Press release

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Euler Hermes: The global economy at the crossroads

A macroeconomic update

- Global economic growth is expected to slow to +2.4% in 2013 before picking up again slightly to +3.1% in 2014, in line with international trade (+5% in 2014 after +2.5% in 2013)
- The euro zone will continue to undermine global growth in 2013 (-0.6%) before rebounding slightly in 2014 (+0.8%)
- Emerging countries continue to drive global growth (+4.4% and +4.9% in 2013 and 2014, respectively) even though the BRIC countries are losing steam
- General decoupling between financial performance and the real economy.

PARIS -- 18 JULY 2013 – Global economic growth will slow to +2.4% in 2013 before rebounding slightly to +3.1% in 2014, according to Euler Hermes. It will be marked by regional contrasts (notably with modest growth in the United States and increasing contraction in the euro zone), a reversal of regional growth rates (rebound in Japan, slowdown in China) and a general decoupling between financial performances and the real economy.

"Leading indicators such as global GDP growth and manufacturing output suggest a delay in the anticipated 2013 year-end recovery in the global cycle," said Wilfried Verstraete, CEO, Euler Hermes Group. "A mid-term global 'crossroads' may be emerging as three growth drivers decouple: regional trade relationships, fiscal policy and regulatory institutions. The next economic scenario – improved growth and sovereign risk, or recession and volatility - will be determined by the degree to which global demand and wealth impacts the real economy, monetary policies are restored and realigned, and competitive playing fields become more balanced."

The euro zone in recession against a backdrop of budgetary consolidation, lack of business financing

The euro zone remained in a recession for the sixth consecutive quarter. In 2013, the region is expected to contract by 0.6% and the near-term outlook remains gloomy in light of ongoing budgetary consolidation, a morose business climate and still unfavorable credit conditions. A modest recovery (+0.8%) is forecast for 2014, driven mainly by a rebound in global trade.

Political and economic choices will be required, as the euro zone continues to deal with institutional dilemmas in addition to specific country imbalances. These imbalances are gradually easing due to the implementation of structural measures making it possible to adjust unit labor costs, continue budgetary consolidation and reduce dependency on external financing.

Without any significant action by the ECB or governments to rekindle financing, the investment cycle will struggle to make headway. Credit to non-financial business continues to be seriously affected (at an all-time low since February 2008), both by the lack of demand as well as the limited supply, since credit risks are still deemed to be high and regulatory constraints remain at the banks level.

Facing structural changes, the BRICs are losing steam

In China, the rebalancing of the economy toward increasingly domestic, as opposed to external, growth drivers will continue apace. This transition will be expressed by a slowing growth rate to +7.7% in 2013 and +7.9% in 2014 (compared with +10% during the past decade). The change in the economic model will not occur in the near term.

"This rebalancing is encouraged by the establishment of infrastructure projects" notes Ludovic Subran, chief economist at Euler Hermes. "The transition will nevertheless take time, given the structural linkage between investment and exports, which account for nearly 45% of GDP, and of the relatively low GDP contribution of private consumption, which remains stagnant at 35%".

Aside from economic challenges, notably the fight against inflation, the BRI countries (Brazil, Russia and India) need to shore up investor confidence. That will require improvements to:

- Still-complex regulatory frameworks which are very accommodating to private initiatives (particularly by foreigners);
- still-fragile governance indicators, undermined by corruption and social unrest, and
- logistical performance.

In this environment, growth rates will be modest relative to the previous decade. Brazil's economy is forecast to grow by +2.7% in 2013 and +3.3% in 2014, while the corresponding figures for Russia are +3.2% and +3.8%, and for India +6% and +7%.

The U.S. economy is resilient and Japan generates positive surprises, despite looming budgetary tightening

The United States is showing signs of resilience thanks to dynamic private consumption (+0.6% in Q1 2013, after +0.5% in Q4 2012) and despite the acceleration in budgetary tightening. Concerns over a less accommodating monetary policy and uncertainty over the debt ceiling level could nevertheless trigger an increase in sovereign bond rates. Economic growth is projected to reach +1.8% in 2013 and increase to +2.7% in 2014.

Japan, meanwhile, is benefiting from a more sustained recovery (+1.0% in Q1 2013, after +0.3% in Q4 2012) due to an increased household consumption, budgetary stimulus measures, and a more aggressively expansionary monetary policy. Economic growth is expected to rebound to +1.6% in 2013 before easing to +1.4% in 2014, limited by nascent budgetary tightening designed to bring public debt back to a sustainable level.

The real economy and the financial sphere: a decoupling that could trigger instability

In addition to social (Brazil, Europe) and political (Middle East) risks, financial uncertainty is growing. The decoupling between the real economy and the financial sphere continues apace despite increasingly expansionary monetary policies. While key financial indicators have shown general signs of improvement in the leading developed countries during the first half of 2013, the trends remain very volatile and are not aligned with macroeconomic signals.

In order to contain the flood of capital linked to unconventional monetary policies by the central banks of the major economies, many countries have chosen to relax their monetary policy. The economic news nevertheless remains disappointing and growth is still anemic considering the many measures that have been implemented. The emerging markets, which are expected to account for two-thirds of economic growth in 2013, recorded a slowdown.

