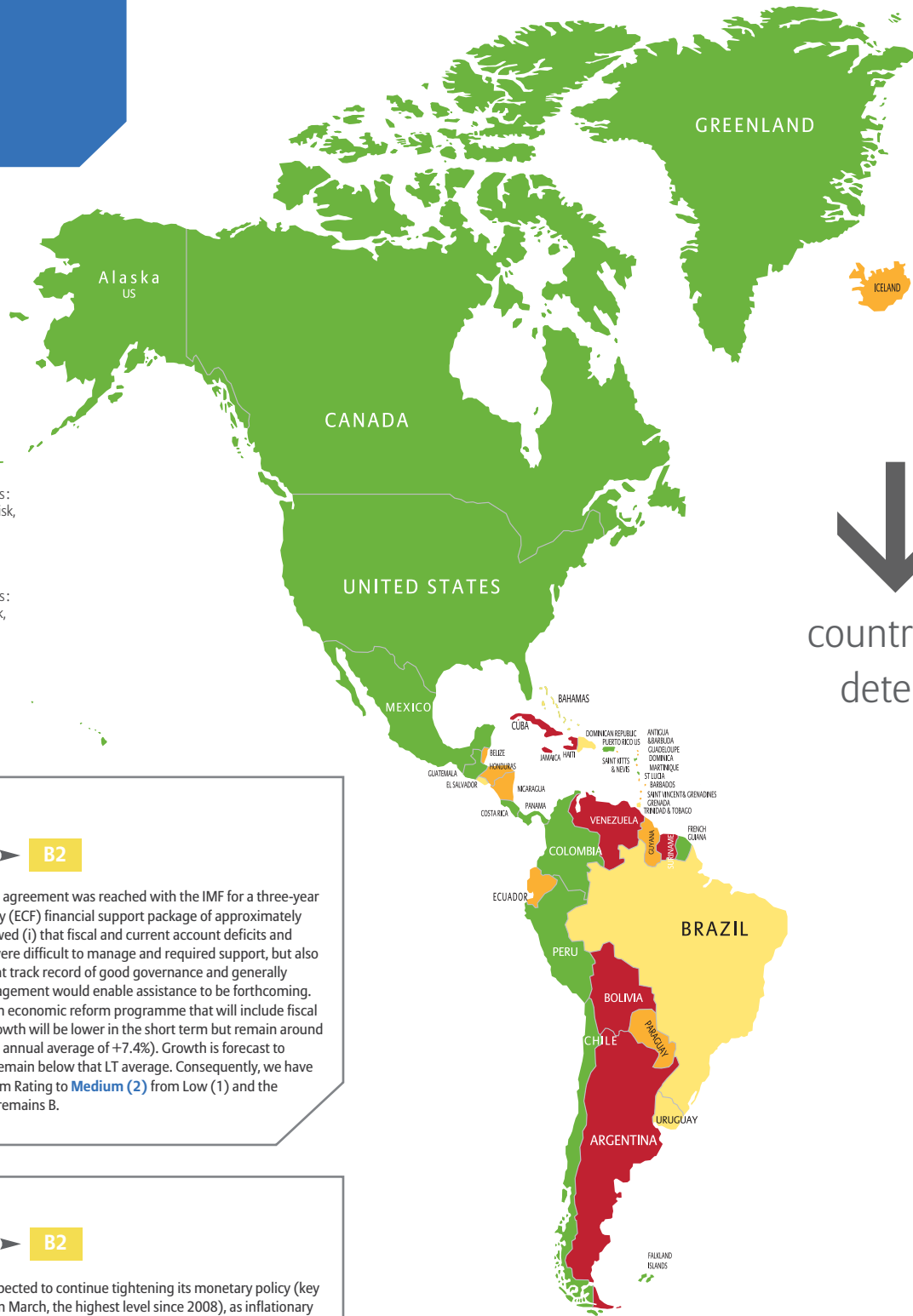
Sources: Markit, National Sources, Euler Hermes

# Country Risk Outlook 2015

Q1 2015 — UPDATE

**Medium term risk:**  
the scale comprises 6 levels: AA represents the lowest risk, D the highest.

**Short term risk:**  
the scale comprises 4 levels: 1 represents the lowest risk, 4 the highest.



↓ 2  
countries with deteriorated ratings

## Ghana

B1 → B2

At end-February 2015, agreement was reached with the IMF for a three-year Extended Credit Facility (ECF) financial support package of approximately USD940 mn. This showed (i) that fiscal and current account deficits and pressure on the cedi were difficult to manage and required support, but also (ii) the country's recent track record of good governance and generally sound economic management would enable assistance to be forthcoming. The ECF will support an economic reform programme that will include fiscal consolidation. GDP growth will be lower in the short term but remain around +4% in 2015 (ten-year annual average of +7.4%). Growth is forecast to rebound in 2016 but remain below that LT average. Consequently, we have changed the Short-Term Rating to **Medium (2)** from Low (1) and the Medium-Term Rating remains B.

