

Fly me to the moon

Economic Research
Paris, December 2017

Image courtesy of pixabay.com, CC0

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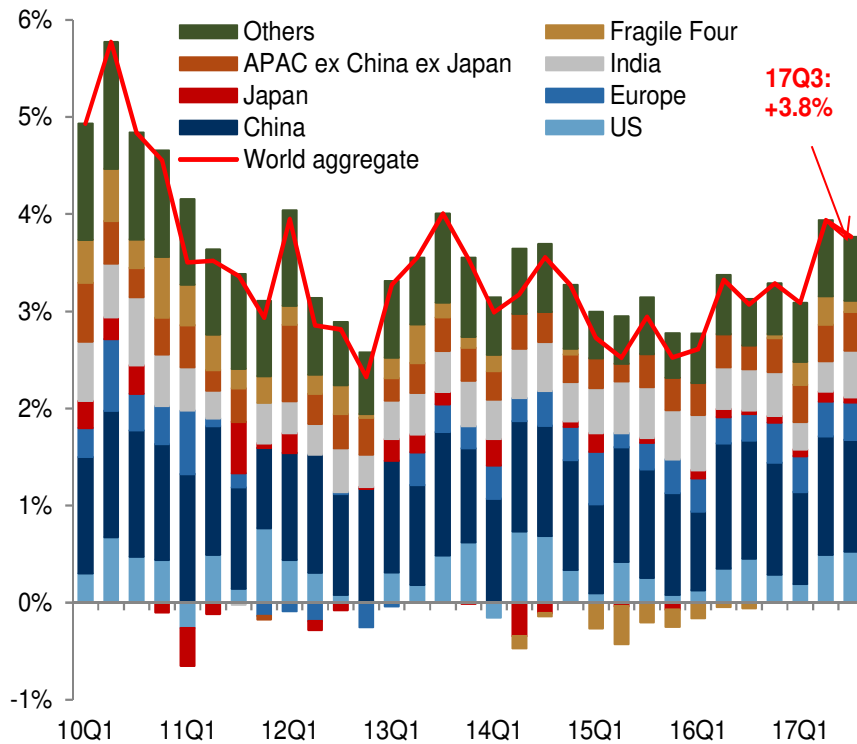
World growth: Let's get it started

Growth on a higher print for a second quarter in a row. These are the best two consecutive quarters since 2010.

Growth is revised up almost everywhere, particularly in the US, and Europe. Exceptions are in the Middle East, Africa and the UK.

World GDP growth, q/q annualized

Fragile four are Brazil, Russia, Turkey and South Africa



Global GDP growth forecasts (%)

	2016	2017		2018		2019
		Latest forecast	Revision (pps)	Latest forecast	Revision (pps)	
World GDP growth	2.6	3.2	0.2	3.2	0.2	3.1
United States	1.5	2.3	0.3	2.6	0.4	2.2
Latin America	-1.2	1.4	0.2	2.4	0.2	2.8
Brazil	-3.6	1.1	0.4	2.5	0.6	3.0
United Kingdom	1.8	1.5	0.1	1.0	=	0.8
Eurozone members	1.7	2.4	0.3	2.2	0.4	2.0
Germany	1.9	2.6	0.4	2.5	0.5	1.8
France	1.1	1.8	0.2	1.9	0.2	1.9
Italy	0.9	1.6	0.2	1.3	0.2	1.2
Spain	3.3	3.1	0.1	2.4	0.1	2.2
Russia	-0.2	1.6	0.1	1.9	=	1.8
Turkey	3.2	6.7	1.5	4.0	0.5	3.7
Asia	4.9	5.2	0.2	5.0	0.2	4.9
China	6.7	6.8	0.1	6.4	0.1	6.2
Japan	0.9	1.7	0.2	1.2	0.3	1.0
India	7.1	6.5	=	7.3	=	7.3
Middle East	4.7	1.8	-0.1	2.7	0.1	3.0
Saudi Arabia	1.7	-0.3	-0.8	1.7	-0.3	2.0
Africa	1.3	3.0	-0.3	3.5	0.5	3.5
South Africa	0.3	0.8	0.2	1.4	0.2	1.8

* Weights in global GDP at market price, 2016

NB: The revisions refer to the changes in our forecasts since the last quarter

2017 was about growth acceleration, despite numerous policy nudges



Positive surprises

Global GDP growth accelerated by +0.6pp to 3.2%

Trade flows recovered more than expected by +7.5% in value

A synchronized growth momentum in the US, the Eurozone and Asia

Recession in some (Brazil, Russia, South Africa) Emerging Markets ended

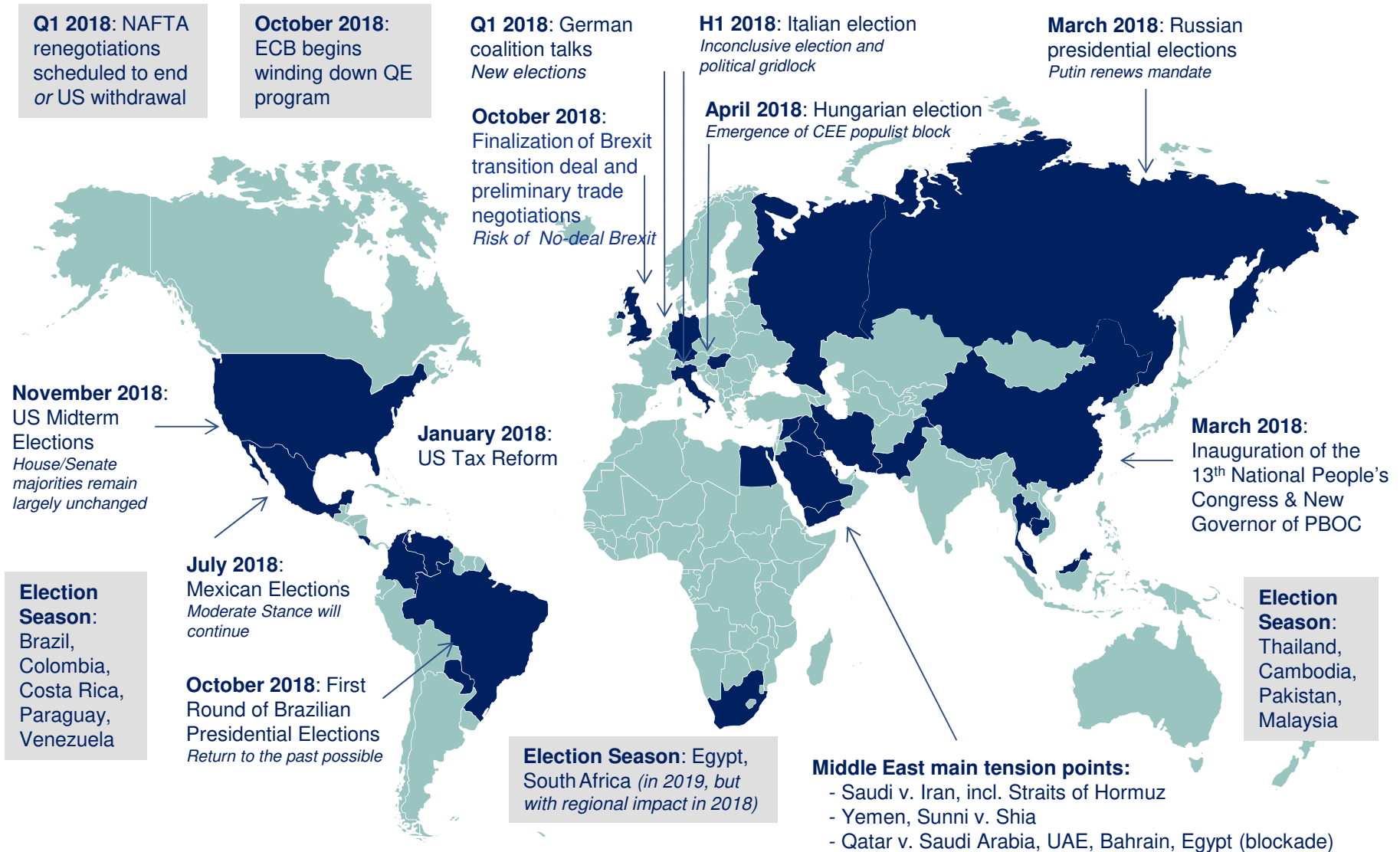
Negative surprises

World insolvencies finally increased by +1% (big insolvencies particularly on the rise)

Increased protectionism from the US to China

The Middle East crisis worsened

2018 should remain quite a busy year



NB: *In Italic our baseline assumptions*

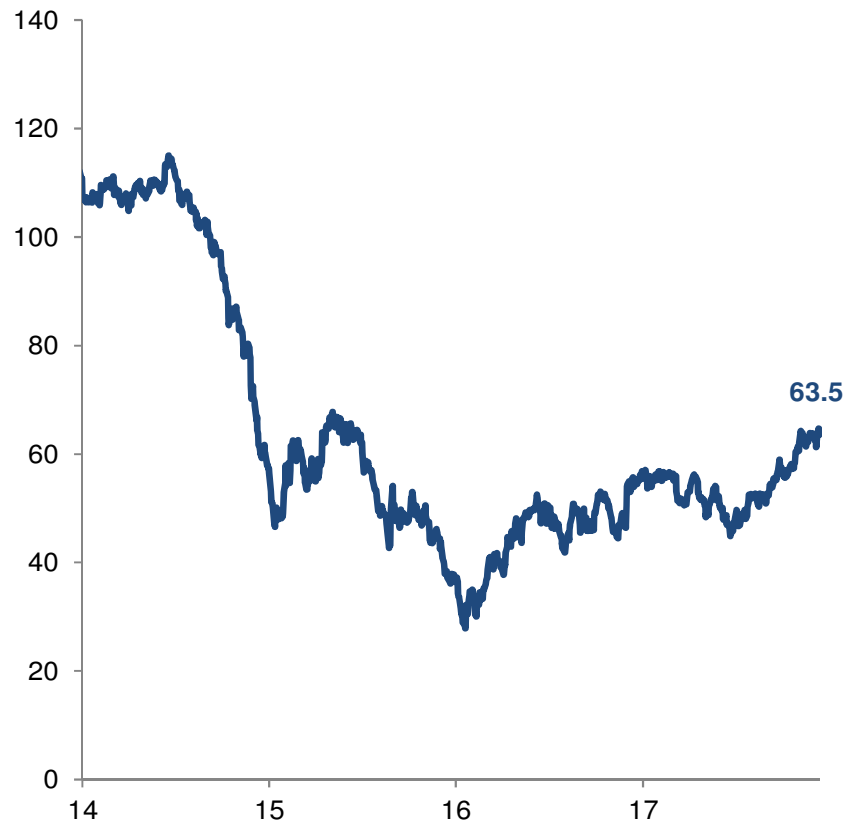
Source: Euler Hermes

Prices in a nutshell: No big changes

Oil: Average oil prices are revised up to 62 \$/bbl in 2018. Downside risk limited by good growth momentum.

Exchange rates: Increasing interest rate divergence to nurture dollar appreciation, to USD 1.15 / EUR on average in 2018

Oil price, brent \$/bbl
Last data, as of Dec. 12th



Sources: Euler Hermes, Allianz Research

Exchange rate, USD/Euro
Last data, as of Dec. 12th



Sources: Euler Hermes, Allianz Research

Agenda

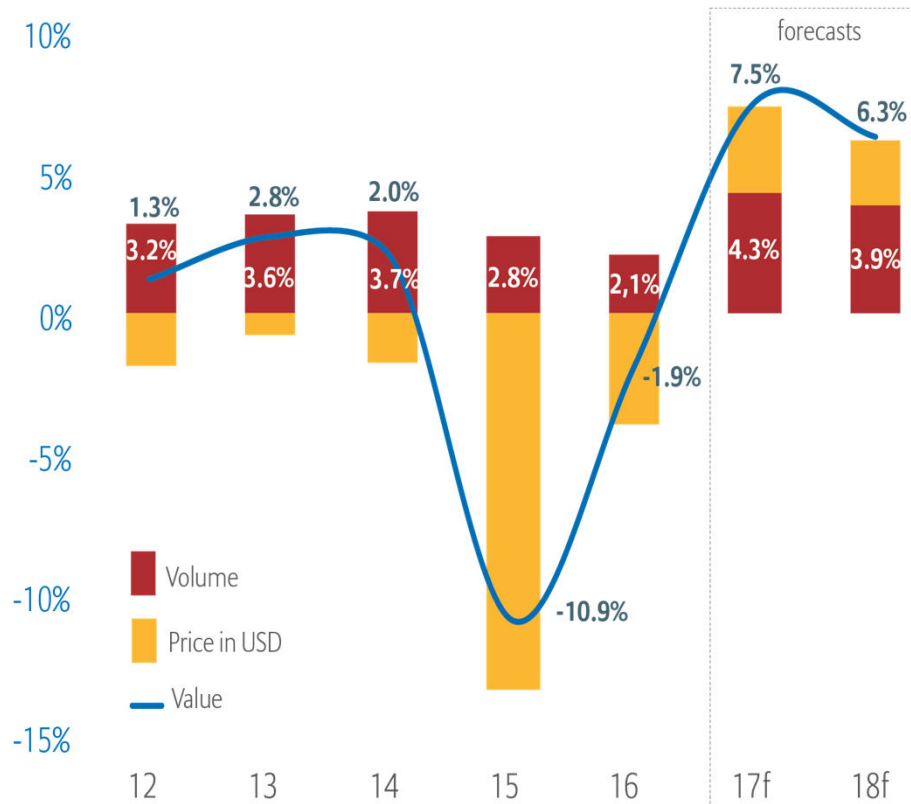
- 1 Global themes: Walking on the moon**
- 2 Regional outlooks: What to watch in the US, Europe, China and Emerging Markets

Theme #1: Trade, driving faster

Global Trade is levelling off to a new regime characterized by a recovery of prices and an improvement in volume.

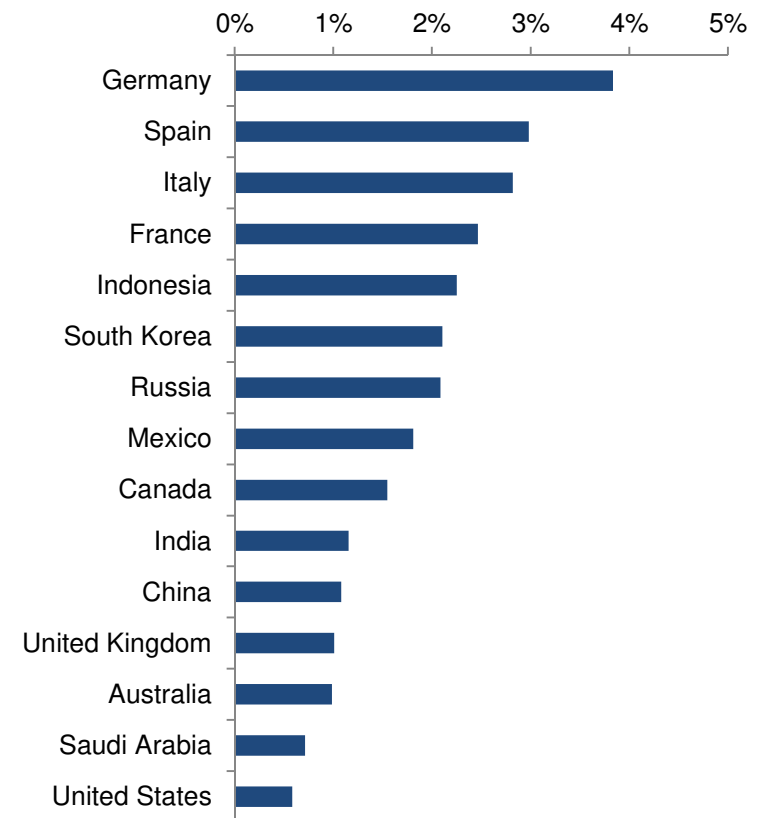
Strong demand growth will benefit to (and come from) the Eurozone and Asia.

