Managing risk, enabling trade

Economic Update

January 2019

Summary

Global

Real GDP growth forecasts

	2018	2019
World	3,0	2,8

Source: Oxford Economics

Global growth softening in 2019

The best of the current economic cycle appears to be over for the global economy. In 2018 global growth was supported by still loose financing conditions and significant fiscal stimulus in the US. In 2019 the world economy is expected to lose some steam as the effects of the US stimulus fade, global monetary conditions continue to tighten and financial markets are experiencing more volatility. Moreover, moreover uncertainties about future trade relations have risen.

The most dire risk for the world economy is the unfolding of a trade war between the US and China. This creates uncertainty for firms, leading to lower investment. It will also hamper trade, given the trade-intensity of investment. Global trade growth remains strong. But is decelerating. After a remarkable 4.7% expansion in 2017 (in 12-month rolling terms), trade growth has eased to 4.1%. Amid increasing uncertainty and lower investment, the trend in new export orders was particularly weak in recent months, boding ill for the trade outlook. Accordingly, we forecast full-year trade to expand 3.7% in 2018 and to decelerate further, to 3.0% next year. However, should the US and China significantly ramp up their trade conflict or, possibly worse, should the trade war expand to Europe, these forecasts would certainly be revised downwards.

Aside from trade policy uncertainty, the global economy is also facing higher oil price volatility. In the face of current geopolitical tensions and the re-imposition of US sanctions on Iran, the price of oil gained 25% between August and October, reaching a peak of USD 86 per barrel Brent on October 4 2018. Since then, increased production from Saudi Arabia and Russia followed by the US decision to grant temporary waivers from US sanctions for several large economies importing from Iran has contributed to a sharp price decrease. More recently, expectations of lower global demand for oil have also pushed the price down. On December 28 2018 the Brent oil price was back at a level of USD 54 per barrel. The US Energy Information Administration has revised down its price forecasts: USD 71.4 in 2018 and USD 61.0 in 2019.

Oil price

Daily spot price, USD per barrel Brent

Sources: Macrobond, Atradius Economic Research

Eurozone

Real GDP growth forecasts

	2018	2019
Austria	2,6	2,1
Belgium	1,4	1,5
France	1,6	1,7
Germany	1,6	1,6
Greece	2,2	1,9
Ireland	6,1	2,5
Italy	0,9	0,4
Netherlands	2,6	1,7
Portugal	2,1	1,7
Spain	2,5	2,4
Euro Area	1,9	1,6

Source: Oxford Economics

Eurozone: leading indicators suggest weak momentum

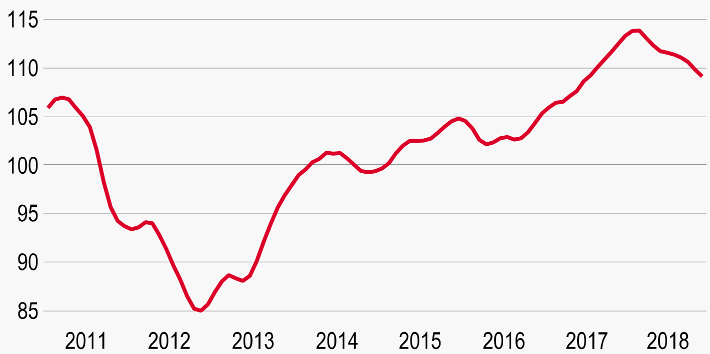
The eurozone economy has slowed towards the end of 2018. Real GDP increased by 0.2% q-o-q in Q3 of 2018, following an average growth of 0.4% q-o-q in the first half of 2018. The slowdown is in line with a decline in confidence indicators. The European Sentiment Indicator (ESI) softened from 110.0 in September to 108.8 in October and remained more or less constant in November. GDP expansion in 2018 is forecast at 1.9%. This year GDP growth is expected to decelerate to 1.6% as stronger import growth will result in a negative contribution from net trade.

The risk of an escalation of the conflict between the European Commission and the government in Italy has diminished now that an agreement has been reached on the budget. While internal risks have diminished, external risks are mounting. The unfolding Sino-US trade war clouds the outlook. Tensions between the EU and the US have eased for the time being after a visit by EU Commission President Juncker to the White House in July. The effects of US tariffs on steel and aluminium and the retaliatory measures by the EU remain limited. But this could change if the US decides to target other sectors, for instance the European automotive industry.

