Atradius

Managing risk, enabling trade

November 2015

Economic Outlook

Traversing turbulent water

Editorial

If there had been any doubts before, they will have been removed by now. China dominates the global economic scene and the rest of the world must accept it. The events of this past summer are proof.

There was a storm from China. In July, stock exchanges declined all over the world when the Shanghai Stock Exchange plummeted. Investor confidence was hardly restored when the Chinese authorities intervened by buying stocks. In early August, there was a comparable picture in the foreign currency markets. Exchange rates, especially those of Asian countries, faced volatility when the Chinese authorities decided to let the renminbi depreciate. It led to further downward pressure on the renminbi and it cost China 15% of its foreign exchange reserves to stabilise the currency. In September, even the US Federal Reserve (Fed) admitted the impact of the storm. The decision to not raise interest rates was partially based on this impact, as mentioned through a noteworthy sentence in the press release: '…but is monitoring the developments abroad.'

It will come as no surprise that this Economic Outlook acknowledges China's dominance on the global economic stage. China's share in global GDP has raced up six percentage points since 2008 to 18%. No wonder Asian GDP growth has peaked now that China's economic growth is slowing. No wonder global trade growth has been on a slower track since China is producing more, and higher value-added products for its home market. No wonder China's transition to consumption- and services-led growth has caused a fall in commodity prices and volumes, and pressure on growth for commodity exporters. No wonder capital flows to emerging economies have plummeted during 2015 as Chinese firms, anticipating further renminbi depreciation, massively repaid foreign loans. And, indeed, no wonder we have placed a hard landing of the Chinese economy at the top of our list of concerns for global growth, replacing the much-anticipated Fed interest rate hike.

The deceleration of the Chinese economy is expected to continue over the coming years, but a hard landing may be avoided. The government has room for further stimulus and has plenty of reserves to plug any gap in the financial sector or its state-owned enterprises. Yet, as developments over the past year have shown, even a steady deceleration is enough to cause significant trouble in countries across the globe. The global economy may be expected to pick up slightly in 2016 compared to 2015, but that picture is surrounded with a lot of downside-tilted risks, especially for the emerging economies. With China's increasing global economic weight, it is no wonder, it will play a dominant role in determining the health of the global economy over the coming decades.

John Lorié, Chief Economist Atradius

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Executive summary

The global economy has entered turbulent water. Global growth has been sluggish in 2015 and risks abound for the 2016 outlook. Troubled emerging markets are the main source of weakness and concern.

Key points

- The global economy is expected to grow just 2.5% in 2015, less than in 2014. Economic growth is currently foreseen to accelerate to 2.9% in 2016.

- The economic recovery in advanced markets has taken further hold. The euro area is forecast to grow 1.5% in 2015 and 1.7% in 2016. The United States is projected to expand 2.5% in 2015 and 2.6% in 2016.

- Latin America and Eastern Europe are both projected to see modest economic growth of 0.8% and 1.9% respectively in 2016 after contraction in 2015. Economic growth in Asia, excluding Japan, is stable and forecast at 5.7% in 2016.

- Atradius forecasts that insolvencies will fall in most advanced markets in 2015 and 2016, but the level of insolvencies will remain relatively high, especially in the eurozone. Insolvency conditions in many emerging markets have, however, deteriorated notably.

Global economic growth has been disappointing in 2015, being dragged down by turbulence across emerging markets. Chapter 1 shows that as most pressure is expected to remain on emerging markets in 2016, the global economy is forecast to show only a modest increase in growth. As a result, global growth will be well below average historical rates. Global trade is also weak. Atradius forecasts that global trade will grow by only 1% in 2015 and pick up modestly in 2016.

The two top risks to the 2016 outlook are a further slowdown in China and turbulence in emerging markets in response to rising US interest rates. The Chinese slowdown impacts trade partners' capital flows and financial returns. The change in US monetary policy may lead to capital outflows, currency volatility and trouble with corporate debt denominated in foreign currency.

The advanced economies are doing relatively well – as discussed in Chapter 2. The eurozone economy has left the euro crisis behind while the recovery is strengthening. All member states are growing and conditions are expected to improve further in 2016. The expansion is based on solid domestic demand. Nonetheless unemployment remains high and economic growth slow. The United States and United Kingdom have done much better over the past years growing 2% to 3% per annum, and are expected to continue doing so in 2016.

Conditions in many emerging markets have deteriorated significantly. Chapter 3 shows there are three main drivers. The fall in commodity prices, including oil, is hurting commodity exporters. The economic slowdown in China is adversely affecting trade partners and capital flows. Moreover, the expected change in official US interest rates has made investors less likely to invest in emerging markets. The adverse developments have hit emerging markets across the globe and are likely to last into 2016. A number of countries are, however, doing well. Commodity importers are enjoying the lower prices, Central America is benefiting from the economic growth in the US, while Eastern Europe is benefiting from the recovery in the eurozone.

Insolvency conditions are deteriorating in many emerging markets while they are generally improving across advanced markets – as argued in Chapter 4. Insolvencies in the eurozone are forecast to fall 7.0% in 2015 and 5.4% in 2016, but the level remains 66% higher in 2016 compared to 2007. Despite better economic conditions, insolvencies are forecast to rise in Portugal, France and Greece in 2015. Insolvencies in New Zealand, Australia and Canada are also up in 2015 as a result of the lower oil price and the slowdown in China. China itself is forecast to see a strong increase in insolvencies in both 2015 and 2016. Among the BRICs, insolvencies are projected to fall only in India. As long as global economic growth remains sluggish, business conditions will remain difficult.

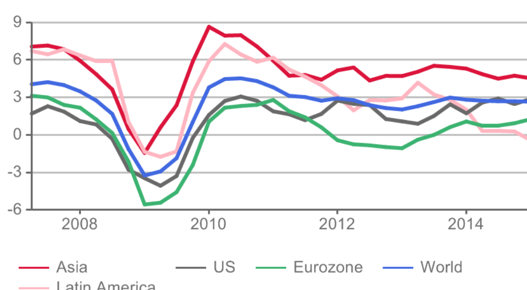
1. The global macroeconomic environment

Global growth sputters as emerging economies slow

In our May Economic Outlook, we signalled that a new normal of global economic growth had become manifest. High and rising debt levels were observed, boding ill for future spending by households and firms when they start to deleverage. More fundamentally, aging, slower information technology application, lower investments and infrastructure constraints, have been putting pressure on potential growth, even in the emerging economies. These factors are expected to stay for the coming years, burdening global growth.

1.1 Global economic growth

Real GDP growth, percentage change y-o-y

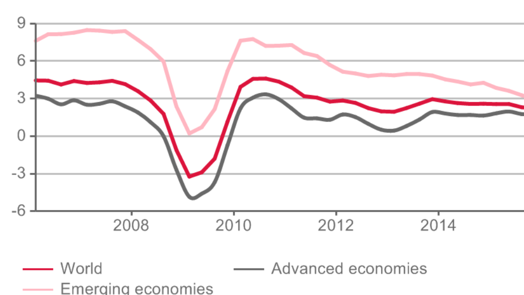


Source: IHS

With the impact of these factors still difficult to gauge, especially over shorter time periods, and forecasts inclined to be positively biased, global growth is bound to disappoint.[1] At least, the likelihood of positive surprises is low, relative to negative ones. What we have observed over the past six months neatly fits into the picture we depicted in the May Economic Outlook (and previous ones), at least on a global level. Indeed, global economic growth again receded, albeit marginally, to 2.6% (from 2.7%). Still, in 2016, a recovery to 3% is expected, which is arguably optimistic in view of the above.

1.2 Global economic growth

Real GDP growth, percent change y-o-y



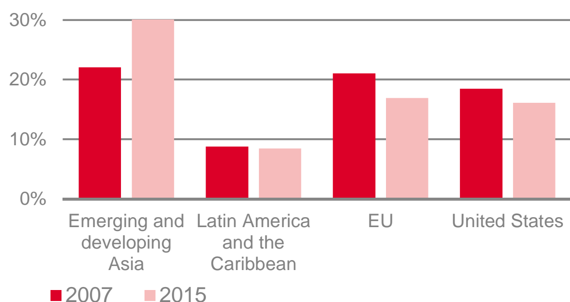
Source: IHS

While the overall picture is a bit disappointing, it is not an across-the-board phenomenon. Advanced economies have continued to improve and even beat forecasts, while growth pressures in emerging economies already reported in May have further intensified. Growth differences between advanced and emerging economies have now narrowed to a record low of around one percentage point. Moreover, the previously reported picture within the two groups strengthened as well. As the US economy grew steadily despite a lacklustre first quarter, the eurozone further improved, indeed above expectations, with limited impact from the Greek turmoil this summer. In the emerging economies, Asia was still the bright spot, although Chinese growth is under pressure. Latin America fared even worse than the already poor predictions. Economic growth across emerging economies is definitely slowing.

The impact of this slowdown on global growth is softened by the ever-growing share of the emerging economies in global GDP (which continues as long as the latter group grows faster). In 2007 both groups held 50% of the global GDP pie, in 2015 this will be 58%-42% in favour of the emerging economies. The latter improvement is fully borne by Asia, whose share of global GDP has climbed from 22% to 30%. China drove the improvement as its share increased six percentage points to 18% of global GDP in 2015.

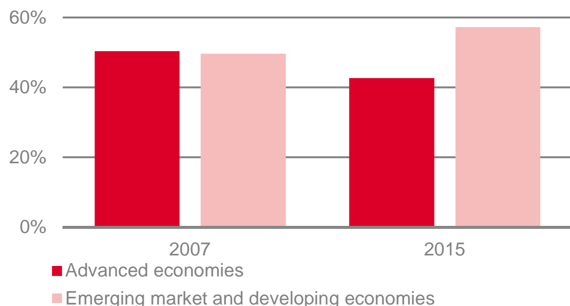
[1] **See IIF, Global Economic Monitor, July 2015.**

1.3 Regional share of global GDP
Percentage of total GDP



Source: IMF World Economic Outlook

1.4 Share of global GDP
Percentage of global GDP



Source: IMF

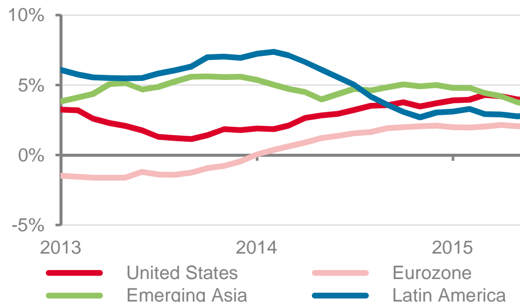
The observation has implications for future global growth. Growth developments in emerging economies will simply dominate global growth. Indeed, this comes at the expense of the United States and the eurozone, whose economic growth is becoming less important. Emerging economies, and especially China, have become the leading force in global economic growth.

Trade on slower growth track

The cautiously optimistic tone on trade growth struck in our previous Economic Outlook is not supported by the data that have been released since then. While trade growth in the US and, to a lesser extent, the eurozone, has been steady in the first part of 2015, Latin America and Asia have disappointed. This can be largely attributed to the slowdown and rebalancing of the Chinese economy. This has caused lower demand for imports in China – especially for machinery and metals like copper, iron ore and steel – reflecting declining investment activity. This translates into declining trade growth figures in countries in Asia, and, more pronouncedly, Latin America. Most prominently, Brazilian trade figures are under pressure.

The result is that global growth figures for the first half of 2015 are disappointing, and even indicate a negative figure of 0.7% according to the WTO. But recovery is underway. WTO expects a strong recovery in the second half of 2015 and 2.8% trade growth for the full year. On a more cautious note, according to our newly developed Atradius International Trade Forecasting Model, an overall figure in the range of 1% can be reached. The jump in the IMF-developed World Trade Leading Index provides further support for trade growth recovery.[2] In 2016 a further pick-up is forecast.