Growth in Global Trade of Goods and Services (in %)



Sources: IHS, Euler Hermes, Allianz Research

Nominal exports gain (in GDP point) for selected economies on 2018



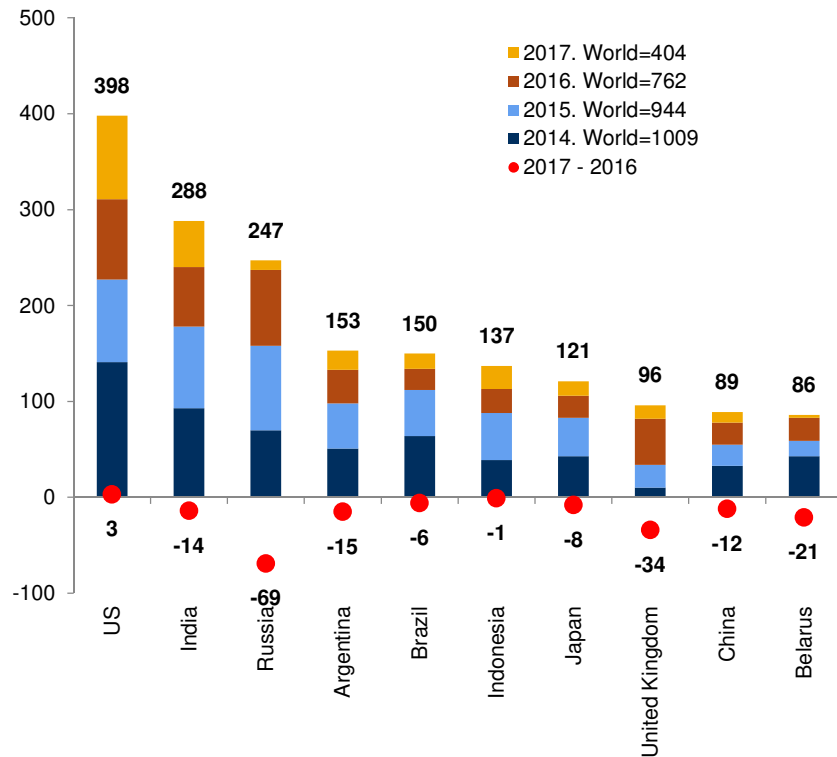
Sources: Chelem, Euler Hermes, Allianz Research

Weigh #1: A marked slow-down in 2017, though the US are heading the opposite way

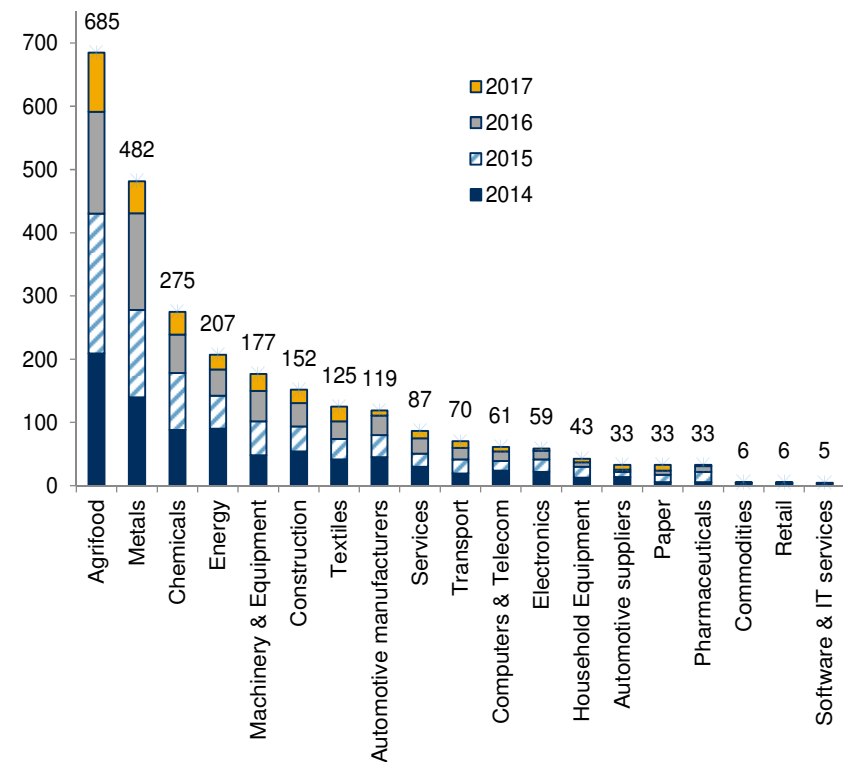
Among the top 10 most protectionist countries, only the US has deployed more measures in 2017 compared to 2016.

Agrifood, Metals and Chemicals are the most impacted sector. Some others industries don't see much attention (Retail, Commodities..)

New protectionist measures



Protectionist measures against specific sectors

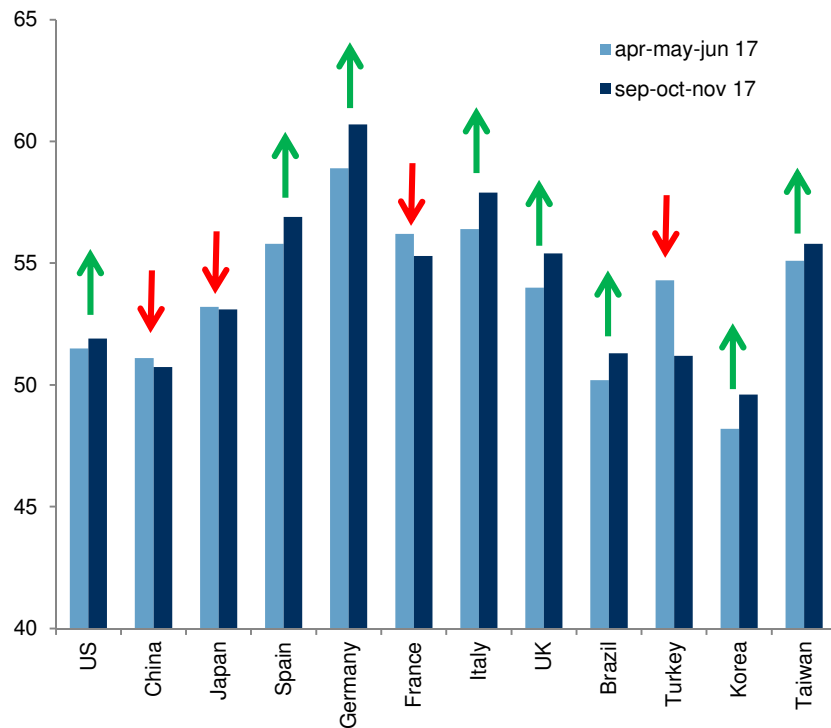


Trend #1: Trade and growth, they live together

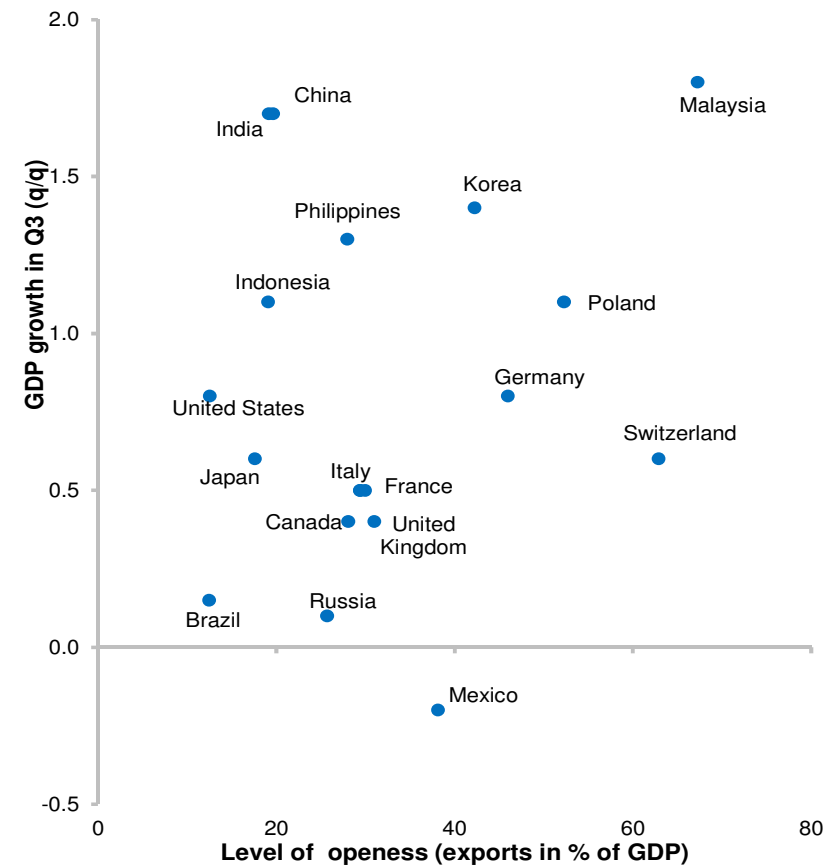
New exports orders are growing at an increasing pace for most countries.

Compare trade openness to growth q/q Q3 figures (scatter plot) to show how open economies are driven by the momentum

PMI manufacturing: new export orders sub-indices (%)



Trade openness and GDP growth in Q3 (q/q)

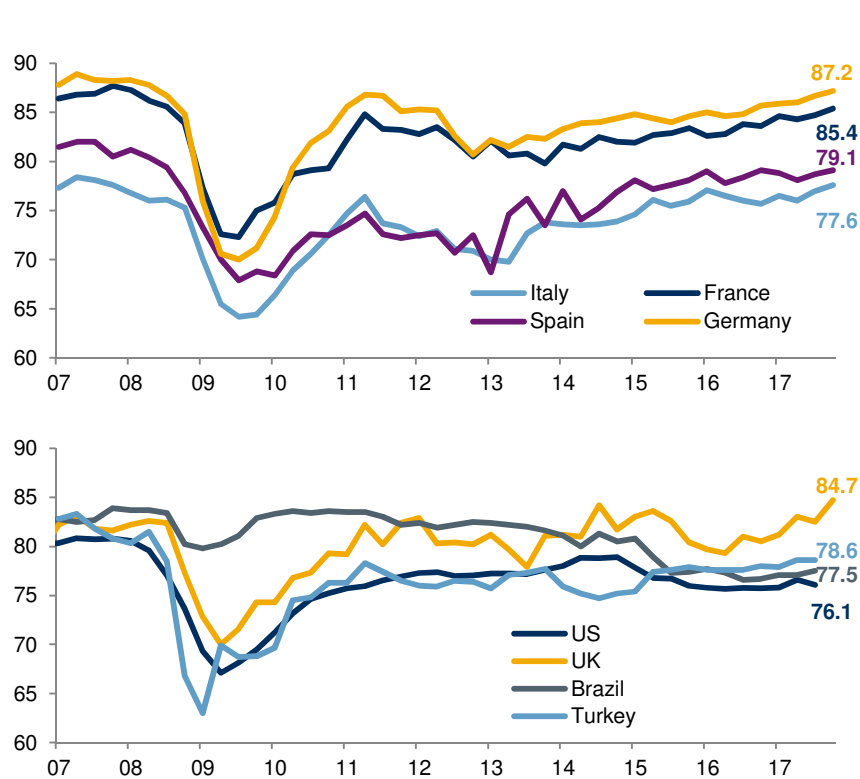


Theme #2: Goodbye slack, Hello nominal growth

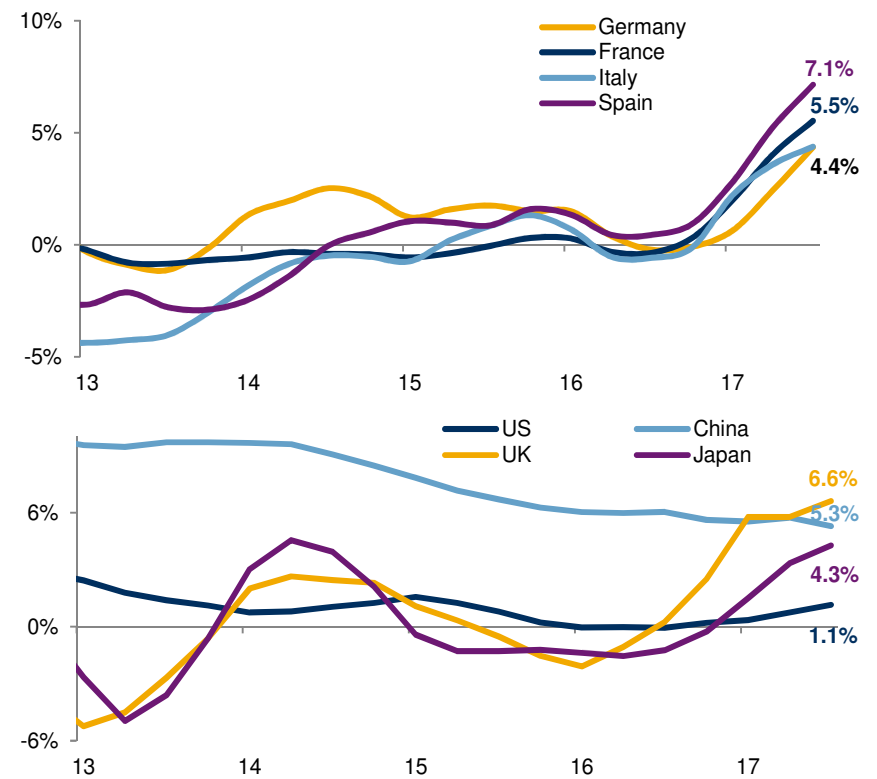
No more slack in the Eurozone, some leeway to grow without inflation in emerging markets.

Corporate turnover growth kept accelerating, particularly in the Eurozone.