## Brazil

BB2 → B2

The Central Bank is expected to continue tightening its monetary policy (key rate raised to 12.75% in March, the highest level since 2008), as inflationary pressures continue to strengthen (7.7% y/y in February, a 12-year high). Fiscal consolidation is a key target of the government for 2015. However, austerity measures are likely to be difficult to enact amid political tensions. Combined with restrictive economic policies, economic activity will be heavily impacted by the fragile outlook for investment plans of Petrobras (which accounts for around 10% of total Brazilian investment) as well as by water and electricity cuts. After stagnating in 2014, we expect Brazil to fall into recession in 2015, with real GDP contracting by -0.7%, at least. Consequently, we have changed the Medium-Term Rating to **B** from BB. The Short-Term Rating continues to be Medium (2).



**Sector Risk Outlook 2015**  
Q1 2015 — UPDATE

# 66 changes of sector risk ratings at the end of Q1 2015

SECTOR AND INSOLVENCY RESEARCH TEAM

**↑ 26**  
sectors with improved ratings

**40 ↓**  
sectors with deteriorated ratings



Automobile    Car component    Construction    Air transport    Chemicals    Pharmaceuticals    Agrifood    Textile

SECTOR RISK RATINGS  
END OF Q1 2015  
COUNTRIES WEIGHTED  
BY THEIR SHARE IN  
REGIONAL GDP IN 2014

Region	Automobile	Car component	Construction	Air transport	Chemicals	Pharmaceuticals	Agrifood	Textile
North America	●	●	●	●	●	●	●	●
Latin America	●	●	●	●	●	●	●	●
Western Europe	●	●	●	●	●	●	●	●
Central and Eastern Europe	●	●	●	●	●	●	●	●
Africa and Middle East	●	●	●	●	●	●	●	●
Asia-Pacific	●	●	●	●	●	●	●	●





## Already issued:

no. 1197

- **Global Sector Outlook**  
Reconciling economic (dis)illusions and financial risks

no. 1198

- **Special Report**  
The Mediterranean: Turning the tide

no. 1199

- **Macroeconomic and Country Risk Outlook**  
Half-baked recovery

no. 1200-1201

- **Business Insolvency Worldwide**  
Patching things up: Fewer insolvencies, except in Europe

no. 1202-1203

- **Macroeconomic and Country Risk Outlook**  
Top Ten Game Changers in 2014: Getting back in the game

no. 1204

- **Global Sector Outlook**  
All things come to those who wait: Green shoots for one out of four sectors

no. 1205-1206

- **Macroeconomic and Country Risk Outlook**  
Hot, bright and soft spots: Who could make or break global growth?

no. 1207

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Insolvency World Cup 2014: Who will score fewer insolvencies?

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Global trade: What's cooking? Introducing twelve countries' recipes for boosting exports

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- **Macroeconomic, Country Risk and Global Sector Outlook**  
Focus on the signal and ignore the noise

## To come:

no. 1217

- **Special Report**

## The Economic Talk



[www.youtube.com](http://www.youtube.com)

## Weekly Export Risk Outlook



[www.eulerhermes.com](http://www.eulerhermes.com)

## Economic Insight



- Germany's 3D export strategy to bring an additional EUR36bn in 2015 ► 2015-03-18
- Mexican exports: Time to bring in the Mariachis? ► 2015-03-16
- Latin America: Fall in oil prices will cut growth by -0.4pp ► 2015-02-26
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- FAQ: #QEmania - What does it mean for European companies? ► 2015-01-22
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- Spain: Cautiously taking the bull by the horns ► 2014-10-08
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- Russia and the West: Tough Love? ► 2014-09-12
- Non-payments in Italy: It's not over... yet! ► 2014-09-04
- Don't cry too much for Argentina ► 2014-08-08
- Fertilizer: The seed growing secretly ► 2014-08-05
- Road transport: Labor costs explain the large gap in profitability in Europe ► 2014-07-08

## Country Report



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- Brazil ► 2015-03-19
- Bulgaria ► 2015-03-19
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- Germany ► 2015-03-19
- Ghana ► 2015-03-19
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- South Africa ► 2015-03-19
- Spain ► 2015-03-19
- Switzerland ► 2015-03-19
- Tunisia ► 2015-03-19
- Ukraine ► 2015-03-19

## Industry Report



- The paper industry in Italy: Time to turn the page ► 2014-12-16
- Consumer electronics: Only a timid rebound in 2015 ► 2014-12
- Construction in Italy: Only a timid rebound in 2015 ► 2014-12-02
- Textile & Clothing in Germany: A two-gear reality ► 2014-10-31
- Textile & Clothing in Italy: Bronze medal on the international podium, but facing obstacles ► 2014-10-31
- Italian car sector: Time to do an oil change ► 2014-10-22
- U.S Automotive ► 2014-10-03
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