1.5 Trade growth per region
(Annual percentage change)



Source: CPB

There are several reasons for this.[3] Global supply chains are changing. The movement of production to China (following its WTO accession) and emerging Europe (following the fall of the Berlin Wall) has phased out. This is signalled by the fall in foreign value of exports, which has declined, for China alone to 33% in 2009 from 36% in 2005. China, as well as other countries, is simply producing more for domestic consumption. Moreover, US imports are structurally lower now that the country is no longer an oil importer due to the shale revolution that has boosted home production. That shale revolution, in turn, has contributed to the halting of off-shoring, and potentially re-shoring, by US firms, putting pressure on trade.

[2] The World Trade Leading Index, which depends on six indicators and indices for global trade: the Baltic Dry Index, the Brent price, the Commodity Research Bureau Index, the PMI, the Ifo Business Climate Index and the US dollar nominal effective exchange rate. Turning points of the composite WT Leading Index are shown to be similar to those of the global trade y-o-y changes. See IMF (2015), "World Trade Leading Index", working paper 15/20.
[3] The slowdown in world trade: temporary or permanent? Atradius, October 2015.

Box 1.1 Atradius International Trade Forecasting Model

The Atradius global trade forecasts are based on a statistical model. The model is an Error Correction Model which links trade growth to the short-run and the long-run relationship between trade and GDP in the following formal manner:[4]

$$\Delta Trade_t = \alpha \Delta \ln GDP_t - \lambda (\ln Trade_{t-1} - \beta \ln GDP_{t-1}) + \varepsilon_t$$

This yields estimates of a short-run and a long-run elasticity, α and β respectively, as well as a parameter λ that represents the speed of adjustment (in a year) when the long-run relationship, $\ln Trade_{t-1} - \beta \ln GDP_{t-1}$, is deviated from. This deviation is the error, with the speed-of-adjustment parameter correcting the error and explaining the name of the model. The model is developed in a working paper by IMF.[5]

Using quarterly trade volume data from the Dutch Centre of Policy Research (CPB) for the period 2007 Q1 to 2015 Q2 we find that the short run elasticity α = 4.4, the long run elasticity β = 1.1 and speed of adjustment λ= 0.27, which are all significant at the 95% confidence level.

This implies that an additional one percentage point of global GDP growth leads to an additional 4.4 percentage point short-term trade growth. This figure needs to be corrected in case there is an error in the long-term relationship, which is estimated $\ln Trade_{t-1} - 1.1 \ln GDP_{t-1}$. That error will be corrected in a period by 27%. Thus, if $\ln Trade_{t-1} > 1.1 \ln GDP_{t-1}$, trade growth in that year will be lowered 27%.

1.6 Global trade forecast

Growth over the past 12 months

Sources: CPB, Atradius

[4] Atradius, International trade forecasting model, Internal note, August 2015.
[5] IMF, The Global Trade Slowdown: Cyclical or Structural, Working Paper 15/6.

These two factors are unlikely to change, but several other factors are. Firstly, eurozone trade is likely to pick up now that the rebalancing of external imbalances, which has been driving import contraction, for instance in Greece, has more or less ended. The eurozone is by far the largest trade bloc in the world. Secondly, investment in advanced economies has been slow since the Global Financial Crisis in 2008. That is unlikely to last, with US investment picking up to pre-crisis levels providing support for this. The eurozone is likely to follow suit, helping the most trade intensive component of aggregate demand: capital goods. Thirdly, there are signs that the increase in trade-hindering measures is being reverted. The number of trade liberalisation measures, such as tariff cutting, increased between October 2014 and May 2015. Still, the number of protectionist measures is on the rise.[6] Fourthly, the on-going reinforcement of the banking sector, especially in the eurozone, should release a higher level of trade finance,[7] supporting trade. Finally, regional trade deals, such as the recently-closed (but still to-be-ratified) Trans-Pacific Partnership (TPP) agreement will clearly help as well.[8] With these factors turning positive, trade growth could indeed reach average levels between 3% and 4% per year. This is well below the 5.5% growth level reached over the past decade.

Oil prices further down

In our May Economic Outlook we have extensively discussed the rather spectacular fall of the oil price during the autumn of 2014. Oil prices tumbled from USD 90 per barrel (Brent) to a level between USD 50 and USD 60. We have argued that supply factors were at the heart of the fall, with OPEC countries not willing to turn off the tap as they feared (lasting) loss of market share to US shale producers. Those shale producers were indeed expected to reduce their own production levels as prices reached levels below their cost price. As a result, prices could be expected to recover relatively quickly.

Unfortunately, as a further sign of volatility – and arguably unpredictability – of the oil market, prices have not risen, but instead slid further to levels between USD 45 and USD 50 per barrel. There are

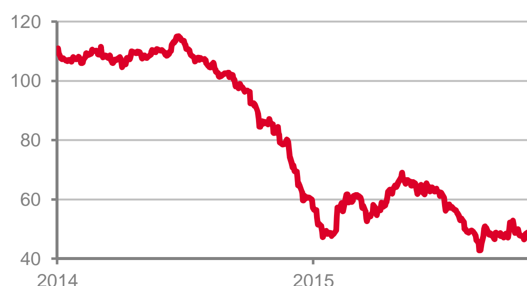
[6] See https://www.wto.org/english/news_e/archive_e/trdev_arc_e.htm
[7] WTO indicates that for Africa a trade finance shortage of USD 100-110 billion exists, whereas this figure is much higher for Asia: USD 1.1 trillion.
[8] Chartered members are Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the US and Vietnam, comprising one third of global GDP and one-quarter of global trade.

several reasons why this has occurred. Firstly, despite a decline in investment, production growth is still significant. US shale production has proven to be more resilient than expected and the pace of production growth has so far only slowed. Costs have been cut by more than one-third, allowing more producers than expected to remain in business. OPEC production has been increased to a level of 31.5 million barrels a day, 1.5 million barrels above target. Russia is producing at record levels as it attempts to keep up oil sales at lower prices, and so is Brazil. This development is compounded by the nuclear deal with Iran that was struck over the summer. Iran is expected to push up its production from 0.5 to 0.8 million barrels per day at short notice after the sanctions are lifted. That regular flow comes in addition to the 30 million barrels it has stocked and can be released for sale as well. Furthermore, whereas demand for oil has increased because of the lower price (IEA revised demand upwards to 1.7 million barrels above trend), it has not been sufficient to halt pressure on prices.

The upshot is that price recovery is forecast to be much slower. The US Energy Information Administration price forecast now indicates USD 51 per barrel for Brent by the end of 2015 and USD 59 by the end of 2016. The IMF, using futures as a forecast basis, anticipated a similar number for 2015 and forecasts even a slight decline to USD 50 for 2016.

Meanwhile, the likelihood of another 'shot in the arm' for the global economy is diminished. The spending boost of any further oil price decline will be lower since energy consumption as a part of total spending is now much lower, especially for households. On the other hand, oil exporters such as Russia, continue to be affected by lower prices and may be forced to cut spending further. The impact of low oil prices may then turn out to be negative on global demand.

1.7 Oil price
Brent, USD per barrel



Source: IHS

Box 1.2 Oil price forecasting

Although oil prices are notoriously difficult to forecast, it does not stop acclaimed research institutes from doing so. The economic literature assessing the predictive power of forecasts is rather thin.

The IMF simply uses the price of NYMEX oil futures as a predictor. However, widely hailed as sound predictors in theory, quantitative research proves otherwise. Predictive power is very weak. Only at short time horizons up to one year, using daily rather than monthly data, the futures model performs better than the simple 'no change random walk' forecast. [9]

The International Energy Agency (IEA) employs the World Energy Model, a heavily data-driven simulation model based on supply-demand equilibrium. While the current data limitation prevents performance measuring, research shows that IEA's forecasts up until now are on average underestimations and get even more inaccurate the further in the future forecast.

The US government's Energy Information Administration (EIA) uses a model similar to the IEA one, although focusing on the US market. Their model, the National Energy Modelling System (NEMS), is built from a number of sectors to model energy demand. An iterative process leads to an equilibrium oil price. Other research suggests that the EIA one-quarter forecasts outperform the no change forecast.[10] Other research shows that equilibrium type models outperform the no change forecasts up until the mid-level horizon (from two to 11 quarters).

Other commodity prices show a similar pattern

In a sense, commodity markets, at least those for metals,[11] bear a resemblance to the oil market. In both markets, prices are under pressure as demand growth is unable to keep up with supply. On the supply side, giants like Rio Tinto and BHP Billiton behave like OPEC as they continue to increase production. Like in the oil market, where OPEC attacks US shale producers, these firms attempt to push the high-cost producers, especially those in China, from the metals market.[12] Interestingly, these firms were helped by lower energy

[9] See Alquist, R., L. Kilian and R.J.Vigfusson (2011), 'Forecasting the Price of Oil, Handbook of Economic Forecasting, 2, Amsterdam; North-Holland.
[10] Idem.
[11] Such as iron ore, aluminium, copper and nickel.
[12] See Goodbye to all that, The Economist, August 22nd 2015, p. 54-55.

prices, which – being inputs for production – made investments at lower prices still beneficial.

1.8 Global commodity prices

Price indices by commodity class

Source: IHS

On the demand side, however, the comparison with the oil market is lost as China dominates the scene. It consumes more than half of the global production of iron ore, nickel and (refined) copper. With China slowing down and rebalancing, indeed its demand growth for commodities has been reduced. The pressure coming from this combined force of oversupply and pressure on demand has led to continuation, and even slight acceleration, of the price decline in 2015. This will definitely not go on forever, and importantly, like in the oil market, investments have already been reduced. Still, the end of the price pressure is not in sight as the IMF points out.[13]

This is not good news for commodity exporters, a set of countries already relatively hard hit by the price declines that started in 2011. Metal exporters that face this most prominently are a diversified bunch: Mongolia, Zambia, Mauritania, Chile, Iceland and Peru (using a minimum of 5% exports to GDP benchmark).

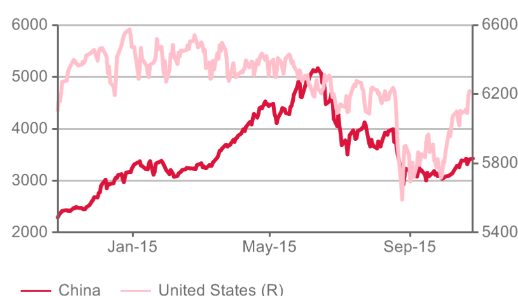
China's summer turmoil adds to worries

With China now having an 18% share of global GDP and a 50% share of the commodity market, developments are being closely watched, if not scrutinised. During the early summer of 2015, China released a number of high frequency data that gave rise to concerns over whether the targeted growth level of 7% for 2015 would be achieved. Notably, exports were down. Then, after a steep climb during the late spring, the Chinese stock exchange tumbled, having lost 40% of its value since mid-July. The Chinese authorities intervened in the market, spending an amount of around USD 200 billion to halt the fall, but to no avail. Other stock exchanges in the world were down as well. The situation stabilised by late August.

Finally, in early August the Chinese central bank took the markets by surprise with a devaluation of the renminbi. It was small in size, almost 2%, but it sent a shock wave through the currency market, especially in Asia, as fears of the Chinese-led currency war rose. Further pressure on the currency forced the Chinese central bank to intervene heavily in the market in order to maintain the renminbi within its band versus the USD. Chinese turmoil clearly matters.

1.9 Global stock exchanges

Shanghai Stock Exchange and Dow Jones composite indices



Source: IHS

The assessment of the impact of the turmoil is a bit of a balancing act itself. Firstly, as to growth, the authorities have sufficient means at their disposal to keep growth at the targeted level. Secondly, the impact of the stock exchange fall should be fairly limited. Less than 20% of Chinese household wealth is held in shares, and the part held in shares is fairly concentrated. Thirdly, through the interventions subsequent to the devaluation, China has shown that it does not wish to wage a currency war. Indeed, the devaluation should be seen as a step towards a more freely floating renminbi as recommended by the IMF.