Level of Capacity Utilization (%)



Turnovers growth in manufacturing (% y/y)

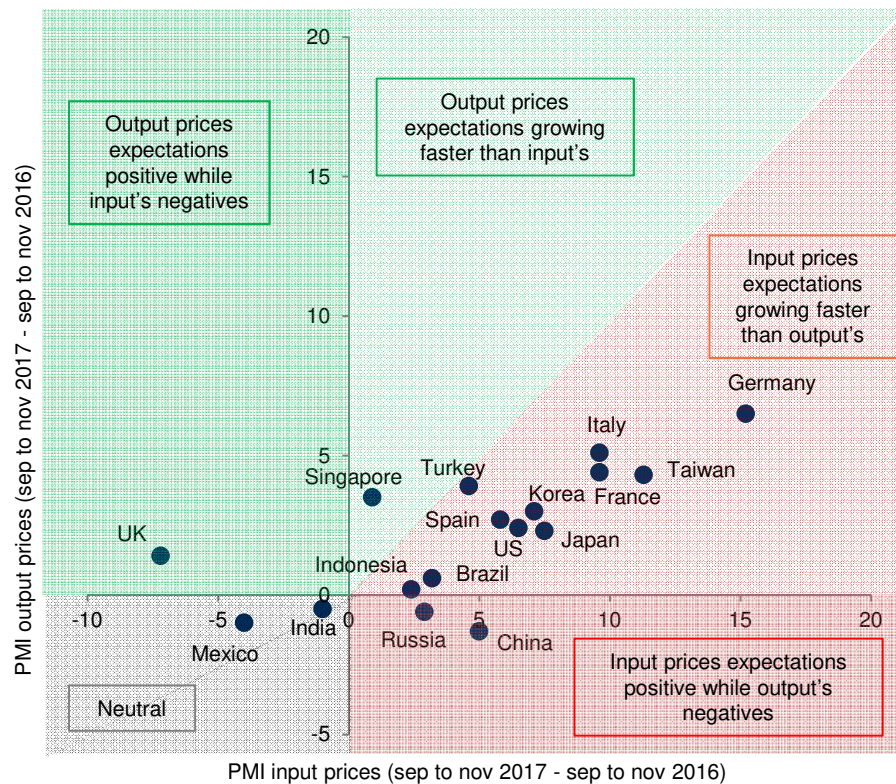


Weigh #2: Cost pressures are mopping up the value chain

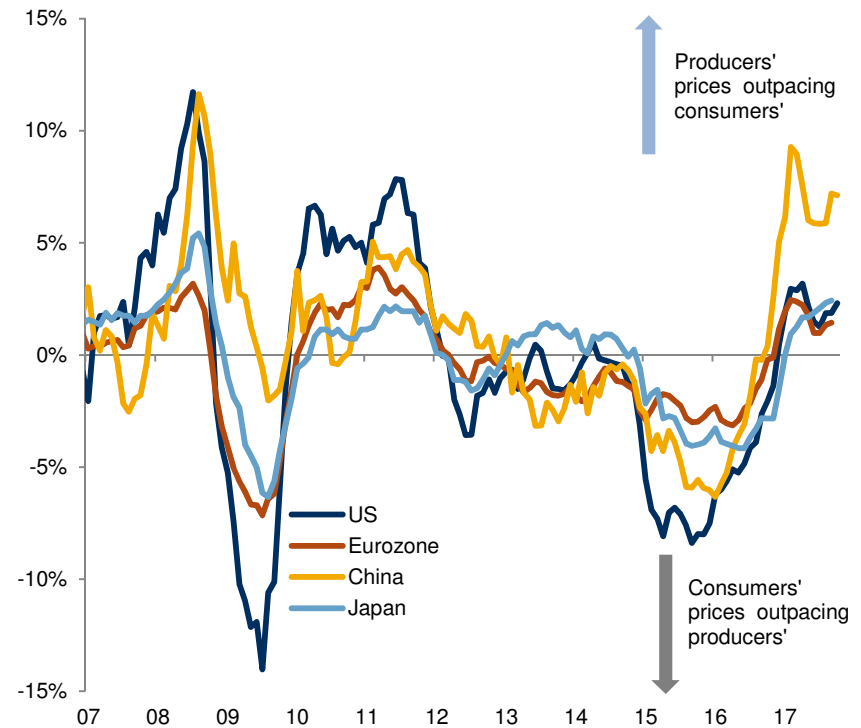
Margins can be squeezed by the return of cost pressures: Corporates saw input prices increasing faster than output prices.

And producer prices' inflation did not translated into higher consumer prices.

PMI: Input prices vs. output prices



PPI – CPI
(%, y/y)



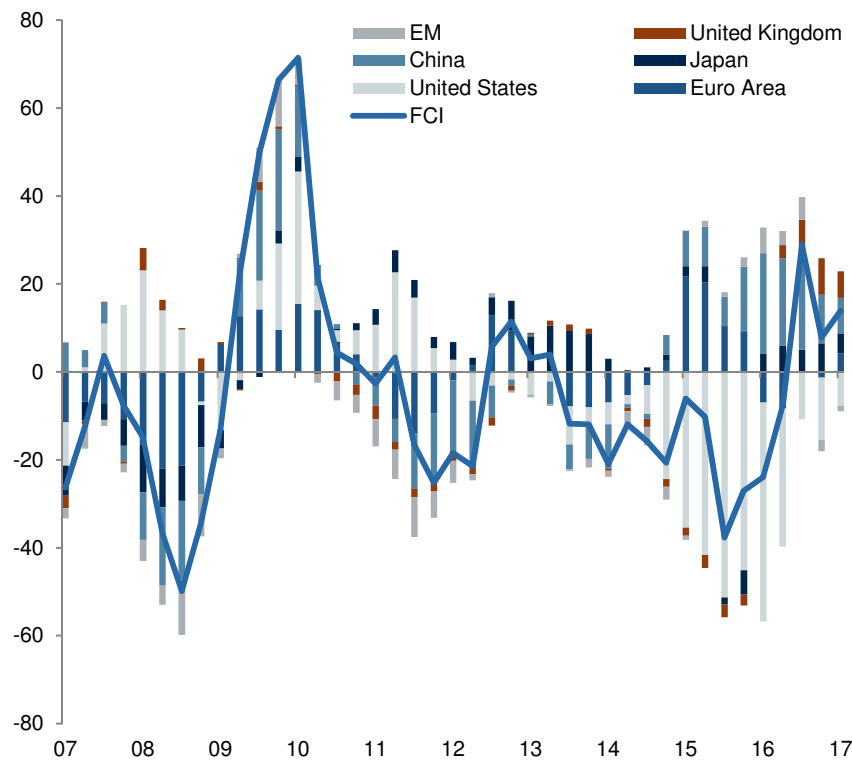
Trend #2: Monetary policy to be tightened, since financial and economic conditions improved

Global liquidity is up, particularly since dollar recession is over.

Labor markets conditions are significantly tightening globally

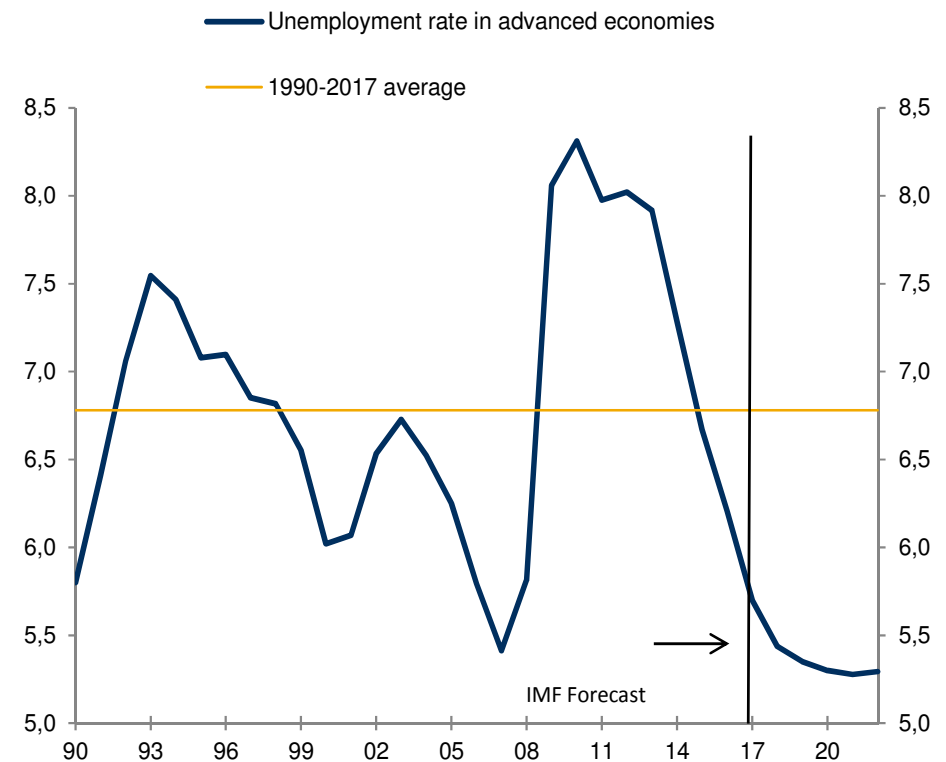
World monetary and financial conditions

Contribution by country



Sources: IHS, Euler Hermes, Allianz Research

Unemployment rate in developed economies (%)



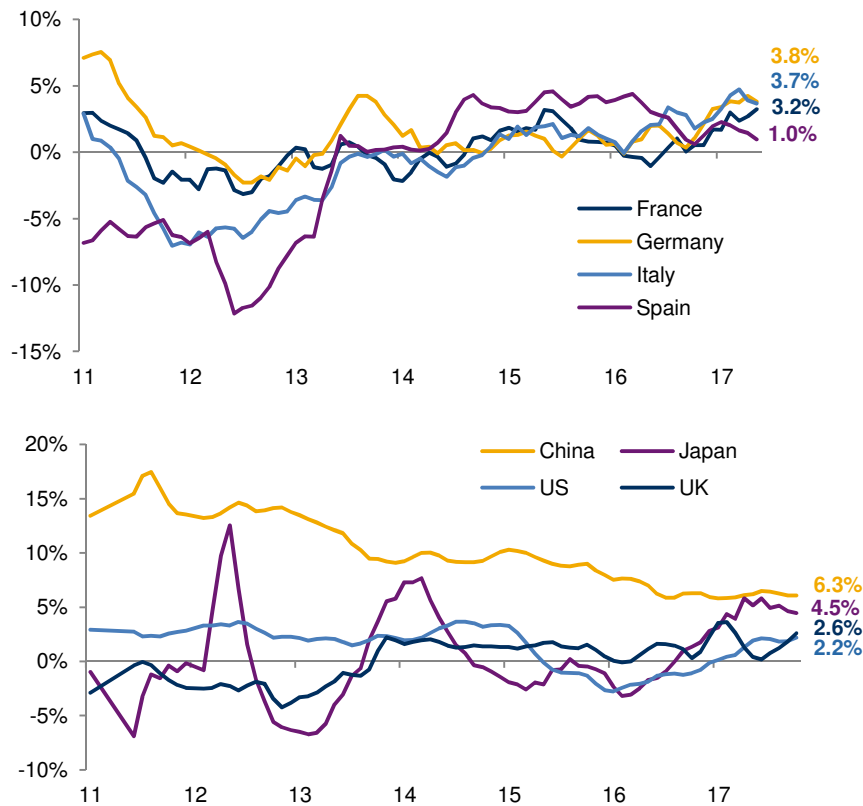
Sources: Euler Hermes, Allianz Research

Theme #3: Growth is in-sync

Super 8: Industrial production is growing in each of the 8 key economies.

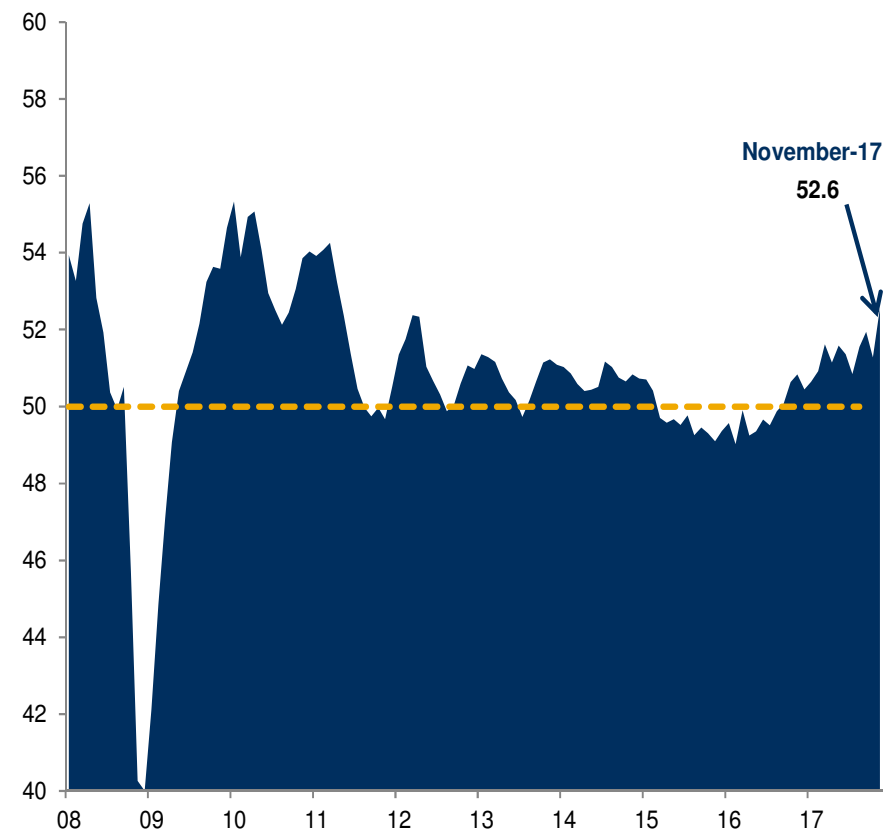
In Emerging Markets, PMI kept accelerating and reached its best level since February 2011

Industrial production growth (y/y, %, 3-month average)



Sources: IMF, Euler Hermes, Allianz Research

Emerging Markets aggregate manufacturing PMI

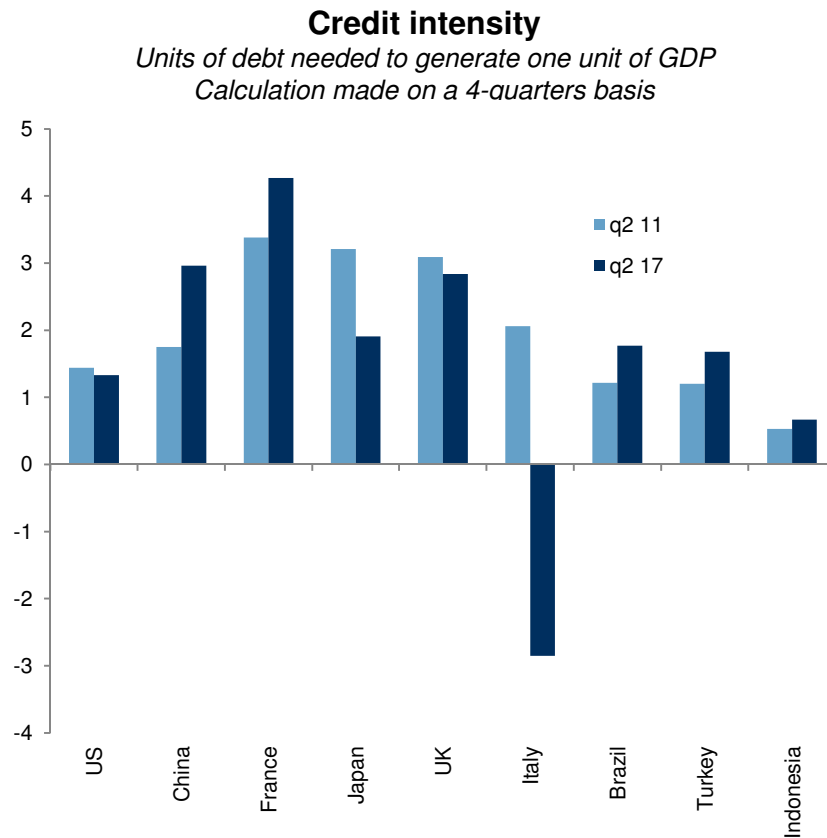


Source: Bloomberg, Euler Hermes, Allianz Research

Weigh #3: Growth is not only about good cholesterol

Compared to the last growth cycle (2011), the debt intensity of growth increased.