In the mature economies, European demand continued to contract and U.S. growth was below expectations. The fear is that less accommodating central bank monetary policies will negatively affect credit availability and, ultimately, the real economy.

This situation reveals the inefficiency of monetary policy transmission mechanisms, as looser monetary policy merely stimulated demand for financial assets and the search for high yields in the near term -- instead of demand for goods and services. A more relaxed monetary policy can have a “salutary” effect if it is temporary and results in wealth effects reinjected into the economy through consumption (notably in countries like the U.S. where share-owning households are numerous) or in company investment (Japan).

“This is our central scenario” notes Ludovic Subran. “In the contrary scenario, this decoupling would be particularly damaging in the euro zone and Japan. In the case of the euro zone, the risk involves a vicious circle where weak demand is accompanied by falling prices. The Japanese situation is even more problematic since the country is already burdened by significant public debt and remains stigmatized by 10 years of deflation and weak growth. While the risk of such a scenario does not appear likely in the euro zone for now, it remains considerable in the case of Japan, especially if the country is not able to put forth a credible plan to resolve its public finances in the medium term.”

Appendix

Economic forecasts

forecasts

GDP	share*	2011	2012	2013	2014
World GDP growth	**100**	**2.9**	**2.5**	**2.4**	**3.1**
Developed countries	**62**	**1.6**	**1.3**	**1.1**	**1.9**
Emerging countries	**38**	**5.1**	**4.5**	**4.4**	**4.9**
North America	**24**	**1.9**	**2.2**	**1.8**	**2.7**
United States	22	1.8	2.2	1.8	2.7
Canada	3	2.6	1.7	1.9	2.3
Latin America	**8**	**4.2**	**2.6**	**3.0**	**3.5**
Brazil	3	2.7	0.9	2.7	3.3
Western Europe	**23**	**1.5**	**-0.2**	**-0.2**	**1.0**
Sweden	1	3.8	1.1	1.3	2.2
United Kingdom	3	1.0	0.3	0.8	1.4
Eurozone	**17**	**1.5**	**-0.5**	**-0.6**	**0.8**
Germany	5	3.1	0.9	0.3	1.5
France	4	1.7	0.0	-0.3	0.4
Greece	0	-7.1	-6.4	-4.2	-0.3
Ireland	0	1.4	0.9	1.0	1.8
Italy	3	0.5	-2.4	-1.8	0.3
Netherlands	1	1.1	-1.0	-0.7	0.9
Portugal	0	-1.6	-3.2	-2.5	0.4
Spain	2	0.4	-1.4	-1.6	0.3
Central and Eastern Europe	**6**	**4.7**	**2.1**	**2.4**	**3.1**
Russia	3	4.3	3.4	3.2	3.8
Turkey	1	8.8	2.2	4.0	4.0
Poland	1	4.5	2.0	1.3	2.2
Asia	**29**	**4.8**	**4.9**	**4.8**	**5.1**
China	11	9.3	7.8	7.7	7.9
Japan	8	-0.5	2.0	1.6	1.4
India	3	6.3	5.0	6.0	7.0
Oceania	**2**	**2.3**	**3.3**	**2.4**	**2.8**
Australia	2	2.4	3.6	2.7	3.1
Middle East	**4**	**4.6**	**3.5**	**2.5**	**3.8**
Saudi Arabia	**1**	**8.5**	**6.8**	**4.0**	**4.5**
United Arab Emirate	**1**	**4.2**	**4.5**	**3.5**	**4.0**
Africa	**2**	**1.1**	**5.8**	**4.5**	**4.8**
Marroco	0	5.0	2.7	4.5	4.5
South Africa	1	3.5	2.5	2.5	3.5

* change from one period to the next

Sources: FMI, IHS Global Insight, Euler Hermes forecasts

Contribution to 2013 GDP growth*

	GDP	=	Domestic demand	+	Net trade contribution
Australia	2.7%		0.3%		2.4%
Canada	1.9%		1.3%		0.6%
United States	1.8%		1.7%		0.1%
Japan	1.6%		1.6%		0.1%
Switzerland	1.3%		1.1%		0.2%
Sweden	1.3%		1.2%		0.1%
Norway	1.2%		2.4%		-1.2%
Ireland	1.0%		0.1%		0.8%
United Kingdom	0.8%		0.9%		-0.2%
Denmark	0.5%		1.1%		-0.6%
Austria	0.3%		0.1%		0.2%
Germany	0.3%		0.4%		-0.1%
Netherlands	0.1%		-0.2%		0.3%
Finland	0.1%		-1.1%		1.2%
Belgium	0.0%		-0.2%		0.3%
France	-0.3%		-0.5%		0.1%
Sapin	-1.6%		-3.8%		2.1%
Italy	-1.8%		-2.7%		0.9%
Portugal	-2.6%		-5.1%		2.5%
Greece	-4.3%		-7.6%		3.3%

* annual average
Sources: IHS Global Insight, Euler Hermes forecasts

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