[13] World Economic Outlook, p. 45.

1.10 Chinese exchange rate

Renminbi per USD, index = 01/01/2013

Source: IHS

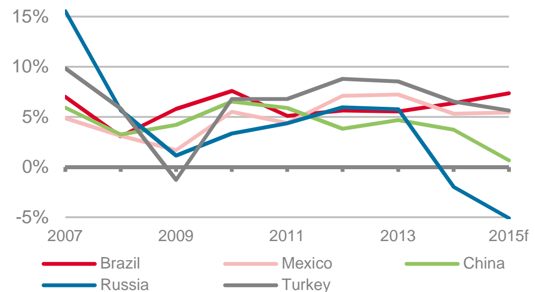
But, one should be careful as well. Further government intervention to boost growth would arguably imply authorities revert to the old trick of investment stimulus. That would run counter to the rebalancing objective towards a more consumption-led growth and the attempts to manage unsustainably high debt levels at local governments, state-owned enterprises and firms. Therefore, the impact of the Chinese summer turmoil should not be overestimated, but authorities have raised doubt, at least some, on their ability to smoothly manage the economy. Nowadays, this is a global concern.

The Fed goes global

As we have discussed in our May Economic Outlook, the Fed monetary policy stance, more than the ECB's, is to dominate the global scene. While this still holds, it gradually became clear that the Fed would not raise the interest rate in its September monetary policy committee meeting, and indeed it did not. Again, this has a lot to do with China, and more generally, the developments in the emerging economies. This is a remarkable development. As the press statement of the September FOMC meeting admits, these are concerns for the state of the US economy and thus warrant being taken into account. We consider two metrics, global financial flows to emerging economies and exchange rates. Both are under pressure.

1.11 Capital flows to emerging economies

Percent of GDP

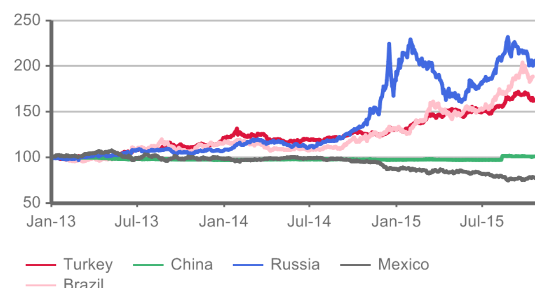


Source: IIF

Capital flows to emerging economies are important as they fuel economic growth. They are expected to reach USD 548 million in 2015, down from USD 1.1 billion in 2014, according to the IIF.[14] The year 2014 was already notably down from USD 1.3 billion in 2013. As a share of GDP, inflows have fallen to 2%, against 8% in 2007. The heart of the problem is in China where capital flows are expected to reach a level of USD 75 billion in 2015 or 1% of GDP, down from USD 385 billion in 2015 (5%). This is directly related to Chinese corporates massively repaying their cross-border USD-denominated debt to off-shore banks, arguably in anticipation of further renminbi depreciation after the August turmoil. Flows to Indonesia are under pressure as well, whereas Russia continues to face net capital outflows due to international sanctions. For 2016 only a modest recovery of inflows to emerging economies is forecast, to USD 776 billion as inflows to China recover. But the outlook remains bleak.

1.12 Exchange rates

National currences per USD, index = 01/01/2013



Source: IHS

[14] **See Capital Flows to Emerging Markets, IIF October 2015.**

As to the other metric, exchange rates of emerging economies relative to the USD have been under pressure since the announcement of the Fed's monetary policy tapering in June 2013. But this pressure has actually existed since the 2008 crisis, and in most cases, even before then. Exceptions to this observation are Mexico and, notably, China, although the currency of the latter has been subject to a managed float regime with clear current downward pressures. Apart from the Fed, and most recently the renminbi devaluation, an array of domestic issues play a role. For Russia the low oil price and international sanctions, for India the lacklustre infrastructure investments, for Indonesia the vulnerability to commodity prices and for Brazil the overreliance on credit-led consumption growth, to name a few.

We wish to emphasise here that exchange rate moves in reaction to these issues are to be assessed favourably. They help rebalance the economy, as is most visible in Russia where the rouble depreciation triggered a dramatic decline in imports. That in turn prevented an external imbalance, and potential Russian default like in the 1990s. Flexible exchange rates help prevent imbalances and so a reprise of the Asian crisis is not in the cards.

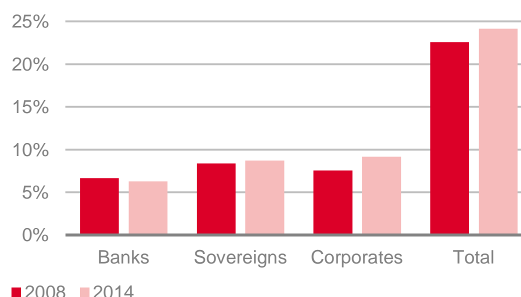
Corporate debt levels on the radar

Care is warranted, especially now that foreign corporate debt has gone up since the crisis. The risk of default for firms is set to increase as capital is reverted to advanced economies and domestic currencies face pressure. Finance may be harder to get, and at a higher price, because of interest rates going up due to (i) central bank rate hikes and (ii) significantly higher spreads for foreign currency denominated debt. The latter arises because of the currency mismatch for firms that have cash flows in home currencies and debt servicing in USD or other foreign currencies. The issue may be systemic for a country, and perhaps a region, if foreign debt has reached danger zone levels.

The question is whether such is the case at this moment. We have only data on foreign corporate debt to assess the situation – no split in home and foreign currency. We also limit ourselves to aggregate figures for emerging economies. On that score, the increase of almost 2 percentage points does not look dramatic for the emerging economies, and although it is highest relative to banks and sovereigns, neither does the current level, at a still relatively low 9.2% of GDP.

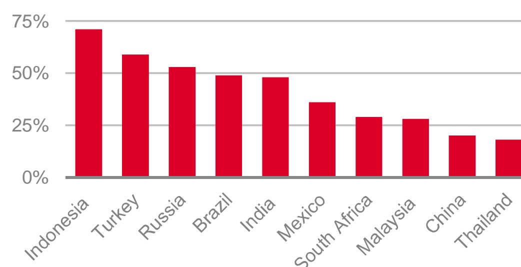
The aggregate figures provide a first impression of the size of the problem, but a closer look at external corporate debt relative to country-wide exports is needed. Doing that, we observe that external corporate debt levels in Indonesia, Turkey, Russia, Brazil and India stand out. Although the absolute levels (between 50% and 75% of exports) still seem manageable, the vulnerability of these firms to changes in capital flows, rising interest rates, and pressure on exchange rates is heightened. Foreign corporate debt in Indonesia, Russia, Brazil and Turkey in particular warrant a closer look in Chapter 3. For now, it seems too early to signal this as the development of a systemic risk for emerging economies, but increased vigilance on individual corporate monitoring is certainly justified.[15]

1.13 Foreign debt emerging economies
Percent of GDP



Source: Fitch

1.14 Corporate external debt
Percent of exports



Sources: IMF, Fitch

Geopolitical issues intensify in the Middle East

The conflict in the Middle East has escalated, now that Russia has decided to step up its support for the

[15] **On that account, we follow the IMF, Corporate leverage in emerging economies – a concern?, October 2015. Their analysis has a broader scope, however, by assessing corporate leveraging as a whole rather than only foreign debt.**

Syrian government. It is backing it up with air strikes on Syrian rebel forces that are supported by the US-led coalition against IS. That complicates the Western approach towards Syria, already put under pressure by the tens of thousands of Syrian refugees fleeing to Europe and seeking political asylum since the summer. In a way, Russia, the US and Europe have another issue to agree on as international sanctions for the Russian approach to Ukraine are still firmly in place. Apart from that, the conflicts have only limited global impact, at this stage.

Outlook indicates slow growth

Global growth in 2015 is bound to disappoint. Changes in the forecasts since the early spring reflect that, especially in Latin America. Due to this, Latin America as a whole is now forecast to witness a weak recession due to the situation in Brazil, but a number of smaller countries, such as Peru and Columbia, are still firmly growing. In Asia, despite Chinese pressure, growth forecasts have only been adjusted down by 0.1 percentage point and the region remains the global growth carrier. In the advanced economies, the GDP forecast for the US was reduced due to an unexpectedly weak first quarter performance. On the other hand, the eurozone outlook remained stable, backed by ECB expansionary monetary policy, the low oil price and a still favourable exchange rate.

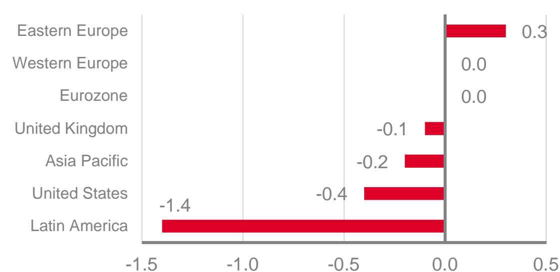
Table 1.1 Real GDP growth (%) – Major regions

	2014	2015f	2016f
Eurozone	0.9	1.5	1.7
United States	2.4	2.5	2.6
Asia Pacific	4.8	4.5	4.7
Latin America	1.0	-0.6	0.8
Eastern Europe	1.8	-0.1	1.9
Total	2.8	2.5	2.9

Source: Consensus Economics (October 2015)

In 2016 Latin America is forecast to move out of recession, pulled up by the Brazilian growth pressures bottoming out. The same holds for Eastern Europe, where the Russian recession will gradually fade over the year, assuming no further fall in the oil price or intensification of the international sanctions. Then, with Asia powering ahead and the US and the eurozone picking up, the overall picture of 3.0% should be achievable. That is indeed our baseline scenario. Still, as we have already mentioned, it may again turn out to be a bit optimistic.

1.15 Change in 2015 GDP growth forecasts
Difference between April 2015 and October 2015



Source: Consensus Economics

Risks to the outlook

Our previous Outlook emphasised the risks for our main scenario for an unanticipated Fed rate rise, eurozone growth, a slowdown in China's growth, and geopolitics, in that sequence. The events over the summer have changed that picture somewhat. Firstly, as can be deduced from the above analysis, China has taken centre stage, and that will have to be reflected in our risk assessment. Secondly, with the Greek uprising against the eurozone bailout terms ending in an anti-climax, the risk of Grexit has arguably declined, at least in the short term. Meanwhile, the Fed has shown a clear sign of empathy for global events. We therefore include the following risks to our main scenario.

(1) Chinese growth: We still take a 5% GDP growth level as a hard landing scenario. If economic data surprise, the authorities may revert to the old tricks of infrastructure spending. That would reverse a positive development towards more consumption-led growth. Moreover, it will further push up already high debt levels in the economy. Phasing that out will mean further strain on the authorities to manage the economy than now. That could prove too much. We have clearly outlined above what the impact of such situation can be on the global economy: financial market stress, currency depreciations against the USD, trade disruptions and even lower global commodity prices.