Equity valuation increased and market capitalization surged to new peaks.



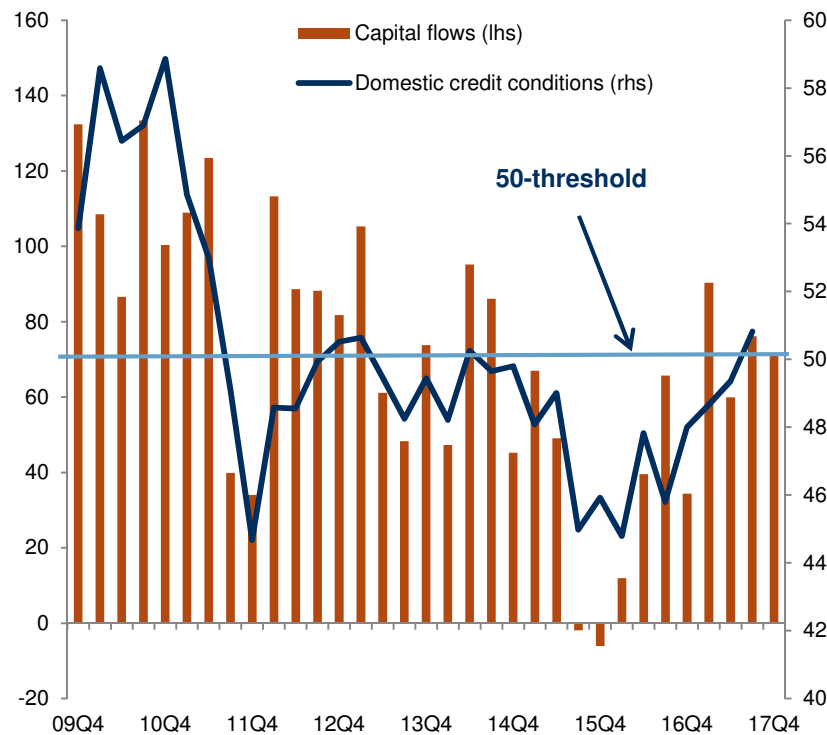
Trend #3: Emerging Markets are ready to grow faster

The Emerging Markets are entering in a new credit cycle: External and domestic conditions are improving at the same time.

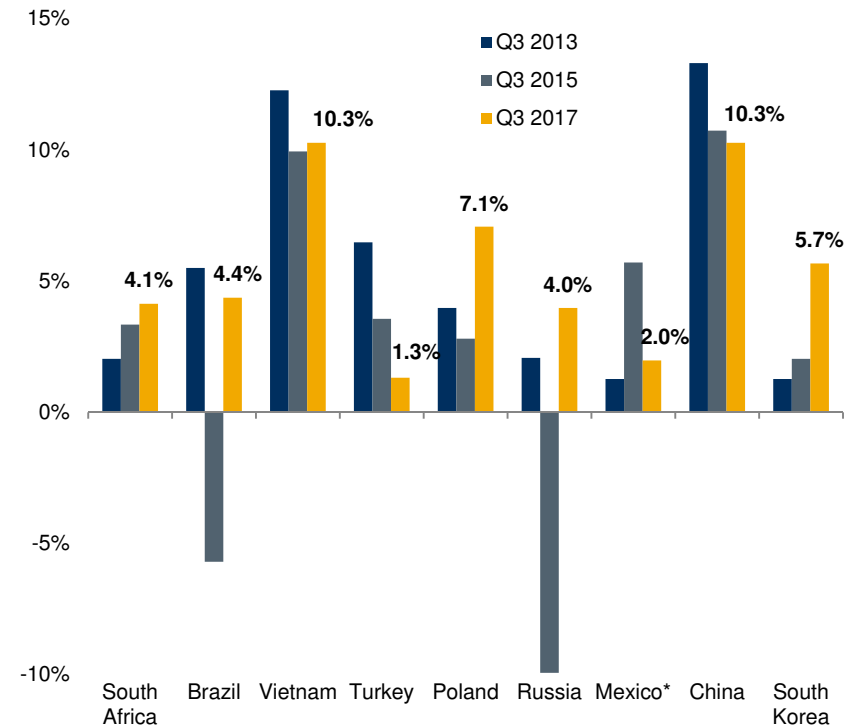
Is the Emerging consumer back in town? Retail sales growth shows acceleration of consumer spending in most EMs

Credit conditions: external vs. domestic

External: Net capital flows, USD bn (excl. China and Russia)
 Domestic: IIF Bank Lending Conditions index (read it as a PMI)



Retail sales growth (y/y, 3-month average)



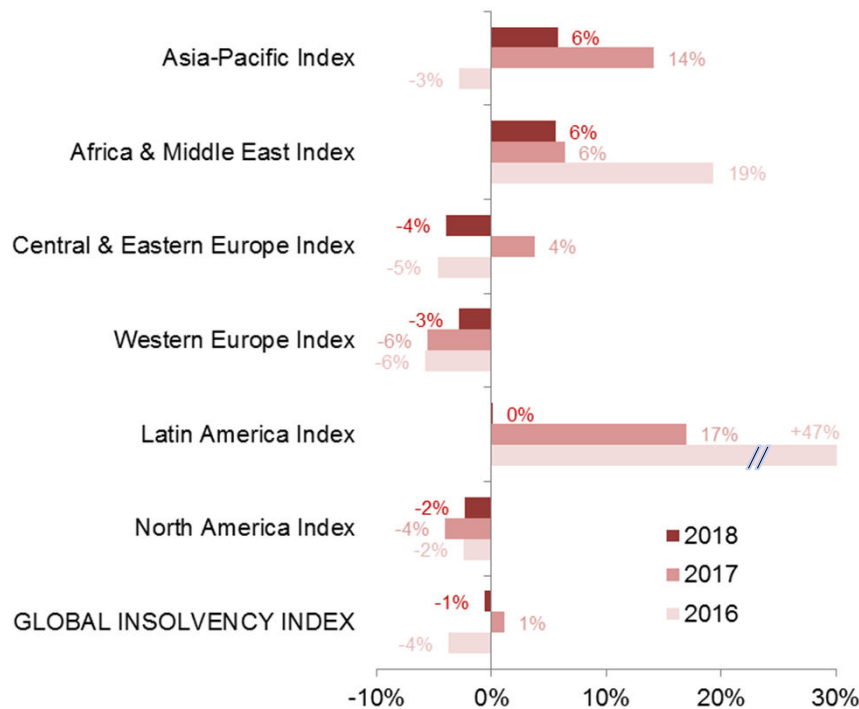
*Q2 2017 was used for Mexico as the economy contracted temporarily in Q3 due to natural disasters

Insolvencies: Come as you are, but big is not beautiful

Good growth momentum (Europe and North America) means less insolvencies. Less good momentum took its toll in Emerging Markets

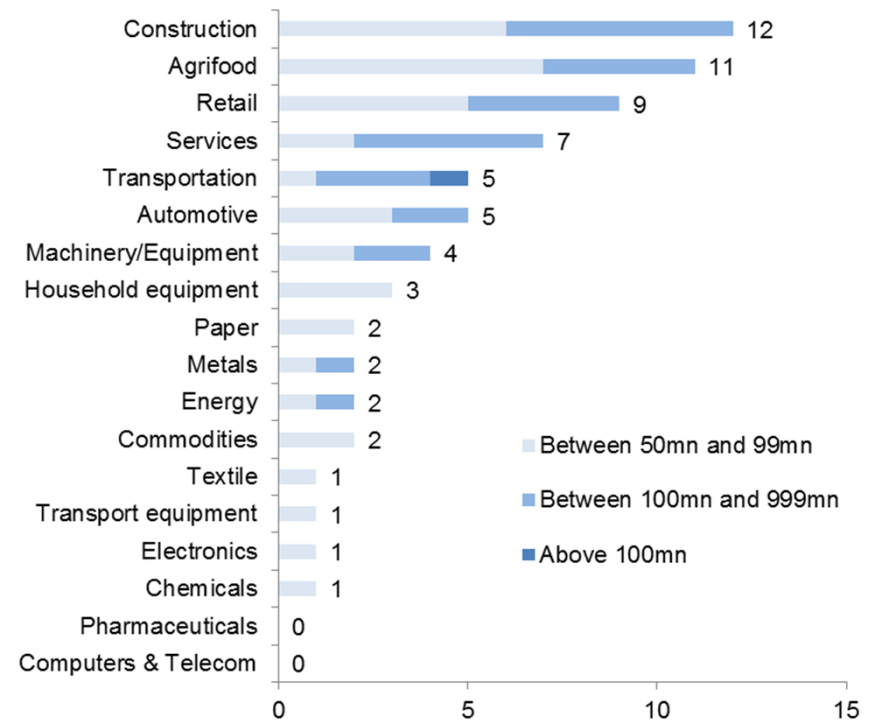
Majors failures surged, e.g. +32% in Western Europe to 101 units representing a cumulative turnover of EUR21.4bn (vs EUR 9.8bn in 2016)

EH Global and Regional Insolvency Indices
(yearly change in %)



Source: Euler Hermes

Major failures* in Western Europe 2017 as of Q3 YTD
(number of companies, by size of turnover in million of EUR)



(*) Companies with a turnover exceeding EUR50mn
Source: Euler Hermes

Agenda

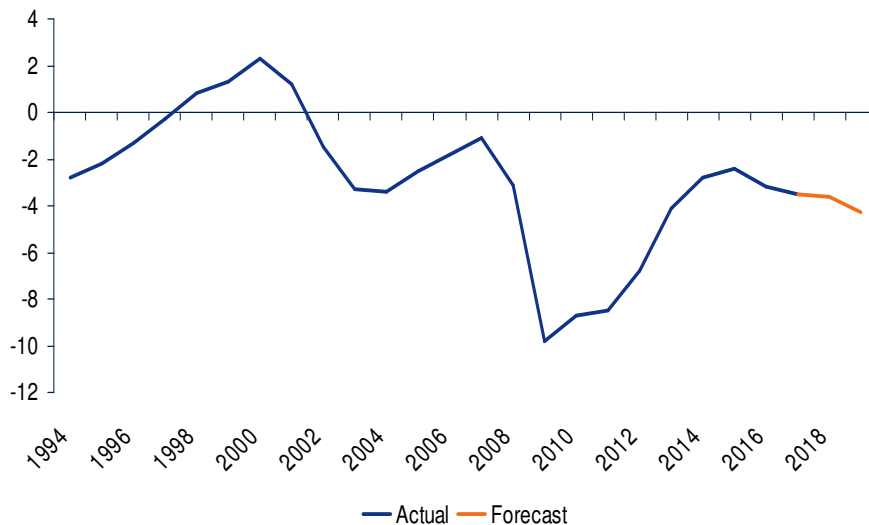
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US: Both the Senate's and House's version of the fiscal reform would add USD 1.4 tn of debt

The net effect on budget could be less devastating taking into account the acceleration of growth...

However, a certain pessimism on the size of this growth impact means further accumulation of debt compared to current legislation

Federal budget balance as % of GDP (fiscal year data)



Arguments of those seeing low impact on growth of the US fiscal reform

- Muted domestic demand, resulting from insufficiently redistributive fiscal policy
- Profit repatriation is expected to nurture dividends and share buybacks
- Potential of growth unlikely to be sufficiently impacted if individual tax cuts are not permanent: no sustained increase in labor supply
- Companies with higher effective tax rates, likely to benefit more from the reform, have relatively lower interconnections with the rest of the economy
- The private equity industry and fiscal advantages of private activity bonds could be penalized by the reform, what could significantly hamper infrastructure projects
- The reform could have a negative impact on residential investment

Estimated budget effects of possible tax reform proposal (USD bn)

	2018	2019	2018-22	2018-27
Conventional estimate	-38,4	-224,5	-926,3	-1414,2
Effects resulting from macro analysis	9,9	35,7	238	407,5
Net Total	-28,5	-188,8	-756,8	-1006,7

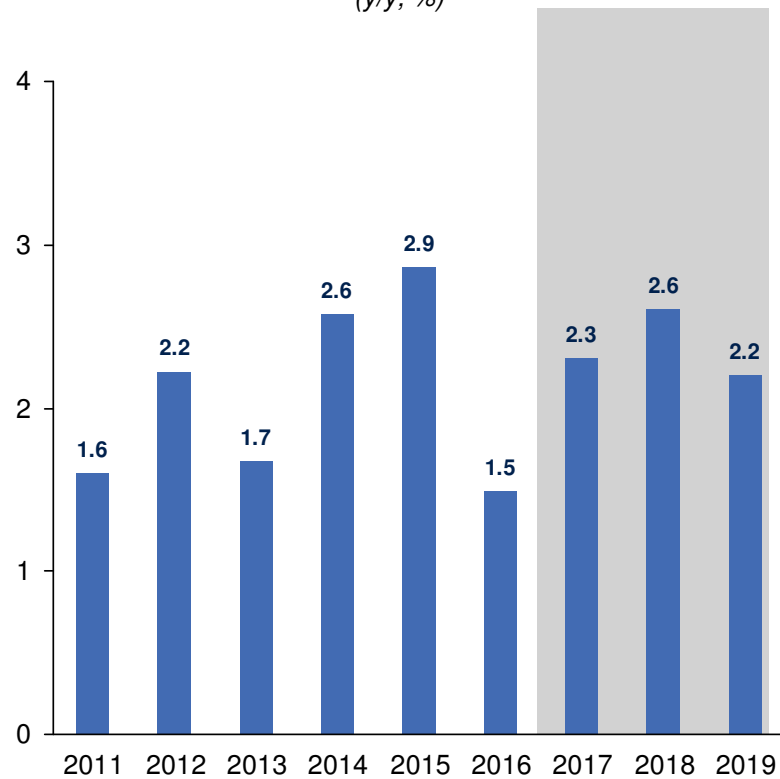
- **Static impact:** increase of USD 1,4 trillion of the US debt
- **Dynamic impact** on growth produce USD 458 bn of fiscal revenues
- **Fed reaction's** tightening policy would impact growth and reduce fiscal revenues by USD 51 bn
- **Total net impact** of fiscal reform on US debt: USD 1 trillion at the horizon of 2018-27 Taxation expects

US: Further growth acceleration in 2018 – some loss of momentum in 2019

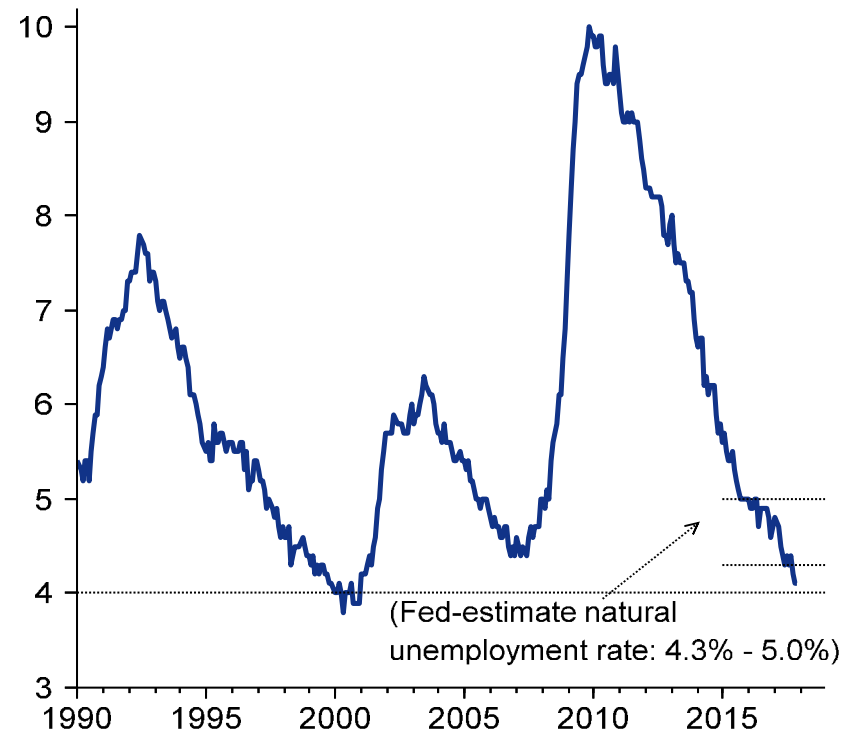
Fiscal policy expected to add 0.2 to 0.4pp to growth in 2018/19 via tax relief, but higher interest rates will act as a counterbalance...