In December 2018 the ECB terminated net asset purchases under the bond-buying programme. The programme was already scaled down considerably: after September 2018 the ECB was buying EUR 15 billion each month of assets, from EUR 60 billion at the start of the programme. The ECB council is sufficiently convinced that inflation continues to converge to its medium target of 2%. Indeed inflation figures in recent months support this view: 2.2% in October and 1.9% in November 2018. However, inflation excluding the effects of food, alcohol and tobacco remains much lower at around 1%.

Economic Sentiment Indicator - eurozone

Seasonally-adjusted, 3-month moving average



Sources: Macrobond, European Commission

Advanced Markets

Real GDP growth forecasts

	2018	2019
United Kingdom	1,3	1,7
United States	2,9	2,5

Source: Oxford Economics

US and UK vulnerable to policy uncertainty

After a remarkable 2.9% expansion estimated in 2018, the US economy is forecast to grow another 2.5% in 2019. By mid-2019, this current economic expansion will be the longest on record in the US, but it is becoming increasingly fragile. Private consumption is continuing to drive the expansion and is supported by the maturing labour market with unemployment at only 3.7% and sturdy wage growth of 3.1% y-o-y. Business investment is set to cool in 2019 as the fiscal stimulus fades, energy sector activity eases, and global growth slows down. Business investment and overall economic growth are facing increasing challenges from trade protectionism increasing input costs as borrowing costs increase as well. The Federal Reserve increased interest rates again in December to a range of 2.25 percent to 2.5 percent, reflecting the ongoing strength of the domestic economy. But with increasing headwinds the pace of tightening will likely slow in 2019. The Fed's next moves will be data-dependent but markets currently predict no further hikes in 2019.

Economic growth in the UK is likely to have slowed in Q4 of 2018. GDP rose by 0.1% in October, after being flat in the previous two months, while in November the composite PMI fell to its lowest level since the aftermath of the EU referendum. Easing inflation and some fiscal relaxation should provide relief to households going forward, but a tighter monetary policy alongside slowing employment growth in an already-tight market will keep spending muted. GDP growth is forecast to rise to 1.7% in 2019, from a historically low growth of 1.3% in 2018. However, this outlook is subject to uncertainty as it is based on the assumption of a smooth Brexit, including a transition agreement.

UK parliament was due to vote on the withdrawal agreement on 11 December, but the vote was postponed pending an attempt to gain "further reassurances" on the backstop for Northern Ireland. However, the EU's leaders offered little hope of any significant change to the deal. The vote in UK parliament will now take place in the week beginning 14 January. There is still a substantial risk of the UK departing the EU with no transition arrangement in place. Should negotiations break down, trade with the EU and countries with whom the EU has free-trade agreements in place would revert to WTO rules, substantially increasing both tariff and non-tariff barriers. The loss of confidence in the UK economy and associated depreciation of the sterling improves the UK's competitive position, which could mitigate some of this negative impact on exports. At the same time, it could drive inflation up to above 4%, straining consumer purchasing power. Appropriate policy response from the Bank of England and fiscal loosening could cushion the impact, keeping growth positive at 0.5%, but risks are clearly to the downside.

Emerging Markets

Emerging markets outlook remains robust

Real GDP growth forecasts

	2018	2019
Emerging Asia	6,0	5,6
Eastern Europe	3,1	2,5
Latin America	1,0	1,7
Emerging Markets	4,4	4,2

Source: Oxford Economics

Emerging market economies (EME) as a whole are likely to see their growth slowing to 4.2% this year, following 4.4% growth in 2018. Growth is supported by solid global demand, relatively loose financial conditions and improving domestic policymaking in some markets. However, trade tensions between the US and China and policy rate hikes by the US central bank continue to cloud the growth outlook. EMEs with high current account deficits and foreign-denominated debt have recorded sharp currency depreciations (for example Turkey and Argentina).

Economic growth in China continued to slow towards the end of 2018, due to weaker exports and softer investment growth. This is also weighing on growth of smaller Asian markets dependent on exports to China. The gradual economic slowdown of China is likely to continue into 2019, when we expect a GDP growth of 6.1%. Along regions, growth will be highest again in Emerging Asia with 5.6%, down from 6.0% in 2018. Next to the moderate slowdown forecast for China, India will become Asia-Pacific's fastest growing economy, with a 7.3% expansion expected in 2019. Strong domestic demand and supportive macroeconomic policies are boosting growth as well as capital inflows.