(2) Global monetary policy: The point here is not so much monetary policy itself but instead it is the timing and communication of rate hikes by the Fed. The decision is data driven, regarding the labour market and inflation. Surprises may come from these data and then uncertainty may arise as to what the reaction of the Fed will be. Add the global economic situation and one can argue that uncertainty regarding the Fed

Table 1.2 Risks to the global economic outlook

	Risk issue	Symptoms	Effects	Probability	Impact
1.	**Chinese growth**	Signs of further slowdown in economic activity. Instability in the banking sector.	Significant lower Chinese economic growth. Spill-overs to the rest of the world via trade and commodity channels.	moderate	high
2.	**Global monetary policy**	Unguided change in US monetary policy. Insufficient liquidity provisioning leads to credit crunch.	Financial market volatility. Capital outflows from emerging markets. Further USD appreciation.	moderate	moderate/high
3.	**Eurozone growth**	Slowing economic growth. Persistent decline in the rate of inflation. Grexit.	Stagnation across the eurozone. Re-escalation of sovereign debt issues.	low/moderate	moderate/high
4.	**Emerging economies' corporate debt**	Firms with high debt and currency mismatches faced with capital outflows, high interest rates and weakened domestic currencies.	Increase in corporate defaults. Financial market volatility. Loss of confidence in emerging market economies.	low/moderate	moderate
5.	**Geopolitics**	(i) Escalating political and social unrest in Ukraine. More US/EU sanctions and Russian counter sanctions, on energy trade.	(i) Severe recession in Russia. Adverse effects on eurozone and energy prices.	(i) low	(i) moderate
		(ii) Further surge of IS, Middle East uncertainty.	(ii) Higher energy prices and high volatility.	(ii) low	(ii) low

Source: Atradius Economic Research

decision has remained unchanged and high: a Fed policy shock can lead to further, and more widespread, capital outflows from emerging economies. A credit crunch may then result.

(3) Eurozone growth: Strengthening growth in the eurozone has taken hold since the early spring, despite the threat of Grexit. That situation, however, did not lead to the feared contagion in financial markets. Given the unexpected U-turn that was made by Greece in July, to accept a new bailout and the confirmation of this by the election results of late September, Grexit is not likely, at least not in the short term. The ECB's quantitative easing programme that will last at least until September 2016 helps as well. Moreover, with the Banking Union well underway, the eurozone financial configuration is stronger. Still, with a region plagued by high unemployment rates and low inflation, as well as a banking sector under repair, the end of the current tailwinds may throw the region back into recession.

(4) Emerging economies' corporate debt: The current risk of a crisis in the emerging economies emanating from corporate debt levels and currency mismatches is not to be considered systemic. It may lead to a high level of corporate defaults, but on a macro level is expected to be contained. This may change if capital flows, exchange rates and interest rates move sharply in the wrong directions, in conjunction with a further decline of commodity prices. Firms in emerging economies, active in commodity production, and highly leveraged in foreign currencies with insufficient hedging may then waver. That could trigger fear and a sharp reaction in the financial markets, creating a vicious circle of corporate defaults as well as a lack of confidence in the emerging economies.

(5) Geopolitics: The situation in the Middle East has escalated, a refugee problem in Europe and Russia potentially thwarting the US-led coalition to fight IS. This has created a second source of significant tension, besides Ukraine, between Russia and the US and Europe as well. So far, the economic impact, has been contained, but further escalation in the Middle East and/or re-escalation in Ukraine is a source of concern. This may extend the term of the current international sanctions against Russia, with potential impact on energy prices. An impact on energy prices, specifically oil prices that may become very volatile, may also occur if the current IS containment is stopped and their surge restarts.

2. Advanced economies – prospects and risks

Back in the driver's seat

Economic growth is forecast to be solid across advanced economies in 2016 as the eurozone and Japan get closer to the positive performance of the US and UK.

Steady does it

The eurozone is set to continue its economic recovery that started in 2013 and is forecast to grow 1.7% in 2016. That is still modest of course, but is based on solid domestic progress in individual member states. The recovery is therefore relatively solid and expected to continue over the coming years.

The US and the UK have seen their economies expand at reasonable rates between 2% and 3% over the past couple years, a trend which is forecast to continue in 2016. Despite these growth rates being significantly higher than those of the eurozone, they remain modest in historical perspective. The respective domestic economies are developing well nonetheless with unemployment falling rapidly in both countries. Japan, the third largest economy in the world, continues its fight against deflation while the economy is forecast to see a modest expansion of 1.6% in 2016.

Table 2.1 Real GDP growth (%) – Major markets

	2014	2015f	2016f
Eurozone	0.9	1.5	1.7
US	2.4	2.5	2.6
UK	3.0	2.5	2.4
Japan	-0.1	0.6	1.6

Source: Consensus Economics (October 2015)

Known unknowns

The outlook is rather solid, but there are a number of risks that could undermine the expansion. The biggest threat comes from a significant slowdown in emerging economies which could lead to a loss of exports by advanced economies and impact financial returns. Another risk stems from domestic dynamics that could turn sour, for example, if interest rate increases in the US lead to more (personal) defaults as debt service costs rise. In the eurozone, the debt sustainability issue is not completely resolved yet and may flare up again in 2016. Overall the risks to the outlook remain on the downside.

Eurozone: out of the frying pan into the fire?

The eurozone economy is finally picking up and after six years is leaving the crisis behind. Growth nonetheless remains muted and unemployment high. 2016 should be a year of better business conditions, but potentially with residual troubles for individual member states.

The eurozone awakens

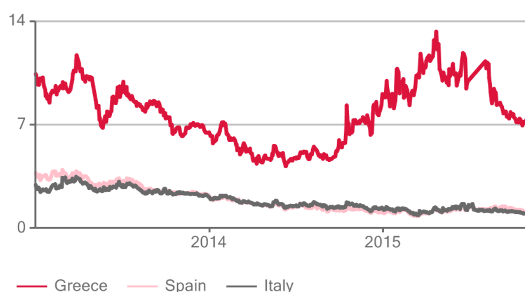
The eurozone moved in and out of recession over the past six years as it was fighting the bust following the financial crisis in 2008. However, since mid-2013 the recovery has slowly but steadily started to take hold. By the end of 2015, the eurozone economy is expected to surpass its beginning-of-2008 size. All 19 eurozone member states are showing positive economic growth figures indicating that the recovery is lifting all boats. That is also clear when looking at the individual components of the economy: consumers are spending again, business investment is growing and exports are rising. This suggests that the recovery is rather stable and likely to last.

At the same time, the sense of crisis has faded. Over the past years when Greek debt sustainability became prominent and financial markets panicked, there was also a strong reaction visible in the yields of other peripheral country government bonds. Yet there was little alarm on financial markets when the Greek crisis reached another boiling point in June 2015. Yields on Spanish and Italian government bonds barely moved.

In fact, Spanish bond spreads correlated 0.85 with Greek ones between January 2008 and September 2014, since then however the correlation dropped to -0.16, meaning that they no longer move in the same direction. Italian and Portuguese spreads show a similar pattern. Exposure to Greece by companies in other eurozone member states has been wound down significantly over the past years, European institutions have strengthened and the macroeconomic and financial picture in the other periphery countries has improved significantly. A potential Greek exit is no longer expected to seriously hurt other eurozone markets.

2.1 Government bond yields

10-year bond yields over the German bund, percentage points



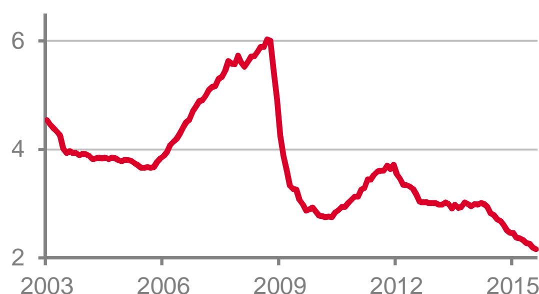
Source: IHS

The measures by the ECB have also contributed to the easing of the crisis while at the same time have made credit for companies extremely cheap. Thanks to low interest rates and its bond-buying programme, interest rates on financial markets are at record lows. Large companies can benefit from these rates directly by issuing bonds. Smaller companies also benefit as banks pass on the low rates. The composite bank lending indicator fell to 2.16% per annum in August 2015, the lowest rate since measures began in 2003.[16] The ECB's bank lending survey indicates that banks are easing lending conditions and expect to continue doing so in the fourth quarter of 2015. In August, lending to companies also increased by 0.4% compared to August 2014. That is still modest, but a clear break from the trend of falling lending conditions since 2012. The ECB policies have also led to a weakening of the euro which is boosting exports. As a result of strong export growth, the eurozone's current account balance is at its highest level since measures began in 1970.

[16] In fact, global interest rates appear to be "lower than at any time in the past 5,000 years", according to the Chief Economist of the Bank of England. http://www.bankofengland.co.uk/publications/Documents/speeches/2015/speech828.pdf

2.2 Cost of borrowing

Lending rate to non-financial companies



Source: ECB

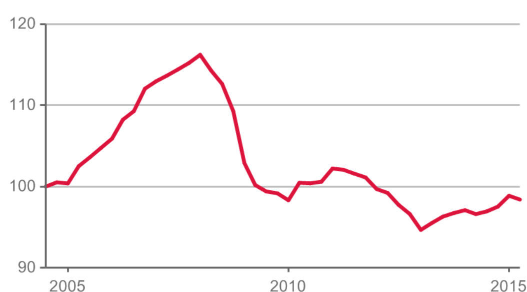
The low oil prices are also providing a boost to consumer purchasing power and company profitability. The eurozone is a large importer of oil and is estimated to benefit to the tune of EUR 100 billion in 2015 from the lower price. Consumers benefit from lower gasoline prices as well as other energy sources such as gas that have their prices linked to oil. Consumer price inflation fell to -0.1% in September thanks to falling oil prices, boosting overall consumer purchasing power. The savings from the lower prices are expected to increasingly lead to additional spending rather than savings deposits as the low oil prices are expected to stick. Not only consumers but also many companies benefit from low energy prices. Industrial companies such as chemical producers enjoy lower input costs boosting profitability. The same goes for the transport sector including the airline industry. As many companies had hedged against oil price fluctuations, the benefits will be felt increasingly as previous hedges expire.

The crisis legacy

Despite positive developments, the aftermath of the financial crisis is not completely gone yet. Unemployment in many eurozone member states is falling only slowly and remains high. The unemployment rate in Spain was still a staggering 22.2% in July 2015. The eurozone aggregate unemployment rate was 10.9%, the last time unemployment was so high was in 1997. The health of the labour market is important because it drives the income of households and determines consumer spending. While GDP may be back at its 2008 level, consumer spending remains 3.5% below it. The retail and hospitality sectors have been hit especially hard over the past years as consumers cut back on spending. It takes a tightening of the labour market

and a subsequent rise in wages before consumer spending can take off again.

Credit may finally be picking up, but banks are still held back by a high share of non-performing loans. The aggregate return on equity of eurozone banks fell from 13% before the crisis to 8% in 2014. This reflects both a higher regulatory burden and a loss of profit from services. According to estimates by the IMF, the banking sector has around EUR 1 trillion worth of non-performing loans on their books, about 9% of eurozone GDP. Offloading these to investors would free up EUR 600 billion in capital for lending. This implies settling non-performing loans with debtors. Private sector debt rose rapidly from 123% of GDP in 2000 to 155% in 2008 fuelled by the credit boom. With the bust of the financial crisis, the share of non-performing loans rose rapidly, but consumers and companies have been unable to offload their debt over the past six years: in 2014 private debt was still 156% of GDP. This is one of the reasons why investment remains low. Capital expenditure as a percentage of operating cash flows was below 48% in 2014, compared to around 58% in 2007. The low investment, in turn, helps explain the low job growth and poor labour market conditions.



Source: OECD

The eurozone aggregate also hides the much weaker performance of individual member states such as Italy, where the economy is forecast to grow only 0.7% in 2015. The French economy, the second largest in the eurozone, is also growing only slowly. Despite many reforms planned by the French government, they have not translated to effective action and the economy is not taking off. It will in fact require a much more fundamental overhaul of labour market regulation in order to structurally improve the economic growth prospects. The government is unlikely to take such unpopular action as it faces numerous local elections in the next two years. At the same time, the German government is overly focused on maintaining a balanced budget in its efforts to set an example to the rest of the eurozone. That however hinders the government from providing a much needed boost to domestic demand in Germany, for example by investing in infrastructure. This investment would also spill over to the rest of the eurozone, but the government refuses to consider such action.