... as the Fed likely will progressively hike rates to avoid overheating. The unemployment rate is already below the level generating inflation.

GDP growth
(y/y, %)



Unemployment rate
(%)

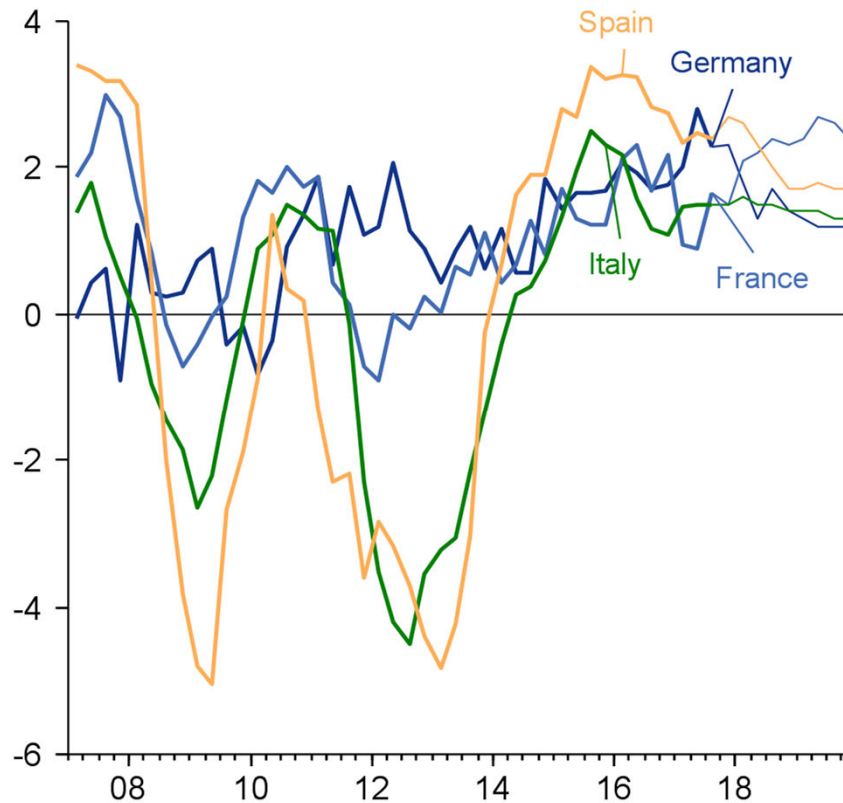


Eurozone: Private consumption continues to power the upswing in 2018/19 while export growth tapers off

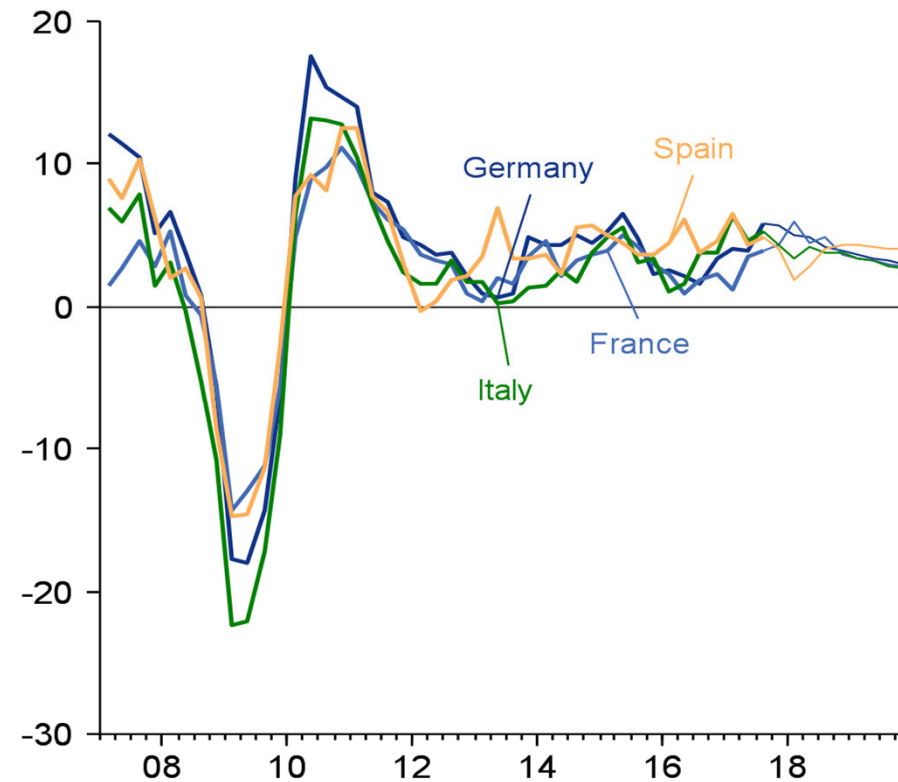
Private consumption to remain relatively resilient supported by favorable labor market outlook and only a modest rise in inflation

Eurozone export growth looks set to cool in 2018/19 in line with a weakening of global trade

Private consumption (y/y, in %)



Exports (y/y, in %)

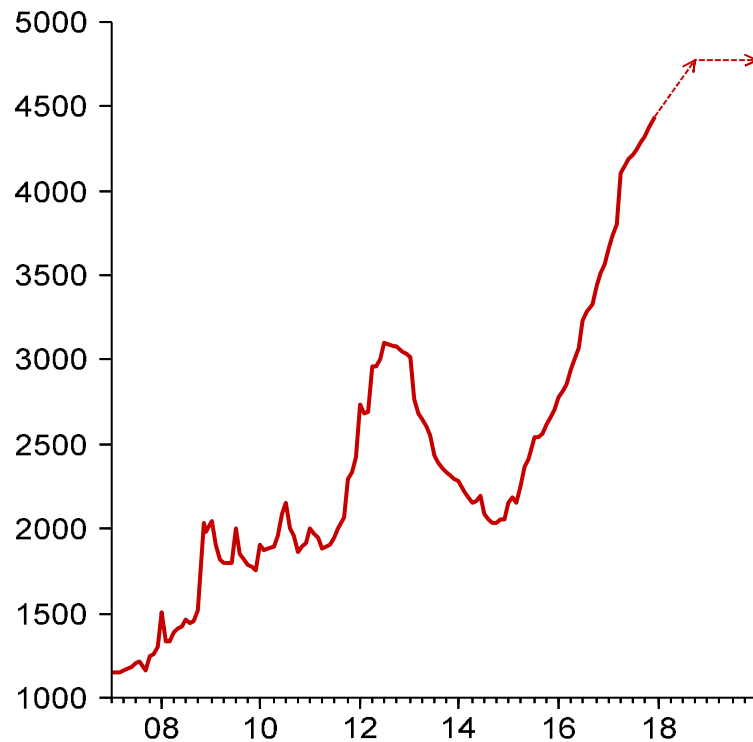


The ECB will keep financial conditions favorable

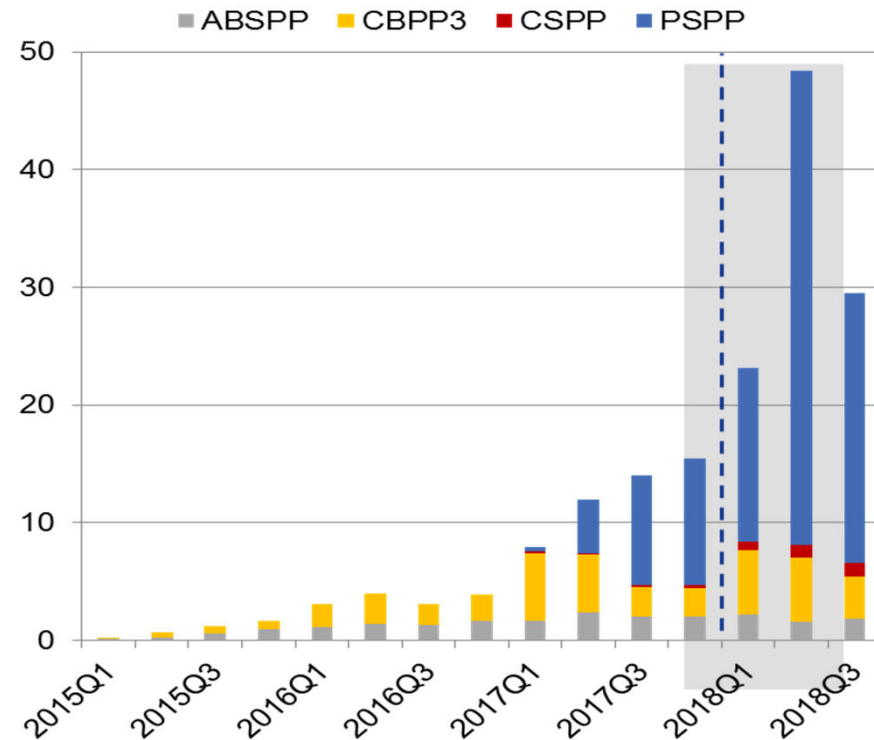
The ECB to end asset purchases in October 2018, keep assets level unchanged thereafter and deliver first rate hike in 2019Q2.

The ECB will need to keep buying bonds after October 2018 in order to replace matured bonds.

ECB balance sheet, total assets (EUR bn)



ECB redemptions/reinvestments (EUR bn, after November 2017 ECB forecasts)



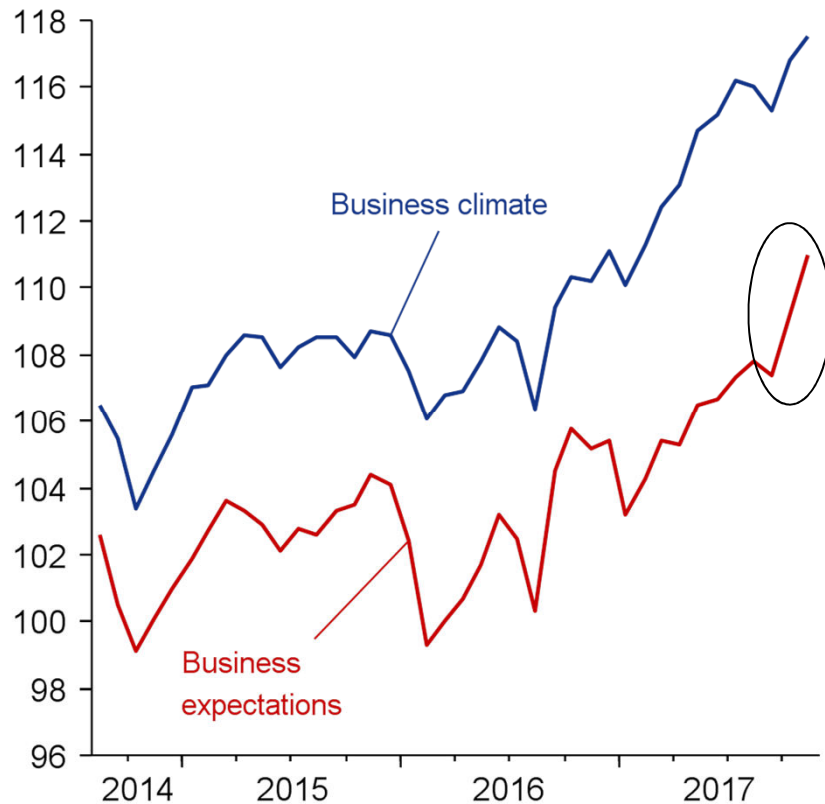
ABSPP: Asset-Backed Securities Purchase Program; CBPP3: 3rd Covered Bond Purchase Program; CSPP: Corporate Sector Purchase Program; PSPP: Public Sector Purchase Program

Germany: The boom goes on, with real GDP expanding by 2.6% in 2017 and by 2.5% in 2018

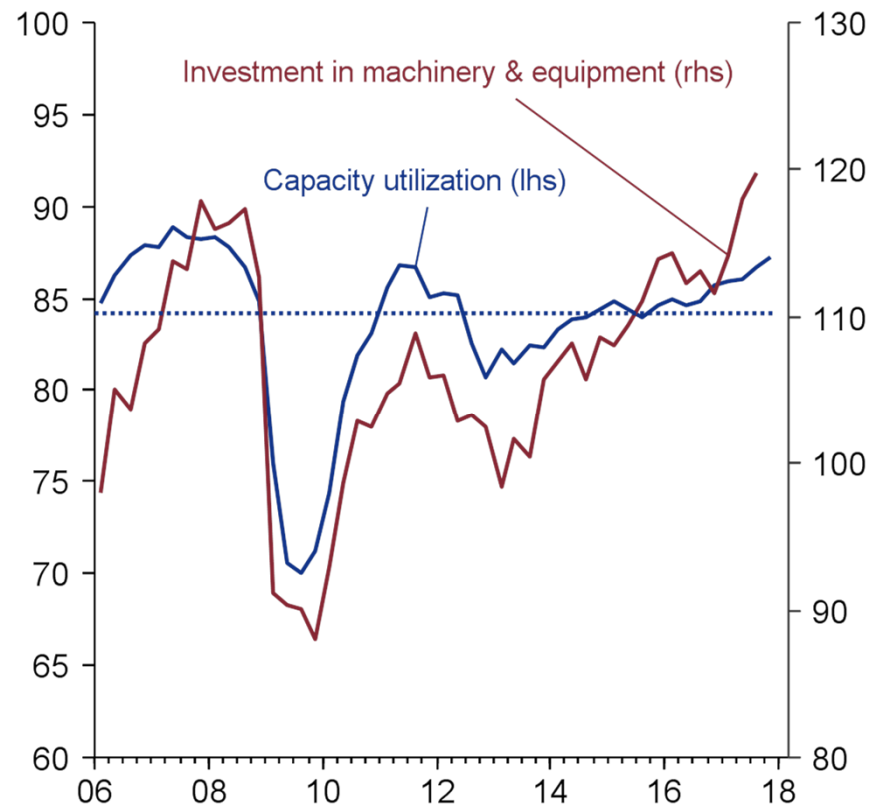
Sharp upward trend in business expectations signals robust upswing to continue

Above-average and rising capacity utilization finally translates into higher investment spending

Ifo index: Manufacturing (2005=100)



Capacity utilization* (manufacturing, %) and investment (chain index, sa)



* Dotted line: Average since 1990

France: Investment is booming and sectors are in-sync

Industry: Manufacturing confidence increased to its best level since 2001.