Growth in Latin America is forecast to rise to 1.7% in 2019, from 1.0% in 2018. Brazil's new president Jair Bolsonaro is likely to continue the sounder, market-oriented policies started by the Temer government. Among the structural reforms needed, one of the most urgent is a shake-up of the unsustainable pension system. In Argentina an economic crisis emerged in 2018 after several poorly communicated policy steps and concerns about its ability to cover its high financing needs. Argentina agreed on a USD 56 billion IMF programme in an attempt to stabilise the economy and to bolster investor confidence. The economic contraction is likely to continue in 2019.

Eastern Europe is likely to see growth declining to 2.5%, from 3.1% in 2018. But individual country growth rates are very diverse. In Russia growth is set to slow from 1.6% in 2018 to 1.4% this year. Western sanctions weigh on sentiment and continue to hamper the recovery of the Russian economy. Growth in export-oriented EU member states will remain reasonably strong, supported by external demand and high investment. Turkey is likely to enter recession in 2019, after it was confronted last year with a sell-off in the Lira over its vulnerable external balance and doubts about its macroeconomic policy framework. Turkey's central bank hiked the policy rate to 24% in September 2018 in an attempt to contain rising inflation.

Credit and insolvencies

Insolvency outlook is stabilising

We project a modest 1.7% decrease of insolvencies in 2019 across advanced markets in North America, Asia-Pacific and Europe. This compares to a 3.6% decline in 2018. The outlook is subject to increasing downside risks, especially due to potential trade wars and monetary tightening. Increasing uncertainty could depress investment and GDP growth, and in turn lead to higher insolvencies.

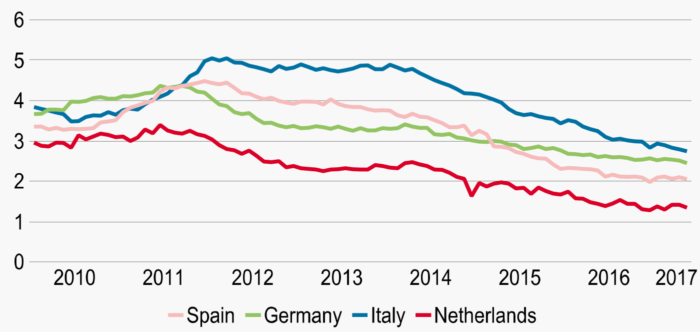
As regional GDP growth slows, insolvencies in the eurozone are expected remain more or less stable in 2019 (-1%). The best performing countries are Luxembourg (-6% in 2019) and Portugal (-5%). The worst performers in 2019 are expected to be Italy and the UK (+4% in both countries). Insolvencies in the UK already spiked in 2018 after the construction sector's difficult start of the year and weakening purchasing power hurting retail sector. This year continues to be challenging as ongoing uncertainty is weighing on investment. In Italy political uncertainty drags on activity.

The corporate sector in the US continues to benefit from high confidence, fiscal stimulus, easy financial conditions, and high domestic demand. Insolvencies are forecast to have decreased by 8% last year. But as business risks mount due to monetary tightening, USD strengthening and overall trade policy uncertainty, business failures are expected to decline by only 2% in 2019.

In emerging markets, the insolvency outlook is worsening. In 2018 the situation was still benign thanks to a strong global economy and still-loose financing conditions. However, as global financial conditions become increasingly volatile and some countries face unfavourable domestic policy situations, we expect to see some large increases in insolvencies in 2019.