Table 2.2 Real GDP growth (%) – Major markets

	2014	2015f	2016f
Austria	0.4	0.8	1.5
Belgium	1.1	1.2	1.4
France	0.2	1.1	1.5
Germany	1.6	1.8	1.9
Greece	0.8	-1.3	-1.8
Ireland	4.8	5.4	3.8
Italy	-0.4	0.8	1.3
Netherlands	1.0	2.1	2.0
Portugal	0.9	1.6	1.7
Spain	1.4	3.2	2.7
Eurozone	0.9	1.5	1.7

Source: Consensus Economics (October 2015)

The uncertainty over the debt sustainability of Greece and its place in the eurozone also remains far from resolved. The new third bailout package agreed between the Greek government and the European Union does not sufficiently address the problem of the high Greek government debt levels. The agreement only addresses the short-term funding needs of the Greek government, which mostly encompasses the repayment of earlier borrowed funds from the IMF, ECB and European Union. Talks on a restructuring of the debt are likely to continue into 2016. So will discussions on the extent of implementation of recommended measures by the Greek government as all lending to Greece is conditional on implementing reforms. The economy is meanwhile forecast to contract more than 1% in both 2015 and 2016. This comes on top of the previous six-year recession that left the Greek economy 25% smaller than it was at the beginning of 2008.

Return of the periphery

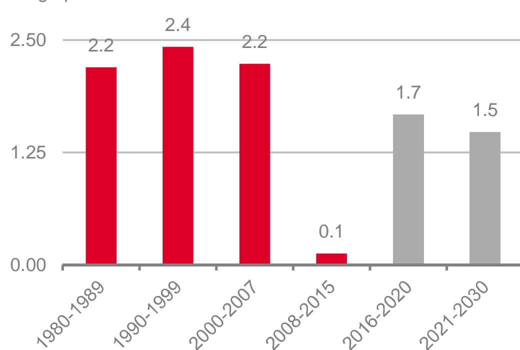
Yet it is also telling that the best performing markets currently are the 'trouble shooters' of the past years. Ireland, which received a bailout in 2010, is growing

by more than 4% in 2015. Also Spain, which received a EUR 100 billion bailout in 2012, is growing by around 3% this year and is expected to continue at this pace in 2016. The distinction between 'core' and 'periphery' no longer applies: the by-many-analysts dubbed 'PIGS' (Portugal, Ireland, Greece and Spain) are, on average, forecast to grow faster than Germany in 2015. With the return of economic growth in these countries, (except for Greece) the discussion around government debt sustainability has disappeared. Ratios automatically improve as the denominator, GDP, grows more quickly, but also government finances automatically improve when the economy picks up as tax income rises and social spending falls. This is not to say that there are no risks anymore. Indeed sovereign ratings have not yet improved and the debt situation in Greece remains unresolved. However, the direction of the economy has changed, the buffers have improved and the risks are falling.

Aging: the long decline

The crisis may be behind, but that does not mean the boom years of before 2008 are going to return. The eurozone enjoyed strong and stable growth in the 1980s, 1990s and first part of the 21st century. This was violently disrupted by the financial crisis, but at the same time, the crisis masked a more fundamental change in the composition of eurozone growth. Economic growth in the eurozone was set to decline either way and is forecast to reach only 1.7% on average per year between 2016 and 2020. It is expected to decline further to 1.5% in the decade to 2030. This means that a small setback may push the economy immediately into recessionary territory.

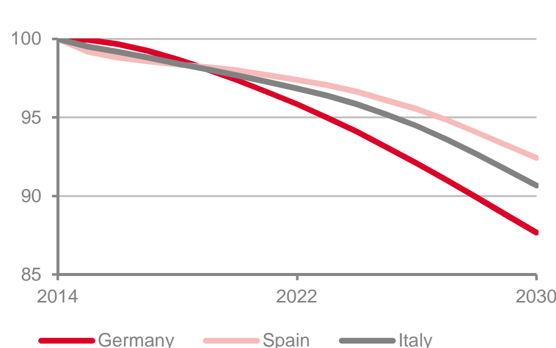
2.4 Real economic growth
Average per annum



Source: IHS

The structural decline in growth potential is largely driven by slowing population growth and ageing. As a result, in Germany, Italy and Spain the working age population (ages 15-65) is forecast to fall by around 10% between 2014 and 2030 and may continue to fall in the decades thereafter. Because the size of an economy, measured in gross domestic product (GDP), is broadly based on the cumulative output of all working people in the country, this will directly lower economic growth. The aging population will also put pressure on pension systems and government-funded healthcare. According to the European Commission, expenditures on health care and long-term care may rise from 8.5% of GDP in 2014 to 10.5% of GDP in 2060. While pension assets will rise strongly over the next years, the return on these assets could fall short of their payment promises if interest rates remain low according to the OECD. This would mean pensions have to be cut or pension fees have to rise significantly.

2.5 Working age population
Index 2014=100



Source: UN

Slow economic growth also makes it much more difficult to reduce debt ratios and for governments to balance their budgets. It will fasten the relative decline of economic importance of Europe in the world. It is not, however, a complete disaster. In fact, labour productivity and total factor productivity are set to continue which will lead to a continuation of the wealth growth that we have seen over the past century. The rapidly aging population in Japan since the 1980s and the subsequent two decades of low economic growth did not bring poverty to the country. Indeed Japan is still extremely rich and it has the lowest unemployment rate among developed countries. With the right government policies such as raising the retirement age and reforming healthcare, the eurozone may continue to be one of the richest,

most modern and economically secure places in the world over the coming decades. As the eurozone leaves the euro crisis behind, governments, companies and households can start looking ahead and adjust to a positive but modest economic expansion.

United States: ready, set...wait!

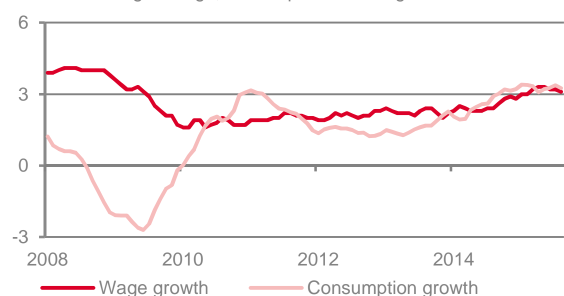
The United States economy is expected to continue as a major global engine for growth in 2015 and 2016. The recovery is robust, marked by a 2.5% growth forecast for 2015 and a further 2.8% expansion forecast for 2016. Downside risks have grown over the year, particularly stemming from external volatility, pushing back a much-anticipated Fed lift-off.

Consumers warm up after cold start

The first quarter of 2015 was marred by one-off factors including harsh winter weather and port closures on the west coast. However, the economy bounced back since the second quarter, displaying broad-based demand-driven growth and rising consumer confidence. Despite cheap oil and a strong dollar, consumption growth stayed modest, below 2% on average from 2010 to 2014. This is partly because low interest rates caused many American consumers to worry about not accumulating as much interest on their pension savings, motivating them to save more than previously planned. Consumption has been gradually rebounding over the past year, averaging 3.3% growth in 2015. Consumer spending accounts for more than two-thirds of US GDP so its expansion should boost overall growth over the remainder of 2015 and in 2016.

2.6 Wage and consumption growth

3-month moving average, annual percent change



Sources: Federal Reserve Bank of Atlanta, BEA

There are several developments encouraging Americans to loosen their purse strings – one namely being the improving labour market. Unemployment has been flat at 5.1% since August 2015, one percentage point lower than in August 2014, and about half of the peak in October 2009. Job security has risen and nominal wages have finally begun to tick up, albeit very modestly, averaging 3.2% annual growth this summer. Wage growth is expected to continue picking up as slack in the labour market disippates.

US consumers are further aided by a strong dollar and low inflation of only 0.2% year-on-year in August. The extra disposable income generated by low oil prices is finally translating into extra spending as well. Furthermore, in the low interest rate environment, Americans have increased their purchases of big-ticket items like cars and houses.

The outlook for US consumption growth is positive and it is helping other sectors of the economy, namely the housing market. Construction spending rose 0.7% month-on-month in August, the largest growth since 2008, as demand for new housing feeds through. Larger stock market volatility, however, could put pressure on spending in the coming year since Americans may be inclined to save instead of spend due to relatively high exposure to equities through investments and/or retirement savings.

Strong greenback weighing on exporters

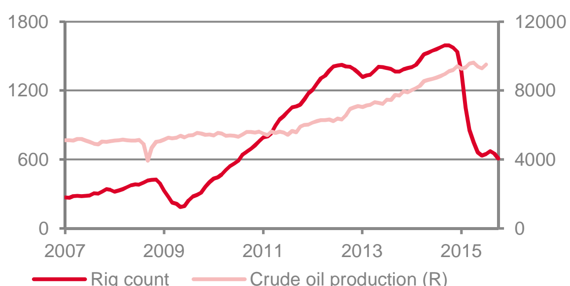
American exporters are not faring as well as consumers. In the first half of 2015, exports contracted for the first time since the height of the financial crisis. The strong USD is partly to blame: in real effective terms, the currency has appreciated more than 10% since mid-2014. Equally important is waning demand for US exports in key markets like Canada and Brazil, whose currencies have depreciated sharply against the USD and China, where growth has moderated. The manufacturing sector in particular has been hit by these developments, with activity falling to its lowest level in two years.

Overall annual export growth is expected to reach 1.7% in 2015 and rebound to 3.7% next year. However, this estimate is likely to be optimistic. Pressure on the USD may continue as domestic demand remains elevated compared to most other advanced economies, the Fed normalises monetary policy and oil prices remain muted. Furthermore, should emerging markets continue to weaken along with external demand, the medium-term outlook will be dampened.

Source: Federal Reserve Economic Data

Oil sector hunting for savings

The American shale industry has become one of the global energy swing producers, but pressure is mounting. A barrel of WTI crude oil hit a seven-year low below USD 39 in late August this year and has stabilised between USD 45-50 in September. For now, US production continues to grow, albeit at a slower pace. US oil producers are now bearing the brunt of the price pressures since such low prices have made it difficult for shale producers to break even and to secure new investment.



Sources: Baker Hughes, EIA

As a result, many US oil producers have shifted their focus to belt-tightening. The number of oil rigs in operation, an indicator for future production, has declined by nearly 60% since the beginning of the year. More than 60,000 jobs were cut in the energy sector in the first half of 2015 and investment in the sector has fallen. Exploration and other capital expenditures will continue to fall. Access to capital is also restricting, particularly for small producers, which could lead to increased bankruptcies. The outlook for 2016 remains bleak as demand for oil outside the US remains muted and oversupply is expected to continue (notably with Iranian oil likely entering the market). The potential lifting of the US ban on exporting crude oil could provide a boost for the American oil industry though.

Fed lift-off: are we there yet?

Despite difficult environment for US shale producers and the drag on net exports, the American recovery is expected to continue strongly over the coming years, driven by private consumption. The negative external pressures will be outweighed by the benefits of lower energy prices, higher consumer spending and an improving housing market. Although generally strong US data pointed to a rate hike in September, the Fed surprised markets referring to the potential consequences of global and financial developments on the US economy. Inflation and the labour market data in particular held back the Fed's decision.

Inflation remains far below the Fed's 2% target: the consumer price index declined 0.2% in September. Core inflation (excluding food and energy prices) on the other hand increased 1.9%. Low inflation appears to be a structural issue, as opposed to one driven by one-off factors like the low oil price and cheap imports. Low wage growth through the recovery, for instance, has weighed on prices. Leading up to the coming FOMC meetings, all eyes will be on the labour market.

Source: BLS

While unemployment has indeed been falling since late 2009, now approaching pre-crisis levels, and wage growth has finally begun responding, the labour market is still not performing at a level to offer enough confidence to pursue a rate hike. Most notably, the labour participation rate remains well below the rate in 2007 and the steady downward trend since 2008 does not appear to be slowing down. The latest participation rate is about 62%, more than four percentage points lower than before the crisis and the lowest rate the US has seen since 1977. Some of this

decline can be attributed to changing demographics (the aging population), but many other advanced markets are facing the same dilemma and not seeing a shrinking labour force participation. Lower participation in the labour force is a significant driver of declining unemployment so until these numbers become more robust, the Fed is likely to remain hesitant to raise interest rates.