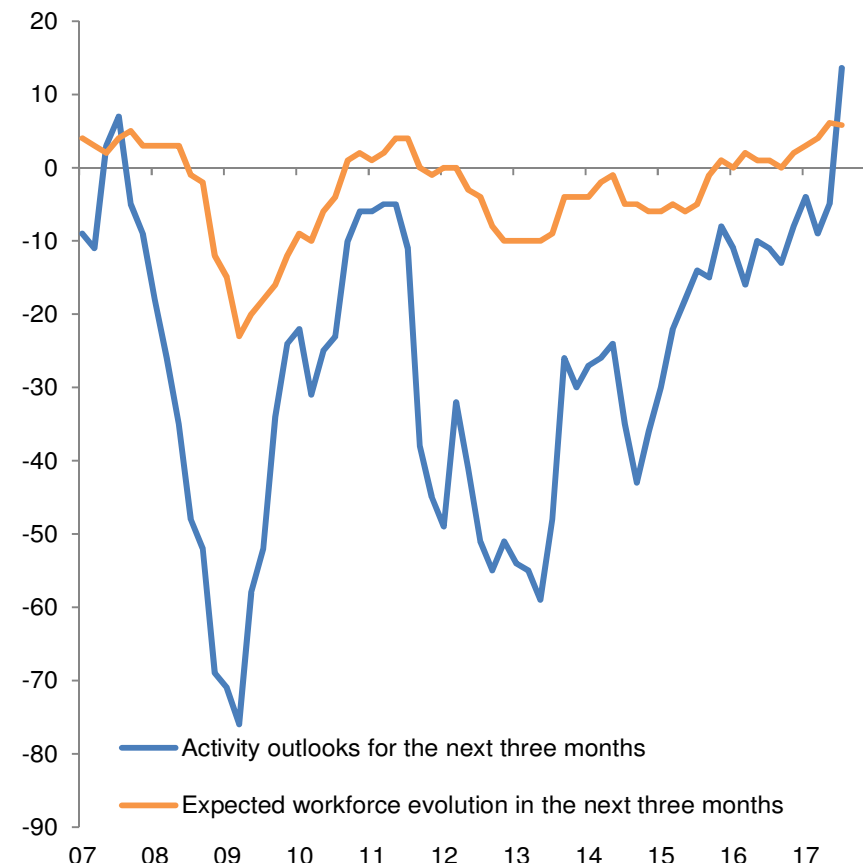
The service sector is also accelerating and wholesale trade expected activity outlook is the best one since September 2000.

France, manufacturing: Confidence and production



Sources: IMF, Euler Hermes, Allianz Research

France: Wholesale trade



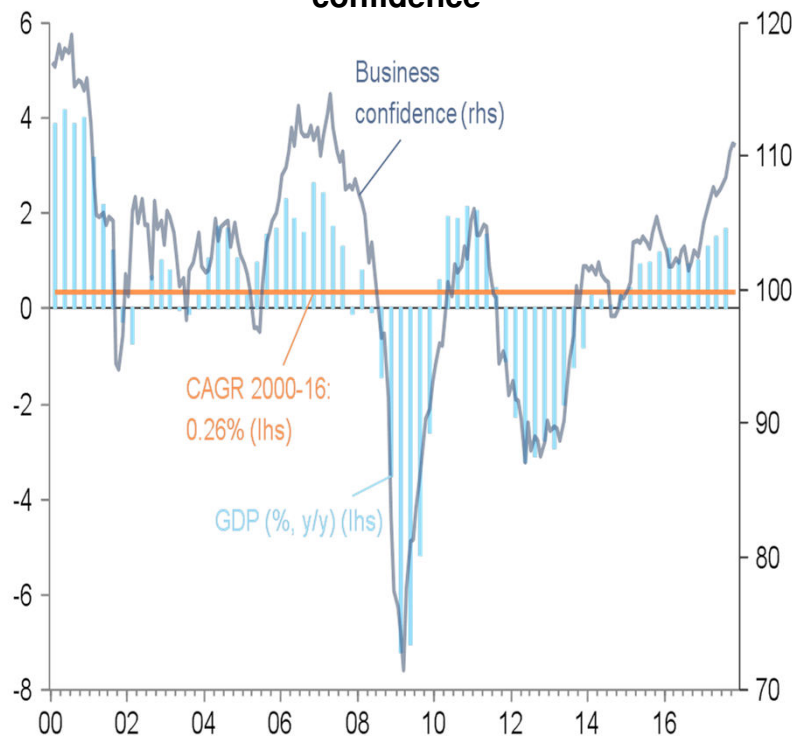
Sources: Euler Hermes, Allianz Research

Italy: Economic recovery finally gaining traction (1.6% in 2017 & 1.3% in 2018) but structural weaknesses will limit cyclical upswing

2017 GDP growth rate highest since 2010 thanks to ongoing recovery in domestic demand and favorable export demand

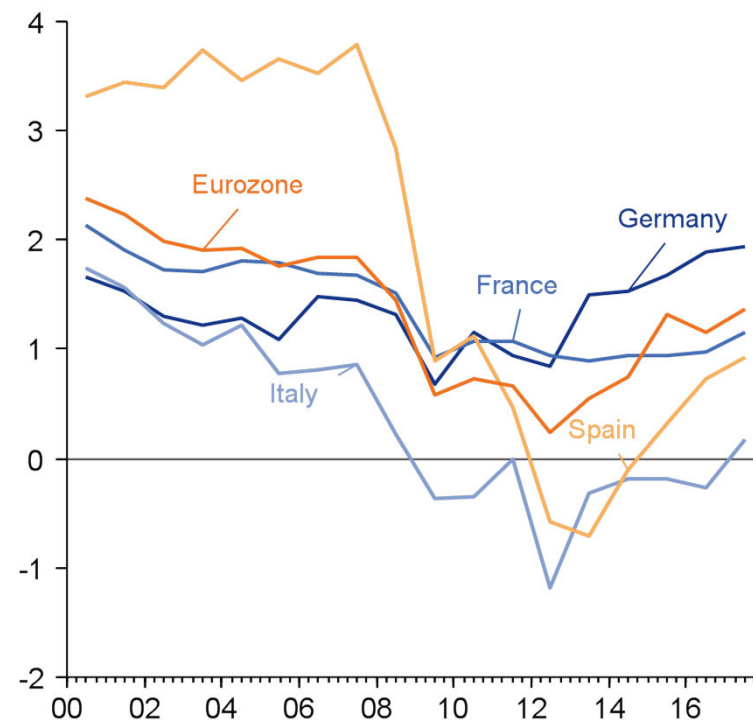
But structural problems still loom large: To exit the low-growth/high-debt/fragile-banks trap Italy is in dire need of more reform

Italian GDP growth (y/y) & business confidence



Sources: Istat, Thomson Reuters Datastream, Allianz Research

Potential GDP (%)



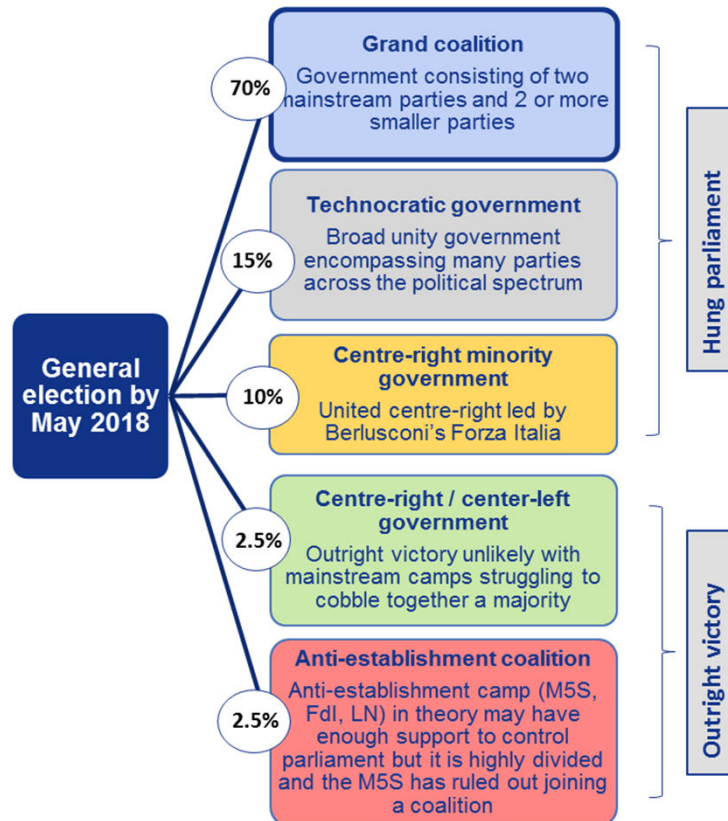
Sources: European Commission, Thomson Reuters Datastream, Allianz Research

Italian elections likely to bring ‘more of the same’: Rising political fragmentation bodes ill for political stability and reform

Political fragmentation bodes ill for political stability and economic reform outlook, but reduces odds of *Italexit*

Italexit is a tailrisk as it requires a long-lived, stable government but cannot be ruled out completely given Italy’s inability to reform and growing euro-fatigue

Coalition games – based on Ipsos poll (November)



Path to Italexit

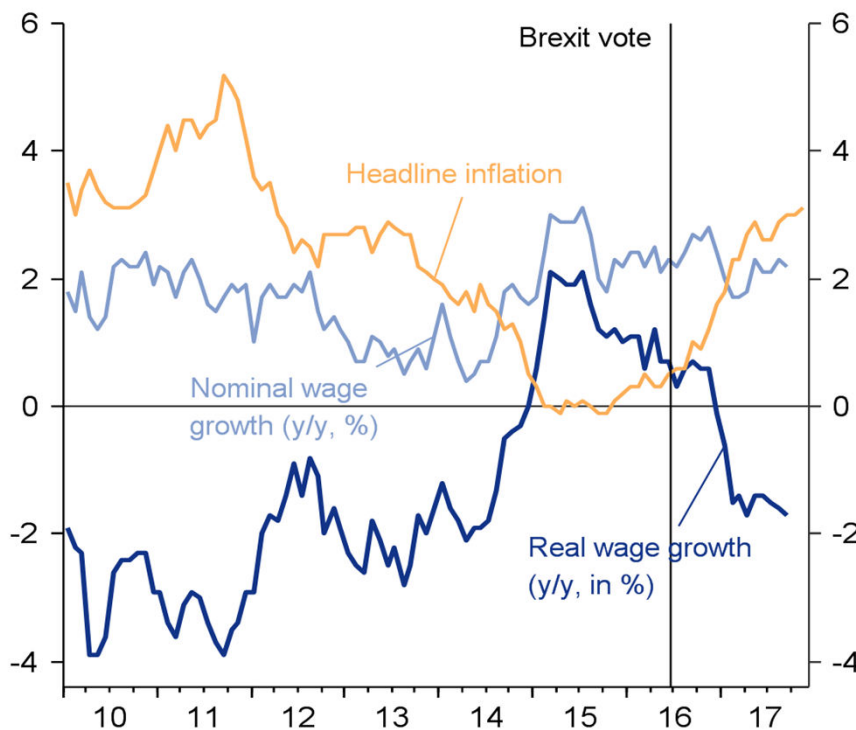


Sources: Istat, Ipsos Thomson Reuters Datastream, Allianz Research

UK: GDP growth will slow to +1.5% in 2017 and +1.0% in 2018 in line with cooling domestic demand

UK consumers face double-whammy blow: High inflation and sluggish wage growth put a squeeze on living standards

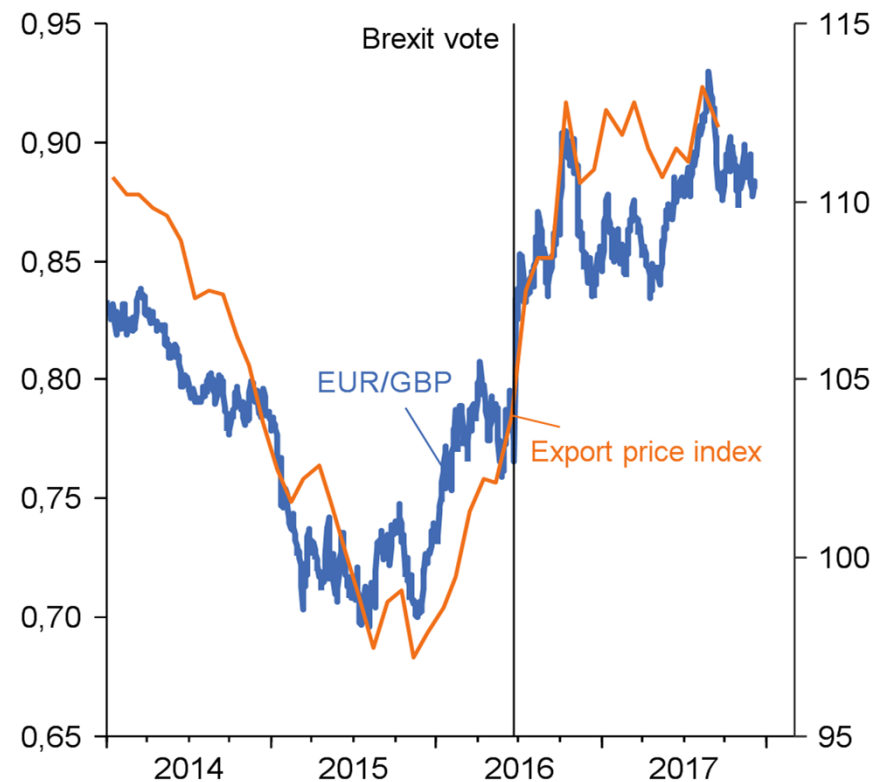
Headline inflation, retail price inflation, core inflation & compensation per employee (y/y, in %)



Sources: Thomson Reuters Datastream, Allianz Research.

External sector not making up for slowing domestic demand with exporters responding to weak Sterling by raising export prices putting profit before volume

GBP/EUR (lhs) & export prices index (2013 =100, rhs)

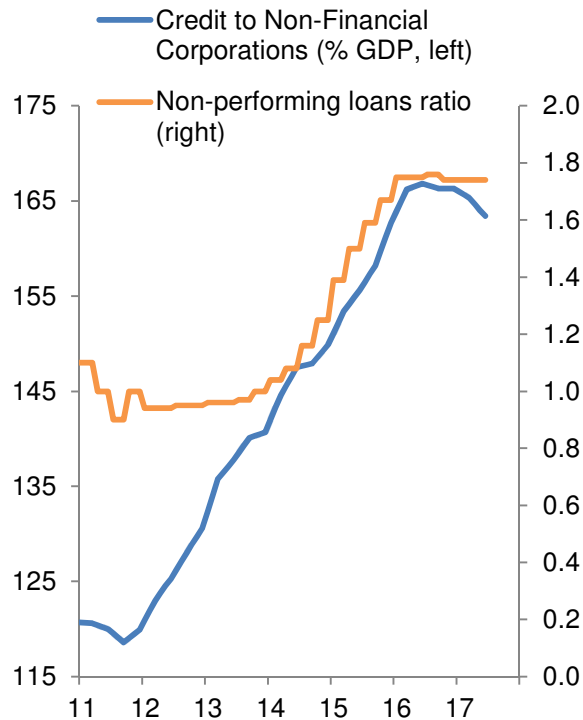


Sources: Thomson Reuters Datastream, Allianz Research.