Corporate interest rates

Interest rates on short-term corporate loans, %



Sources: Macrobond, IMF

Macroeconomic indicators for key markets

	GDP growth (% of GDP)			Budget balance (% GDP)			Current account balance (% GDP)			Export growth (%)			Political risk Rating[1]
	2017	2018	2019	2017	2018	2019	2017	2018	2019	2017	2018	2019	
Western markets													
Austria	2.7	2.6	2.1	-0.8	-0.3	-0.2	2.0	2.8	1.8	4.9	4.1	2.6	2 POSITIVE
Belgium	1.7	1.4	1.5	-1.0	-1.0	-1.1	0.7	-1.4	-0.1	5.0	3.4	3.3	2 STABLE
Finland	2.8	2.4	2.0	-0.7	-0.7	-0.4	-0.7	-1.3	0.0	7.5	0.6	0.9	2 POSITIVE
France	2.3	1.6	1.7	-2.7	-2.6	-2.8	-0.6	-0.6	-0.4	4.7	2.5	2.4	2 STABLE
Germany	2.5	1.6	1.6	1.0	2.0	1.0	8.0	7.5	7.2	5.3	2.2	3.5	1
Greece	1.4	2.2	1.9	0.8	0.7	0.1	-1.7	-3.1	-1.9	6.9	8.9	7.5	6 STABLE
Ireland	7.3	6.1	2.5	-0.3	-0.3	0.0	8.3	7.5	4.0	7.7	5.4	2.5	3 POSITIVE
Italy	1.6	0.9	0.4	-2.4	-1.8	-2.6	2.8	2.6	2.8	6.3	0.8	3.1	4 STABLE
Netherlands	3.0	2.6	1.7	1.3	2.0	1.5	10.5	9.6	9.2	5.6	2.7	3.1	1
Portugal	2.8	2.1	1.7	-3.0	-0.8	-0.6	0.6	-0.1	0.1	7.8	4.1	3.5	4 NEGATIVE
Spain	3.0	2.5	2.4	-3.1	-2.7	-2.2	1.8	1.0	0.8	5.2	1.7	2.9	4 POSITIVE
Eurozone	2.5	1.9	1.6	-1.0	-0.3	-0.8	3.1	2.8	2.8	5.4	2.7	3.2	-
													-
Australia	2.4	3.0	2.5	-1.7	-0.7	-0.4	-2.6	-2.1	-2.3	3.5	5.9	6.2	1
Canada	3.0	2.1	1.9	0.3	0.1	-0.5	-2.8	-2.7	-2.7	1.1	3.0	1.0	1
Denmark	2.3	0.8	2.0	1.1	-0.2	-0.2	8.0	5.8	6.8	3.6	0.3	2.5	1
Norway	2.4	1.7	2.2	6.9	6.9	6.3	5.7	8.6	7.0	0.1	0.2	2.3	1
Sweden	2.4	2.3	2.0	1.5	1.3	1.3	3.2	2.0	3.7	3.7	2.5	2.7	1
Switzerland	1.6	2.6	1.3	1.3	0.8	0.5	8.9	7.8	8.7	3.6	1.8	2.4	1
United Kingdom	1.7	1.3	1.7	-1.9	-1.6	-1.7	-3.7	-3.6	-3.1	5.7	1.4	3.0	2 STABLE
United States	2.2	2.9	2.5	-4.1	-6.4	-6.4	-2.3	-2.4	-2.7	3.0	4.1	2.0	1
Central and Eastern Europe													
Czech Republic	4.5	2.8	2.6	-0.1	0.6	0.5	1.1	1.3	0.3	7.2	4.2	3.4	2 NEGATIVE
Hungary	4.4	4.8	3.2	-2.1	-2.3	-2.3	3.2	0.3	0.5	4.7	5.6	2.8	4 NEGATIVE
Poland	4.9	5.3	3.6	-1.5	-0.9	-1.5	0.2	-0.2	-0.2	9.1	5.2	5.1	3 NEGATIVE
Russia	1.5	1.6	1.4	-1.3	2.3	1.5	2.2	6.7	6.6	5.1	5.1	1.7	5 POSITIVE
Slovakia	3.2	4.2	3.7	-1.4	-0.9	-0.7	-2.0	-2.2	-1.6	5.9	4.8	7.3	-
Turkey	7.3	3.2	-1.7	-1.6	-2.1	-2.0	-5.5	-4.8	-1.6	11.9	5.5	8.5	5 STABLE
Asia													
China	6.9	6.6	6.1	-3.6	-3.6	-3.6	1.3	0.2	0.3	6.5	5.4	3.7	3 STABLE
India	6.2	7.4	7.3	-4.1	-3.5	-3.6	-1.6	-2.7	-1.8	6.5	10.5	5.7	4 NEGATIVE
Japan	1.9	0.8	1.0	-3.7	-3.4	-3.5	4.0	3.4	3.2	6.8	3.2	2.5	3 POSITIVE
Latin America													
Brazil	1.1	1.2	2.3	-7.8	-8.1	-7.0	-0.3	-0.9	-0.5	5.7	2.7	6.5	5 POSITIVE
Mexico	2.3	2.0	2.0	-1.0	-2.2	-2.8	-1.7	-1.7	-1.7	3.9	7.4	3.8	4 POSITIVE

[1] Note: STAR is Atradius' in-house political risk rating. The STAR rating runs on a scale from 1 to 10, where 1 represents the lowest risk and 10 the highest risk. In addition to the 10-point scale there are rating modifiers associated with each scale step: 'Positive', 'Stable', and 'Negative'. These rating modifiers allow further granularity and differentiate more finely between countries in terms of risk.

Sources: Oxford Economics, Atradius Economic Research

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