So while the Fed is looking to China and volatile financial markets, they are also looking keenly at domestic inflation and labour market data, in order to justify lift-off. It is important that the American economy can weather negative external shocks and that wage growth and the participation rate in the labour force improve. It is expected that the data will be robust enough to show this by early 2016.

United Kingdom: time to dig deeper

The picture for the United Kingdom is more mixed, but compared to its continental neighbours, the recovery is well-entrenched. Economic growth has been steady at 2.3% in the first half of 2015, supported by lower energy prices and a gradual recovery in wage growth. Annual growth in 2015 is forecast at 2.6% and will continue at 2.5% in 2016.

Recovery benefitting from the "easy" fixes

UK exporters have been hampered by the strength of the pound, reaching seven and a half year highs against a basket of major currencies. The outlook for exports is bleak, due to global economic uncertainty regarding the China slowdown, falling imports in BRICS economies and imminent Fed rate hike. Therefore, domestic demand is critical for growth in the near term. Similar to the situation in the US, UK domestic demand has been strong thanks to rising employment, a long-awaited pick-up in wage growth and the benefits of lower global oil prices.

In the most recent Monetary Policy Committee (MPC) meeting, the Bank of England voted to maintain the key policy rate at 0.5%, citing continued disinflationary pressures from the renewed decline in oil prices and constraint to imports that the appreciated GBP has caused. On the other hand, they recognised that overall economic growth is robust, particularly driven by stronger consumer sentiment, real income growth and higher domestic demand, and gains in productivity. Further gains in productivity, which has flat-lined since 2008, are crucial to sustain growth in 2016 and beyond as consumption could become restrained due to inflation picking up gradually and the government reining in spending.

More challenging reforms needed to sustain growth

Increasing domestic demand has contributed to the rising output of the services sector which accounts for more than 75% of UK GDP and 80% of total employment. Productivity growth in the services sector has been lacklustre – growing an average of 0.5% since the crisis, compared to 2% annually in the period before – but it appears to finally be ticking up. In the first half of this year, productivity growth in the services sector as measured by the annual percentage change in output per job has grown nearly 3%. The manufacturing sector's productivity growth on the other hand has contracted 0.6% in the same period, weighed down by persistent subdued demand in the eurozone and the strength of GBP relative to the EUR.

2.10 Productivity growth
Percentage change per annum, quarterly

Source: ONS

Tradable services – mostly business, professional and financial services – have led productivity growth in the services sector. Services exports account for 12% of UK GDP and according to the WTO, the UK is second only to the US in exports of commercial services. The share of UK service exports is likely to even surpass that of manufacturing exports in the coming years.

While British manufacturers struggle due to the strong pound and weak export demand, the services sector is as important as ever to sustain economic growth in the UK. The UK also needs to liberate trade, particularly for services exports and diversify the destination of exports with the aim on emerging markets.[17] The Bank of England sees a gentle

[17] See Atradius Economic Research note "Brexit: top 5 countries and sectors at risk" for a more in-depth look into UK's trade patterns.

deceleration in the services sector as a natural consequence of the economy finally reaching a balance after the downturn, but improvement of productivity and export capacity of British services is key to sustainable long-term growth.

Japan: recovery failing to pick up steam

The pace of Japan's economic recovery remains slow. A return to positive GDP growth is expected in 2015 (0.6%), supported by lower energy prices, accommodative monetary policy and yen depreciation, but the large monetary and fiscal stimulus still struggles to significantly boost growth and inflation. In 2016, the Japanese economy is forecast to grow 1.6%.

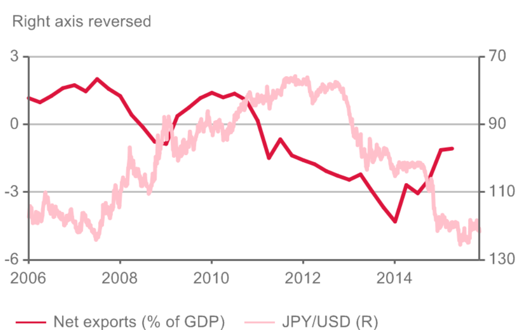
Not so good at archery

Despite a strong first quarter performance, the Japanese economy contracted in the second quarter and industrial production has continued to decline. It appears that the country fell back into a recession in the third quarter. The three arrows of Prime Minister Shinzo Abe's economics plan – otherwise known as Abenomics – have fallen short of their targets.

Rising business profits have not translated into wage growth and inflation is staying stubbornly low. In fact, consumer prices contracted in August 2015 compared to August 2014 for the first time since the quantitative easing programme began. Abenomics has failed to address the large fiscal deficit and government debt so far. Sovereign debt stands at nearly 250% of GDP, warranting a downgrade by rating agency S&P. Despite yen depreciation, net exports have seen a little boost – in fact, exports are even slumping now, largely due to low demand in China.

2.11 Japan: exchange rate vs. exports

Right axis reversed



Source: IHS

There are bright spots such as private-sector investment spending and private consumption which have finally picked up. Core inflation is relatively stable and the Trans-Pacific Partnership (TPP) should provide a boost for Japanese trade in the medium term. Prime Minister Shinzo Abe has also reaffirmed his policy commitment to the economy by aggressively pursuing the third arrow of Abenomics, structural reforms, and revamping his plan to focus on economic growth as opposed to debt.

Structural reforms and deregulation are key to attracting overseas investment and expanding exports. Japan is faced with a similar productivity puzzle as Europe and the UK, as the country is burdened with a shrinking and aging population. The challenges remain high, however, and it is more and more probable that the Bank of Japan will expand its quantitative easing programme. It is expected that in 2016, the benefits that ultra-loose monetary policy provides to private consumption and investment will finally bear fruit.

3. Emerging economies – prospects and risks

Growing fast, but slowing down

Emerging market economies are growing at the slowest pace since the global financial crisis. They are forecast to grow 4% in 2015, weighed down by political shocks, oil price collapse and significant currency volatility. These shocks exacerbate the impact of a secular slowdown led by China, by far the largest emerging market.

The slowdown of the Chinese economy remains the most prominent development for the emerging market economies. Developments in China impact other emerging markets both directly, via lower import demand by China, and indirectly, via falling commodity prices, resulting in a double whammy for emerging market export revenues. Concerns about the Chinese economy have been reinforced by an unexpected and poorly communicated currency devaluation over the summer and lingering weakness of commodity prices sparked a sharp sell-off in emerging market currencies. Emerging economies in Asia and resource-rich Latin America and Africa are particularly exposed to China's slowdown and currency volatility as well as low commodity prices.

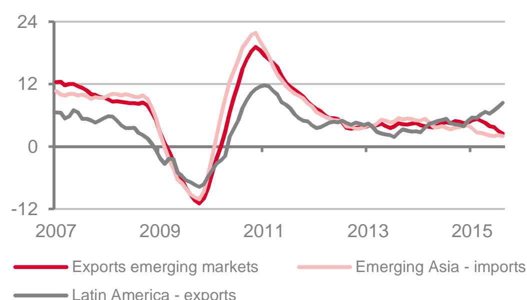
Table 3.1 Real GDP growth (%) – Regional

	2014	2015f	2016f
Asia (excl. Japan)	6.2	5.8	5.7
Eastern Europe	1.8	-0.1	1.9
Latin America	1.0	-0.6	0.8
Middle East & North Africa	2.6	2.3	3.8
Sub-Saharan Africa	5.0	3.8	4.3

Sources: Consensus Economics (October 2015), IMF WEO

Emerging Asia continues to be the fastest growing region, but India is now the leading growth engine of the pack. Low commodity prices are counterbalancing the negative effects of the China slowdown and the outlook remains relatively stable.

Economic developments in Latin America continue to disappoint. Rising political risk in its largest country Brazil will deepen and lengthen its economic contraction, which is dragging down economic growth prospects in the whole region. The good news is that Latin American exports are growing in volume and are outperforming other regions.



Source: CPB

Growth in Sub-Saharan Africa is being hurt by lower commodity prices. South Africa's economic growth has been constrained for several years in a row, exacerbated by low oil prices. Downward pressure has been mounting on the exchange rates of many African countries and has forced Nigeria and Angola to devalue. These pressures should persist in the cheap commodity environment.

Intensified geopolitical conflicts and weak oil prices continue to constrain growth in the Middle East and North Africa (MENA). But the outlook remains fairly positive as many of these countries have ample fiscal buffers and low public debt burdens, putting them in a better position to overcome these challenges. Meanwhile, some of the countries in North Africa are profiting from the gradual recovery in the eurozone.

The gradual recovery in the eurozone also supports economic growth in countries in Central and Eastern Europe. The sharp economic contraction in Russia and growing economic instability in Turkey are negatively impacting growth for the region as a whole. On a positive note, prospects for Russia and thus, for the region, are somewhat improving.

Outlook marred by high external corporate debt

Although growth is set to pick up in 2016, projections have been revised down further over the past six months to 4.5%. The outlook has become more pessimistic as concerns rise regarding the Chinese slowdown, persistent low commodity prices, US monetary policy normalisation, heightened geopolitical risks, reduced capital flows and increasing financial market volatility.

Mounting pressure on emerging market exchange rates and weakening economic growth have increased worries about debt sustainability and creditworthiness. These concerns are being fed by increased external debt, particularly concentrated in the corporate sectors, in some emerging markets in recent years. Externally-financed corporate debt ratios in terms of export receipts are particularly high in Brazil, India, Indonesia, Mexico, Russia and Turkey. This makes corporates in these countries increasingly vulnerable to a shift in global market sentiment, rising interest rates and currency depreciation. Of these countries, Turkey is most exposed, considering relatively low buffers compared to its external financing requirements, which are almost twice as high as official reserves for the country as a whole.

Despite all these risks, shock resistance of emerging markets as a group has improved compared to previous episodes of financial market volatility, due to much improved policy frameworks, more robust foreign reserves, flexible exchange rate regimes and lower external debts; particularly of sovereigns. The latter enables many emerging markets to use the exchange rate as a shock absorber.

Asia: when China sneezes, not all countries get a cold

The growth slowdown in China is the most prominent development in the world economy this year, impacting global commodity prices and emerging economies, including neighbours in emerging Asia. Regional economic growth is forecast at 5.8% this year. This is down from an average growth of nearly 8% over the previous five years, when the region benefited from loose global monetary policy worldwide; which contributed to large capital inflows to emerging markets.

Many countries are in much better shape today to handle the Chinese slowdown and other uncertainties like changing monetary policy and low commodity prices than they were when the Asian crisis broke out in 1998. China may be sneezing, but not all Asian countries will catch a cold. Emerging Asia will remain the global growth carrier this year and next.

Table 3.2 Real GDP growth (%) – Asia

	2014	2015f	2016f
China	7.3	6.8	6.5
Hong Kong	2.5	2.3	2.2
India	7.3	7.5	7.8
Indonesia	5.0	4.7	5.0
Singapore	2.9	2.0	2.4
Taiwan	3.8	1.4	2.4

Sources: Consensus Economics (October 2015), Atradius

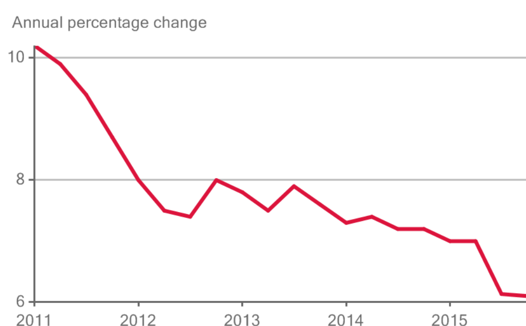
China: soft chance of a hard landing

Will the cold that the Chinese economy has caught turn into a more serious illness? Will it turn into a hard landing where economic growth is insufficient to create enough jobs for the growing urban labour force? If this ends up as the diagnosis, social unrest could occur and the side-effects would be felt even stronger outside of China. Credit risk in the region is then expected to increase and private debt obligations to be harder to fullfil.