China #1: Taming risks

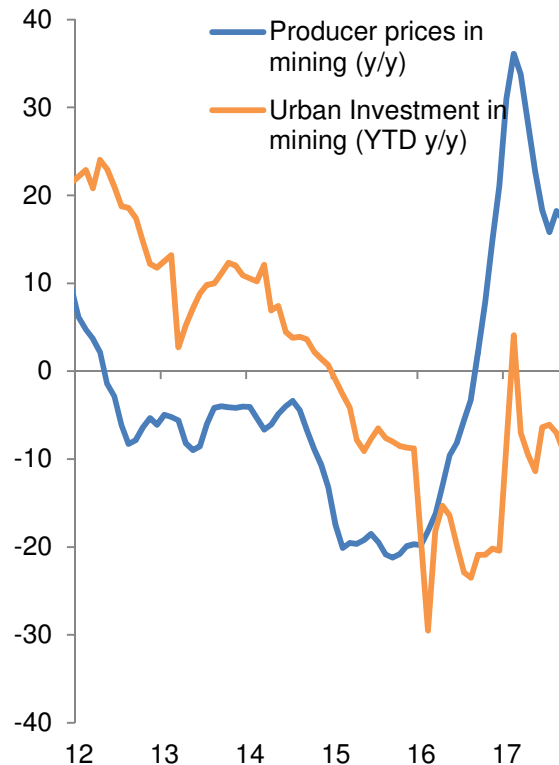
Financial risk: macro-prudential measures bring some improvement

Financial risks indicators



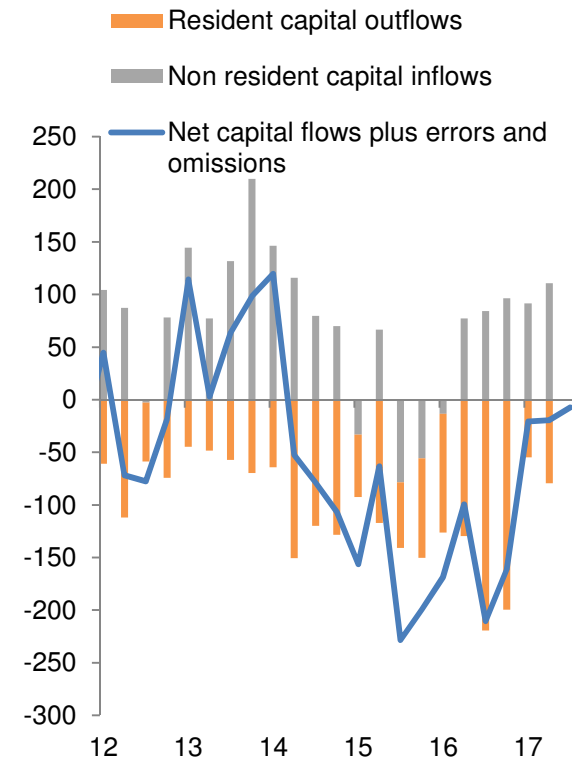
Over-capacity: Efforts to cut excess Capacity bear fruit with continued producer reflation

Producer prices and Investment in mining



Capital flows (and currency) get back under control with tighter regulation

Net capital flows



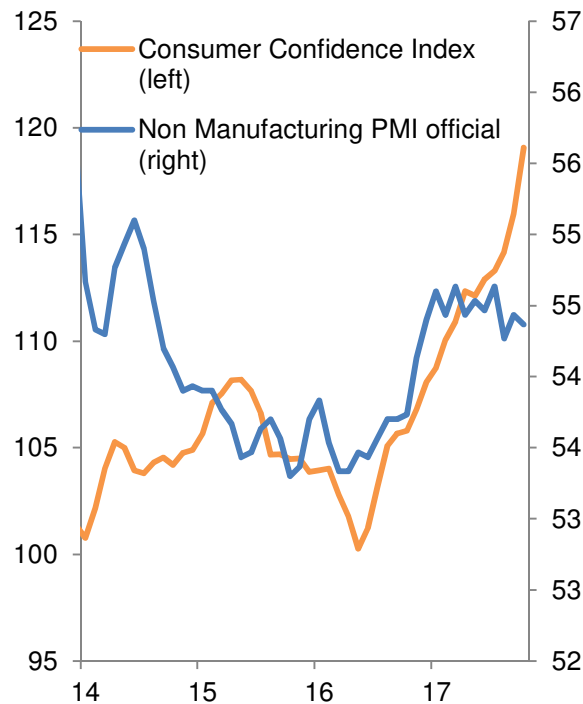
China #2: Building (future) growth foundations

Rebalancing: domestic demand/services growth remain firm and well oriented

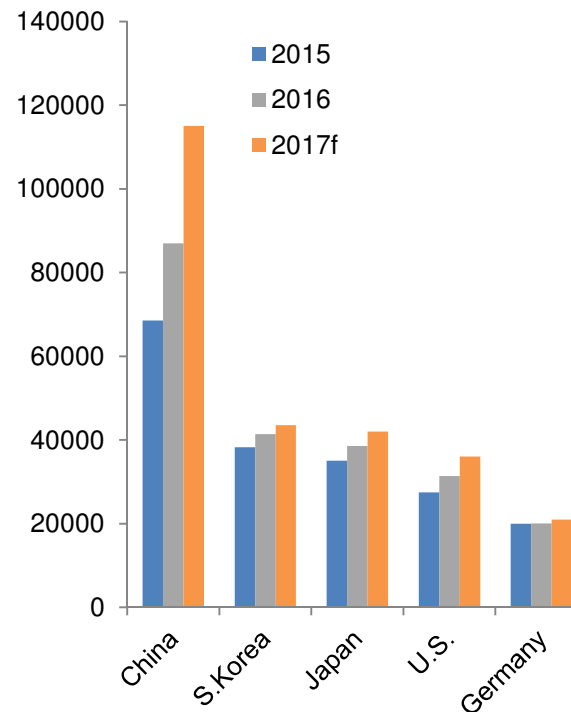
Upgrading: efforts to modernize and improve productivity are accelerating

Connecting: Belt and Road initiative enlarge exports opportunities

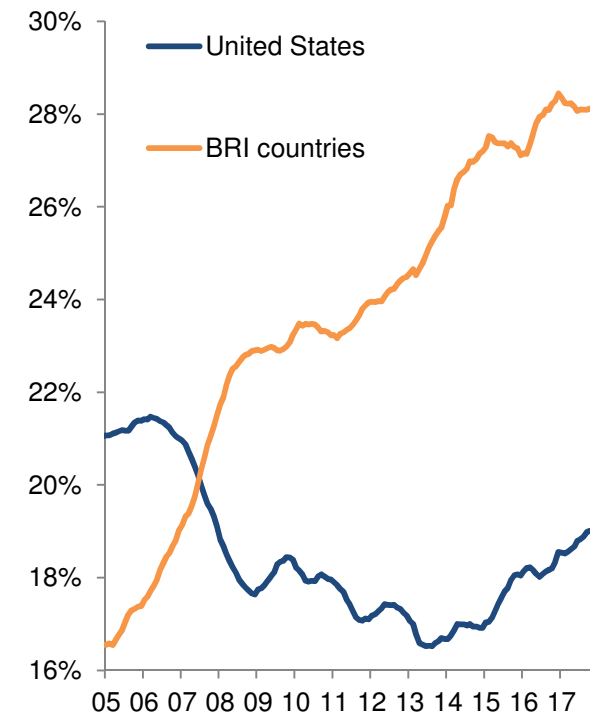
Consumer and business survey (3 months rolling average)



Robots sales (units)



Share in China's total goods exports



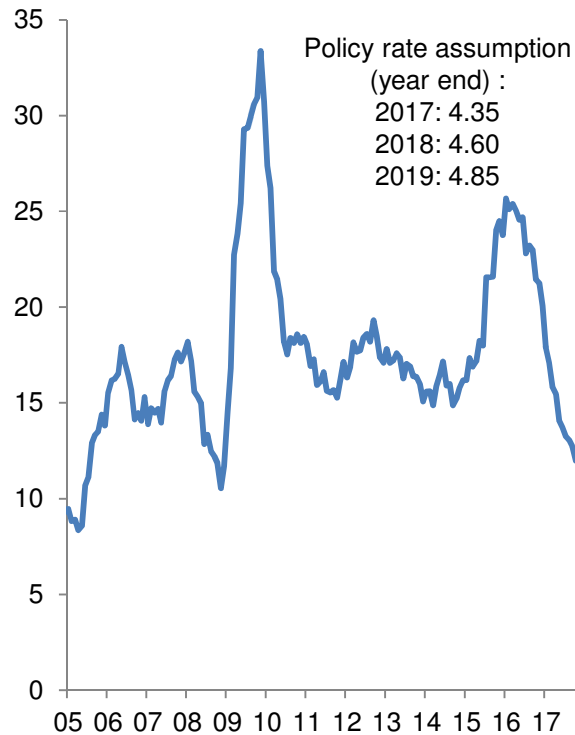
China #3: Preparing for turbulences

Turbulence #1: More difficult access to financing as monetary policy tightens

Turbulence #2: Operating pressure for credit intensive sectors: construction related and heavy industries

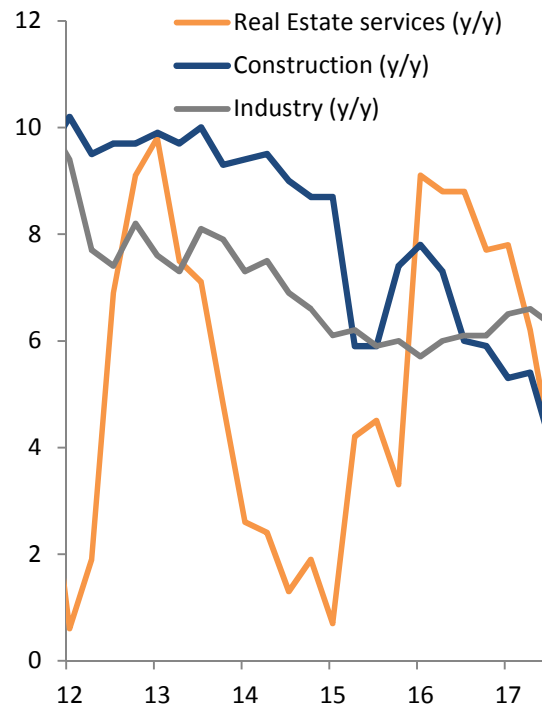
Turbulence #3: Adverse impacts from SOEs restructuring

Domestic credit growth



Sources: IHS, Euler Hermes, Allianz Research

Construction and related sectors (real value added growth)



Sources: IHS, Euler Hermes, Allianz Research

Sources: IHS, Euler Hermes, Allianz Research

SOEs snapshot

	Debt level	Corporate performance	
		Share of total	Leverage ratio*
Total corporate debt	100.0		
Private enterprise	43.0	98.0	5.9
State Owned	57.0	181.0	2.6
Zombie firms**	5.00	346.0	-5.9

* leverage ratio is measured by total liabilities total owners' equity

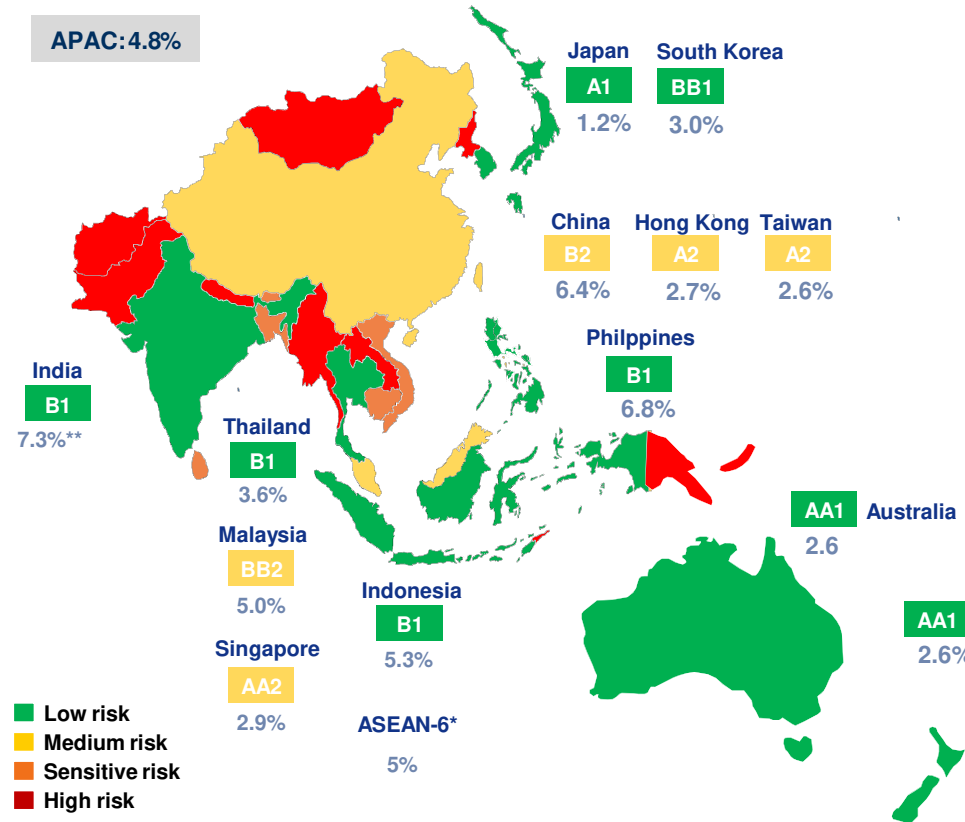
** State council definition

Sources: IMF Working paper "Resolving China's Zombies: Tackling debt and raising productivity"

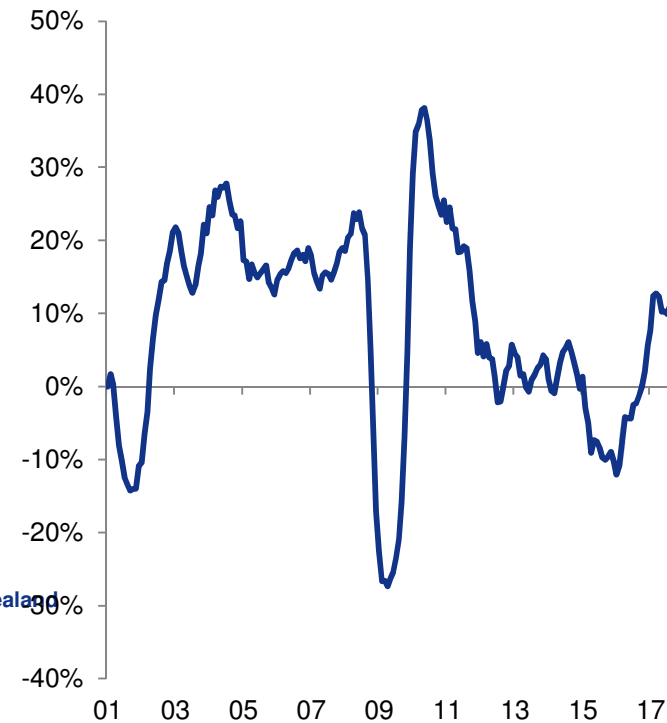
Asia-Pacific: Solid growth expected

Regional economic growth to remain firm at +4.8% in 2018, underpinned by firm growth in China, Japan and stronger performance in India; and solid export performance.

Asia Pacific: country risk and economic growth
growth in 2018 in light grey



Asia-Pacific* USD denominated exports
(%, 3mo y/y)



*China, Japan, South Korea, Hong Kong, Taiwan, India, ASEAN-6, Australia, New-Zealand

** Fiscal year

Sources: IHS, Euler Hermes, Allianz Research

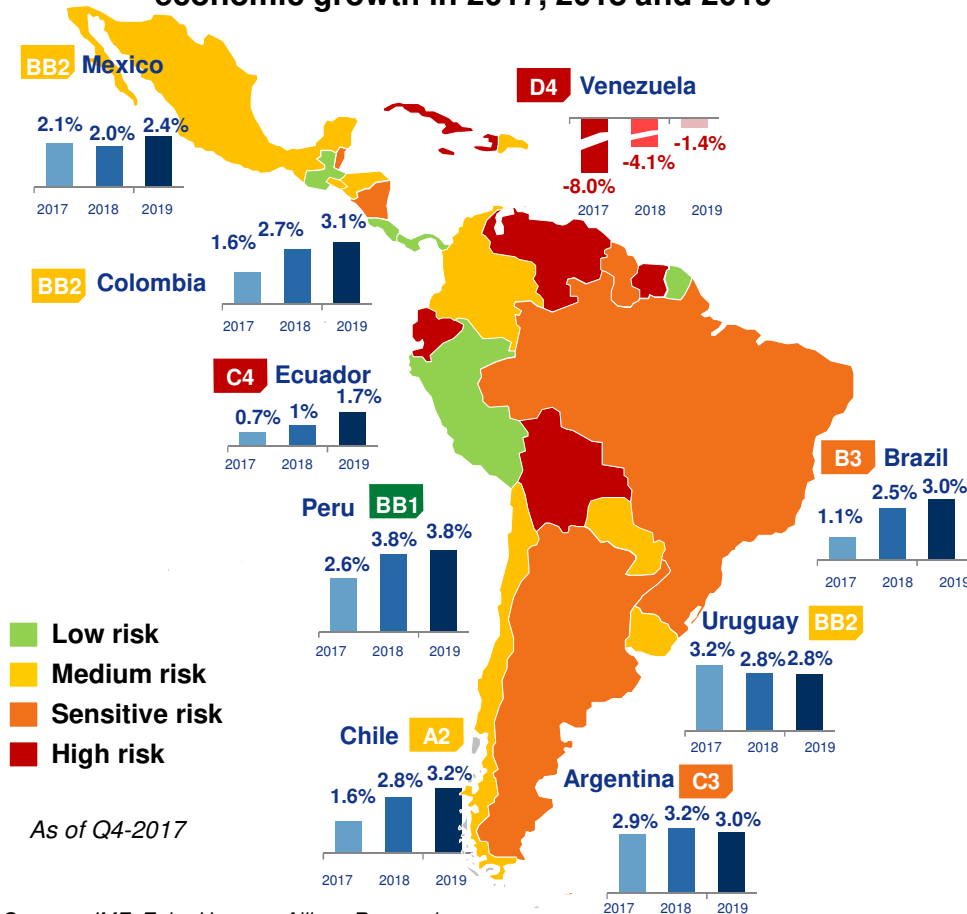
Sources: IHS; Euler Hermes, Allianz Research

Latin America: Ready for take-off, with +1.4% growth in 2017, +2.4% in 2018, +2.8% in 2019

Regional activity accelerates as national growth rates converge. (Geo)political uncertainty still drags growth down.

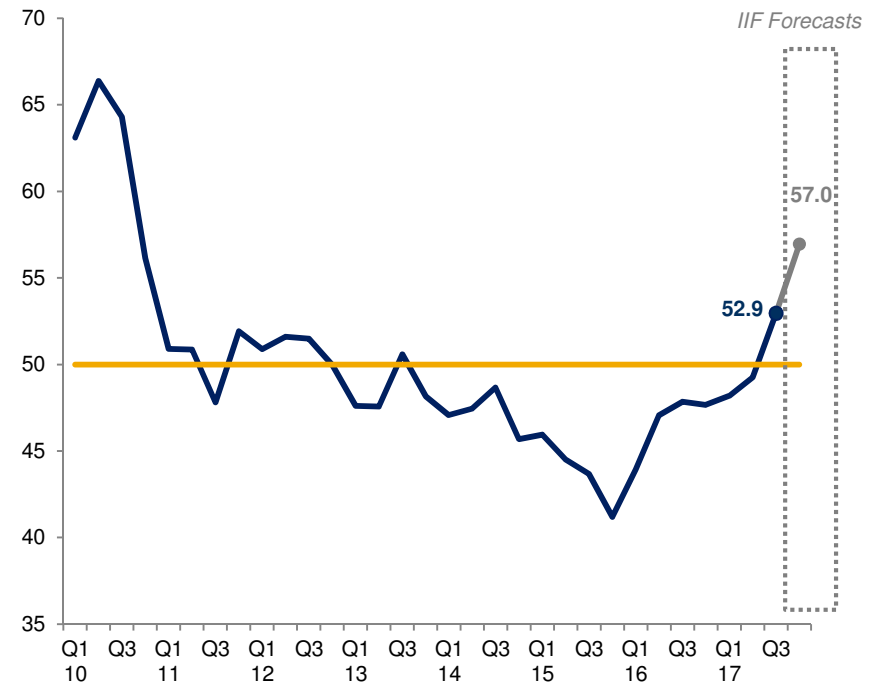
For the first time in 4 years, bank lending conditions have eased in Latin America in Q3 2017 and are projected to ease further

Country risk and economic growth in 2017, 2018 and 2019



Sources: IMF, Euler Hermes, Allianz Research

Latin America: IIF Bank Lending Survey



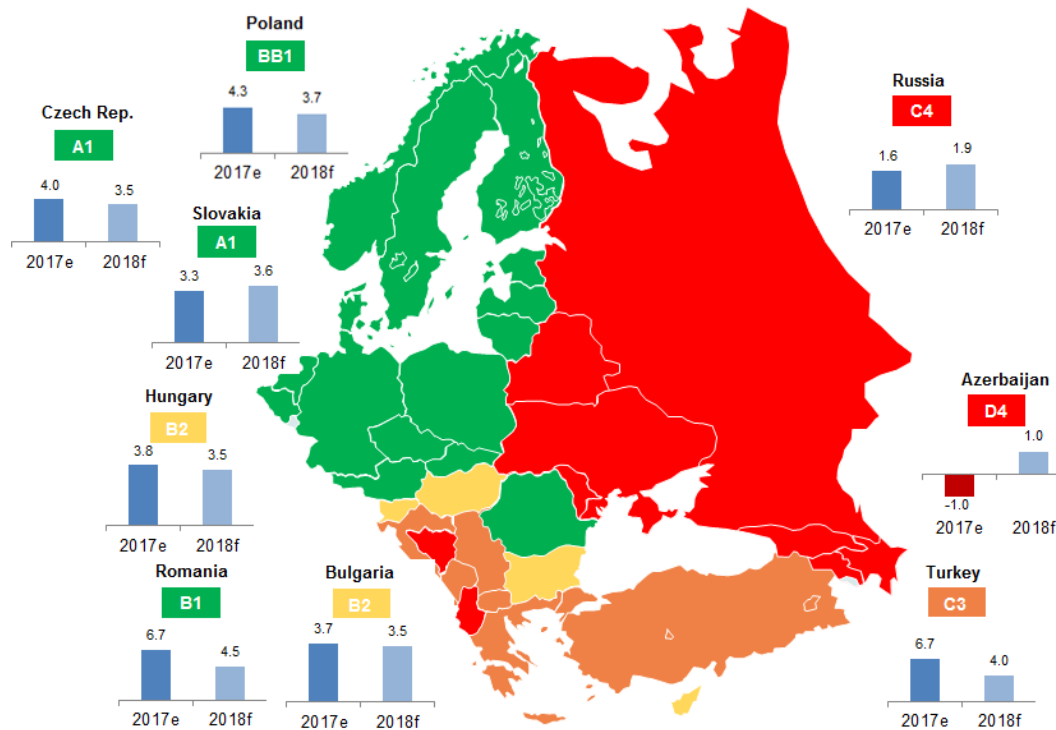
An index > 50 means credit conditions are easing
< 50 means credit conditions are tightening

Sources: IIF; Euler Hermes, Allianz Research

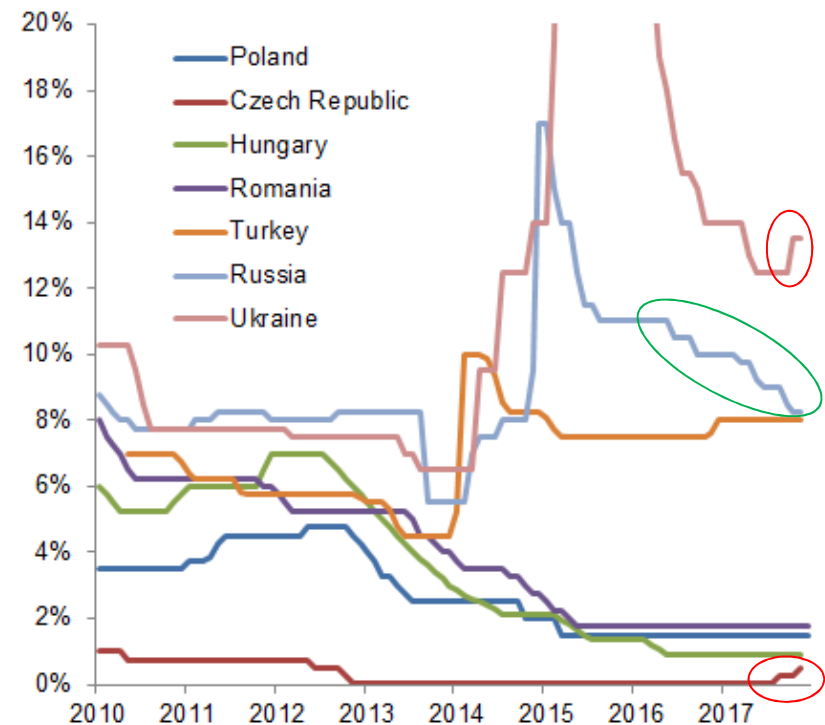
Emerging Europe: After strongly accelerating in 2017, regional growth will remain robust in 2018

The region as a whole is forecast to grow +3% in 2018 (after +3.7% in 2017), with EU members rising by an average +3.7%, while Russia will post a more modest +1.9%. Monetary policy set to diverge in 2018 between EU members (gradual tightening) and Russia (further easing)

GDP growth in 2017 and 2018 (forecast) and short-term country risk as of Q4 2017



Monetary policy interest rates



Source: National sources, IHS, Euler Hermes

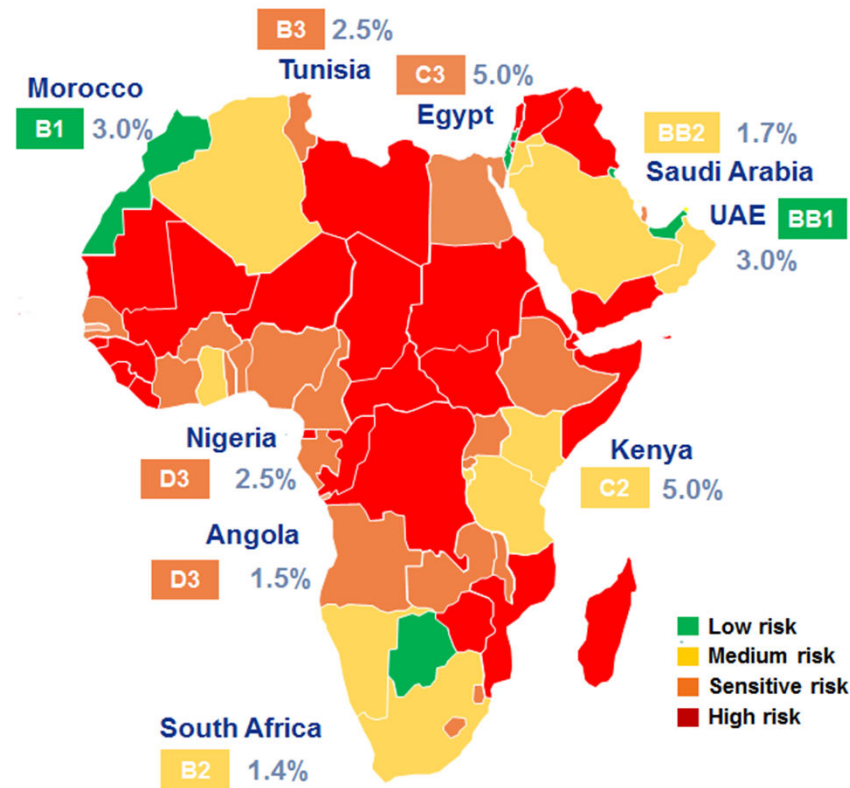
Sources: National sources, IHS, Euler Hermes

Middle East and Africa: Growth should be up, but that's not a green light

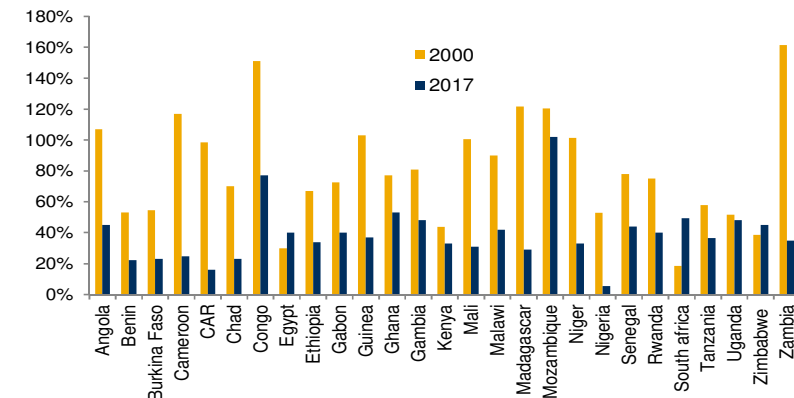
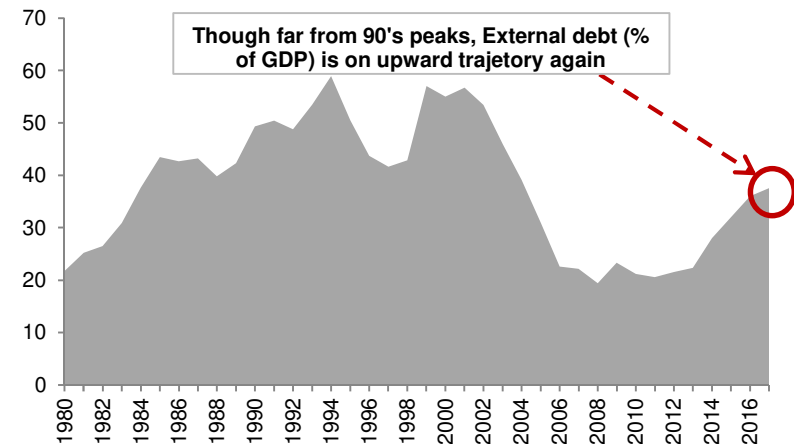
Shades of Africa & Middle East: Reforms are paying off in Egypt, growth to recover progressively in Nigeria and South Africa.

But the commodity price shock has driven external debt higher (but no to 2002 peaks), weighing on small economies.

Middle East & Africa: country risk and economic growth
growth in 2018 in light grey



Sub-Saharan Africa aggregate and country-level external debt (as % of GDP)



Source: Bloomberg, Euler Hermes, Allianz Research

Source Sources: WorldBank, Euler Hermes

Thank you for your attention!

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