It does not seem that such a pessimistic scenario will unfold. Chinese authorities should be able to avoid a hard landing and let GDP growth slow gradually, to levels of about 6% in 2016 and 5% in 2019, after about 6.8% this year. As China's economy loses steam, it seems to fit into a natural transition from an export-oriented economy to a domestic consumption-led one, as Japan and South Korea experienced decades earlier.

Of course, there are some reasons to be concerned that the pessimistic scenario will play out. First, weak macro data have been published, especially in the industrial sector. The forward-looking manufacturing purchasing managers' index (PMI) says it all: it has

declined to the lowest level in 6.5 years. In that context, it is no surprise that investments are growing at the lowest rate in 15 years (which still is more than 10% year-on-year). Secondly, the weak data concerning industrial production is not expected to abate soon. Factories are saddled with overcapacity and the nationwide construction boom is abating. Thirdly, China has to deal with its huge debt burden, of about 280% of GDP, which is the result of government stimulus programmes that started in 2008.



Source: IHS

On the other hand, private consumption is, to a certain extent, counterbalancing investments. The rising incomes of migrant workers (which rose by 10% year-on-year in the second quarter) are spent more and more on furniture, home electronics and even jewellery. Overall, retail sales have increased by more than 10% in real terms this year. Besides this, sales growth is probably underestimated, as services are not included in the retail figures and surveys show that services account for about 40% of consumer spending in China. The services PMI, in contrast with its manufacturing counterpart, is well above the neutral 50 mark. In addition, the services sector now employs more people than the industrial sector.

Another structural tailwind for spending is that the high savings rate of Chinese housholds is expected to fall due to the greying population. Older people draw down their accumulated wealth and the younger generation is more eager to spend than the older generations were some decades ago.

Whether the transition towards consumption-led growth will occur with a hard landing depends primarily on the tools the authorities can use. At the moment, they seem to have enough ammunition to get the economy on the right track. Monetary policy has already been loosened and the People's Bank of China (PBC) has more room to lower rates further. Inflation is rather low at only 2%, whereas the lending rate is still at 4.6%.

The central government also has some room to help the economy. During the summer, fiscal spending rose rapidly, which will be felt in the economy with some lag. The central government is in a position to prolong the fiscal stimuli, but with overcapacity in a lot of sectors, this questions the potential effectiveness of it. Future measures could also be limited by local governments who are in a weaker fiscal position than the central government. They face straitened circumstances because of the introduction of tougher regulatory controls on local government financing vehicles (LGFVs). They try to preserve their spending plans by replacing expensive bank loans with bonds. However, the provinces' dependence on central government funding will make it hard to price default risk effectively.

The tools that the authorities have will most likely allow China to avoid a hard landing, but the high level of total debt will be an obstacle. Besides the local governments, real estate and related industries are highly leveraged, including state-owned enterprises in the real estate sector, as well as in the mining and utilities sectors. Whereas public debt as a percentage of GDP is still much lower than in Europe and the US, total debt excluding the financial sector exceeds the levels there. The debt problem also means that the PBC will remain cautious with further easing of the monetary policy, but still has more targeted means of creating more liquidity in the economy at its disposal.

China's shift from investments to consumption, although gradual, means that the current account surplus should fall in the coming years, from 4% of GDP now to about 0.5% in 2019. The high growth of exports during the period up to 2013 is not expected to return and the services deficit will widen sharply because of rising tourist expenses abroad and the liberalisation of services trade.

The rest of Asia, and emerging economies in the rest of the world, are confronted now with weak demand from China. Imports are declining this year more than 2% year-on-year, and probably will show weak growth again in 2016. Furthermore, a growing portion of imports will be used for domestic consumption rather than in export-oriented manufacturing. The consumption boom in China will not support the world economy as much as the investment boom of the last

two decades. Chinese consumers may buy more South Korean cosmetics and spend more money on vacations in Thailand or the Maldives, but this will not compensate the loss of demand that Indonesian coal mines and Malaysian oil producers will experience.

At a further point in the future, devaluation of the Chinese currency is also a risk for China's trade partners. Since the devaluation over the summer, the PBC has intervened extensively in the foreign exchange market to support the currency, while capital is flowing out of China. Because of this, China's foreign exchange reserves tumbled so much that concerns about the PBC engaging in a currency war have quieted. Up to now, we have seen the devaluation as part of the process towards a more freely floating renminbi. A second step is not probable in the near term. The fall in the foreign exchange reserves in nominal terms was large, but, in relative terms, and compared to other countries, it was limited. However, like other countries with currency pegs, China will eventually allow a further renminbi depreciation.

India: outpacing the others

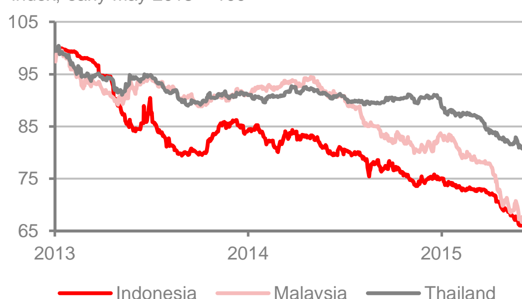
India's growth outlook is the brightest in Asia with a 7.5% expansion of the economy forecast for 2015. The country is reaping the benefits of a stable government, low oil prices (as it is a net oil importer), and record portfolio and direct investment. Domestic demand has been rising on the back of strengthening fixed investment and industrial production. The forward-looking manufacturing and services PMIs are optimistic. However, India's growth story is not without challenges in the near term.

The economic slowdown being seen across emerging markets weighs on India's growth as well – namely through lower demand for Indian exports. Furthermore, ambitious and necessary structural reforms are also progressing at a slow pace due to fierce opposition in the upper house of parliament which is weighing on investor sentiment. These have led to a reduction in India's 2015 growth forecast, but are expected to improve slightly next year, and more so in the medium term should structural reforms be effectively implemented. It is anticipated that India willcontinue its healthy expansion in 2016 with 7.8% growth expected.

ASEAN: turbulent times ahead

The ASEAN economies of Southeast Asia are entering turbulent times from a good starting position. For the so-called ASEAN-5 (the five largest developing ASEAN markets: Indonesia, Malaysia, Philippines, Thailand and Vietnam), economic growth is forecast at 4.6% for 2015, flat from the year before. The aggregate number remains relatively strong, but the region is diverse and external challenges are rising, with each market forced to confront them differently.

3.3 Exchange rate vis-a-vis the US$
index, early May 2013 = 100



Source: IHS

ASEAN's industrial powerhouses of Indonesia, Thailand and Malaysia are countering the hostile external environment by widening the tax base and shifting spending from (fuel) subsidies to considerable infrastructure investments. Meanwhile, they face serious political challenges at home, hindering, but not preventing, the implementation of effective policy. In Thailand, a military government has returned stability, but a military push for constitutional redesign stirs fears of possible unrest. In Malaysia, alleged corruption by the prime minister and a crumbling opposition have led to protests and endangered the ruling coalition. Reformist president of Indonesia, Joko Widodo, has to battle establishment forces to push through necessary reforms and investment.

Thailand is relatively insulated from external trends through its currency, which is one of the region's most stable, is helped by strong fundamentals in the form of high reserves, low foreign currency debt and low portfolio liabilities. Limited dollarisation and high long-term FDI versus portfolio investment make monetary easing a viable stimulus. However, soaring private debt levels over 150% of GDP and declining regional competitiveness will render such policy ineffective, as debt-driven domestic demand cannot be expected to grow much more and exports decline, causing slow

growth. While Thailand has a reasonably diversified economy – it is not a major mineral exporter and does not depend on China for the bulk of its exports – falling export volumes through the beginning of the third quarter still indicate vulnerability to falling external demand and possibly more structural factors. Even so, the Thai economy is showing renewed growth under the military regime. Growth is headed for 2.7% in 2015 and to a solid 3.4% in 2016. This, however, is based on government investment and a return of confidence that may fade as a result of tensions surrounding ongoing constitutional revision and elections set for 2017.

In Malaysia, private consumption continues to drive GDP growth despite rising private sector indebtedness and household debt (87% of GDP at the end of 2014). This is followed by high investment, partially driven by government expenditure. These factors are expected to drive economic growth to 4.8% in 2015 and 4.7% in 2016, in spite of downward pressure on net exports. The Malaysian ringgit has fallen very hard on the back of commodity prices as well as political fall-out from an ongoing corruption scandal that has hurt investor confidence. Portfolio investment and external finance requirement in Malaysia are high compared to reserves, making the ringgit more vulnerable than the Thai baht in the current environment. Dependence on foreign currency inflows from substantial oil and commodity exports amplifies this effect. The ringgit is now undervalued and should be expected to rise but, surprisingly, sharp currency depreciation has not led to high inflation.

Currency woes are more of a headache for Indonesia, which has seen a similarly deep fall. Downward pressure will most likely persist over the coming year due to the slowdown in China and low commodity prices which have reduced exports. This has left Indonesian firms increasingly vulnerable due to their large share of external debt. Corporate external debt has more than doubled since 2010 and is now 71% of total exports, the highest such ratio in the world. This increases refinancing risk for firms and their vulnerability to exchange rate depreciation. Overall, the external debt and current account deficit are relatively low and access to liquidity is very strong for Indonesia. Therefore, corporate external debt is a firm-specific, rather than country-wide issue.

Rupiah depreciation also has wider implications for the Indonesian economy. It is contributing to already high inflation through rising import prices. High import prices stifle previously promising consumption growth, while the central bank cannot ease interest rates for fear of weakening the currency further. Infrastructure spending is lower than planned due to establishment politicians clinging on to fiscal discipline and because of spending inefficiencies, leading to lower-than-potential, but nonetheless high economic growth. Foreign exchange controls have been implemented to reduce dollarisation. With the currency outlook still uncertain, the overall economic outlook for next year is positive with 5.2% expansion forecast.

Thailand and Malaysia will refrain from instituting foreign exchange controls, and overall, flexible exchange rates serve as an effective shock absorber while increasing export competitiveness. Real central bank interest rates remain relatively high and help retain capital and support currencies. Growth is robust but risks linger, and much depends on the ability of the respective governments to implement effective policies while navigating troubled political waters.

Latin America: dragged down by Brazil and falling commodity prices

Economic developments in Latin America continue to disappoint. This resource-rich region is particularly exposed to the slowdown in China and falling commodity prices, with commodities accounting for over 50% of exports and 10% of GDP. Policy shortcomings in some countries, most notably Brazil, which represents 40% of regional GDP, are negatively affecting regional economic growth.

Table 3.3 Real GDP (annual % change)

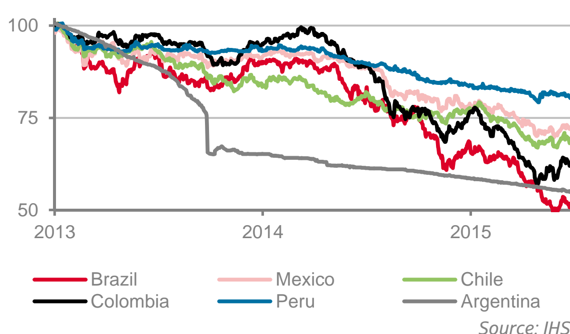
	2014	2015f	2016f
Argentina	0.5	0.9	0.8
Brazil	0.1	-2.8	-1
Chile	1.9	2.1	2.4
Colombia	4.6	2.8	2.8
Mexico	2.1	2.3	2.8
Peru	2.4	2.7	3.5
Venezuela	-3.7	-7.8	-3.7

Source: Consensus Economics (October 2015)

Meanwhile, intra-regional divergences persist. The energy importing and manufacturing countries focused on the US will benefit from cheaper oil and a recovering US economy. These countries are mainly located in Central America and the Caribbean. The

economies of the Pacific Alliance countries – Chile, Colombia, Mexico, and Peru – are holding up and continue to perform above average, despite lower commodity prices. This reflects a much improved ability to withstand shocks stemming from global headwinds than in the past. Stronger policy frameworks, a large stock of foreign-exchange reserves, and modest external refinancing needs enable them to use the exchange rate as a shock absorber. The latter is also true for Brazil, given its still modest external financing needs.

3.4 Exchange rate vis-a-vis US$
early May 2013 = 100



Source: IHS

Argentina and Venezuela: waiting for elections

In both Argentina and Venezuela, hopes for a policy change are elevated ahead of legislative elections, scheduled for late 2015. Credit risks in the short- to medium-term remain very high, independent of who wins, given the dire state of their economies. A change to more market-friendly policies is most likely in Argentina, but also here, unwinding the huge macroeconomic imbalances will be a prolonged affair, undermining growth prospects for 2016.

Presidential elections in Argentina, where the government remains in default, will bring an end to the Fernández administration, as she's unable to run for a third term. The candidate of the government coalition, Daniel Scioli, won the first round against opposition candidate Mauricio Macri, but not by enough votes to take the presidency outright (second round on November 22). Both candidates advocate more liberal, business-friendly policies than the current administration, but implementation speed would differ. A policy shift under Scioli would be more gradual and moderate, whereas Macri's approach would be more forceful. Both candidates have also prioritised reaching a deal with the holdout creditors. Although this is a necessary condition to improve prospects in the medium-term, it will not be sufficient as it needs to be accompanied by a return to more orthodox macroeconomic policymaking.

Meanwhile in the run-up to elections, policies are further radicalized to preserve official reserves and stabilise the exchange rate causing macroeconomic imbalances to continue to grow. Economic growth is being supported by very expansionary fiscal policies, which undermine government creditworthiness and result in accelerating inflation and capital flight. Thereby, they are actually deepening the economic crisis. The risk of uncontrolled currency depreciation and transfer and convertibility risk remains extremely high, given still substantial peso overvaluation, tight liquidity and lack of access to international capital markets. This creates a challenging environment for the next government that takes office in December.

Venezuela's economy is in free-fall, following the most recent drop in oil prices, as oil accounts for almost all exports. With the economic contraction deepening, inflation is accelerating and shortages are growing. In this environment, the ruling Partido Socialista Unido de Venezuela (PSUV) will most likely face massive losses at December 6 legislative elections. Although political confrontation is likely to increase after the election, a policy change is highly unlikely and it is generally expected that president Maduro will stay in office. Next presidential elections are not due until December 2018. Foreign exchange remains extremely scarce as official reserves have dwindled due to low oil prices and allocation is subject to bribe and political relations which result in long waiting lists and payment delays. The country is heavily reliant on financing flows from China, which funds its rising external financing requirements. Financial fragility and the absence of immediate policy change keep risks of devaluation, transfer & convertibility and default extremely high over the outlook period.

Brazil: confidence shaken, current account rebalancing

Credit risks are rising further in Brazil and short-term prospects have deteriorated. The economic contraction is deepening, confidence is badly shaken by a corruption scandal at oil giant Petrobras and mounting political turmoil, and the currency is depreciating. As a glimmer of hope, export volumes are rising due to rising oil production and mining, while external imbalances are narrowing more rapidly. This illustrates the ability of the exchange rate to

absorb shocks. This ability is underpinned by still relatively low external debt and refinancing needs. Meanwhile, international reserves remain high and provide a sound buffer against external shocks. In the medium-term, credit risks should gradually improve, provided that the government is able to restore trust in its fiscal consolidation programme and will push through structural reforms.

Brazil's economic contraction has deepened in the course of the year, on the back of much needed fiscal and monetary tightening by the new economic team, declining business and consumer confidence and a much larger than anticipated negative impact of the Petrobras corruption scandal on the construction sector. Annual real GDP shrank by 2.6% in the second quarter of 2015. Meanwhile, annual inflation jumped to 9.6% in July due to tax increases and currency depreciation but appears to have stabilized since then. Still, at this level, inflation remains well above the 6.5% ceiling of the central bank's target range.

Fiscal consolidation is becoming increasingly difficult due to the deeper economic contraction, higher interest rates and a hostile congress obstructing fiscal adjustment measures. As a result, doubts about the ability and willingness of the government to push through its fiscal adjustment plan have increased. These doubts were reinforced over the summer, when Finance Minister Joaquim Levy sent an unambitious draft 2016 Budget Bill to Congress. This triggered the loss of Brazil's sovereign investment grade rating by rating agency S&P and resulted in a full-blown confidence crisis with the currency breaking the psychological 4.00 barrier vis-à-vis the USD and hitting a low of 4.21 on September 24. The government has responded with a course of measures: it has made revisions to its 2016 budget and reinstalled the primary surplus target of 0.7% of GDP, the central bank has offered foreign exchange credit line auctions to stem currency depreciation, and president Dilma Rousseff has reshuffled her cabinet increasing the share held by junior coalition member, the PMDB. This has somewhat restored confidence but the currency is still over 30% weaker compared to a year ago and volatility will persist until there is greater clarity over the outlook for public finances.

Currency depreciation and a deepening economic contraction are increasing fears over the health of corporate balance sheets. Non-financial corporate debt in Brazil has increased from 30% of GDP at the end of 2007 to 51% of GDP in the first quarter of this year. Although the level is still modest, the increase is one of the strongest among emerging market economies. As a risk mitigating factor, almost 90% of this debt is financed domestically and in local currency, which mitigates refinancing and currency risk of corporates. Still, external debt of Brazilian corporates is at 49% of export receipts relatively high. However, most companies that do borrow in foreign currency appear to be adequately hedged. That said, corporates operating in the commodity sector, that have borrowed extensively in foreign currency, do face a challenging environment as their earnings are negatively affected by low commodity prices. Moreover, their debt servicing costs are under upward pressure from currency depreciation.

Positively, currency depreciation and weak domestic demand are contributing to a much needed adjustment of the external accounts. The trade balance has returned to surplus last spring as imports are contracting faster than exports and the current account deficit has narrowed by a third in nominal terms in the period January-August of 2015. Although exports are still falling in nominal terms on the back of low commodity prices, they have grown significantly in volume in the first half of 2015 due to improving mining activity and record high oil production as offshore fields started producing. However, export momentum lost steam over the summer illustrating the challenging environment for Brazil's economy. For a solid improvement in Brazil's earnings capacity, the government needs to regain confidence and push through with its fiscal adjustment programme. Overall, Brazil's shock absorbing capacity remains strong and underpinned by a diversified economy, a sound banking system, low external debt and solid international reserves.

Mexico: lacklustre economy, energy reforms progressing

Mexico's economy continues to underperform due to domestic political woes and tougher external conditions. The outlook is cautiously optimistic and remains closely tied to that of the US, its main trading partner (80% of exports, 25% of GDP). The country remains well positioned to deal with headwinds from lower oil prices, the fall-out from the Chinese stock market crisis and the impending lift-off of interest rates by the Federal Reserve due to its strong shock absorbing capacity. This is underpinned by sound macroeconomic policies, a stable macroeconomic environment, moderate external debt financing

requirements and sufficient buffers. This has enabled the government to use the exchange rate as a shock absorber. Medium-term growth prospects will profit from opening up key sectors such as energy and telecom, to greater competition and investment. But the extent will depend on the government's success in dealing with institutional weaknesses and high crime rates, which continue to hinder economic growth.

The government of president Enrique Peña Nieto of the Partido Revolucionario Institucional (PRI) has, during the first half of its term, successfully pushed through an impressive structural reforms agenda, including an historic energy sector reform. Although the first auction of shallow water oil fields in July 2015 failed, the government proved to be a quick learner as it adjusted contract terms, thereby showing its continued commitment to these important reforms. The second auction on 30 September went much better, with three of the five fields being sold, one of them to Eni of Italy, which was a welcome sign of faith from one of the world's energy majors. These fields are expected to generate a peak of 90,000 b/d of light and medium crude oil by 2022 and to reverse the downward trend in oil production by 2018.

So far Peña Nieto has had little success in dealing with institutional weaknesses and high crime rates. Worse even, under his presidency, institutional quality and security have deteriorated. His government is suffering from a crisis of confidence after repeated corruption and crime-related scandals since September 2014. This has weighed negatively on confidence and domestic demand. Combined with fiscal consolidation to deal with the negative impact of lower oil prices on government finances, this resulted in a slowdown of annual real GDP growth to 2.2% in the second quarter of 2015 from 2.6% in the previous two quarters. This marked the 10th consecutive quarter in which annual GDP growth was below 3%.

On a positive note, real exports growth has been picking up since the start of this year. Going forward, domestic demand will be supported by declining inflation (2.5% year-on-year in September 2015) and improving business and consumer confidence since last September, albeit from low levels. The latter might be profiting from the approval by Congress of a new anti-corruption framework in May 2015, which is a step in the right direction. Still, a comprehensive and long-term strategy to improve law enforcement and the independence of the judiciary system and to overhaul police institutions remains badly needed for a solid improvement of the country's medium-term earnings capacity.

Chile, Colombia, Peru

Economic growth in the other Pacific Alliance members, copper producers Chile and Peru and oil producer Colombia, is weakening due to further declines in commodity prices, with Chile and Peru being most exposed (commodity exports represent 25% and 16% of GDP respectively). However, prospects are generally good, as growth should profit from government investments in infrastructure (Peru and Colombia) and an expansion of mining activity (Chile and Peru). Meanwhile, sound economic policy frameworks keep inflation expectations in check.

Solid macro fundamentals and sound policy frameworks also mean that these countries are well positioned to deal with the challenges stemming from a Fed lift-off and continuous low commodity prices. They can generally use the exchange rate as a shock absorber (Chile and Colombia) or they can use extensive buffers to deal with the commodity shock (Peru). Moreover, these sound macro fundamentals and policy frameworks mitigate external refinancing risks. So does good access to international capital markets and sufficient reserves, which in the case of Colombia are being underpinned by a flexible credit line from the IMF.

Central and Eastern Europe: stuck in the middle

Many of the Eastern European economies have shown resilience in 2014 and 2015 and are forecast to continue their positive performance in 2016. Central Europe is leading the region with Poland, Hungary and the Czech Republic posting strong economic growth. They have benefited from the recovering eurozone economy, the lower oil price and the quantitative easing programme initiated by the European Central Bank (ECB). As a result, exports have grown and inflation remains low boosting consumer purchasing power. The economic expansion in these markets is based on both internal and external demand, making it rather solid and likely to last.

Table 3.4 Real GDP growth (%) – Eastern Europe

	2014	2015f	2016f
Czech Republic	2.0	4.1	2.6
Hungary	3.7	2.8	2.4
Poland	3.4	3.5	3.5
Romania	2.8	3.5	3.5
Russia	0.6	-3.9	-0.1
Turkey	2.9	2.9	2.8
Ukraine	-6.8	-10.8	0.8
CIS	1.0	-3.1	0.6

Source: Consensus Economics (October 2015)

The story is not so bright further east. The Russian, Ukrainian and CIS economies are contracting in 2015 and are set to see only mild improvements in 2016. EU sanctions on Russia and counter sanctions imposed by Russia, the conflict in Ukraine, the Russian recession and low oil prices are being felt across Eastern Europe. The Turkish economy is still growing, but at a much slower pace than previously expected. All of these countries are facing currency volatility and are vulnerable to external shocks.

Russia: coping with decline

The situation in Ukraine is moving towards a frozen conflict situation, with the intensity of the conflict waning. Russia is not willing to bring the Donbas region under its full control, and Ukraine is not able to do so. Under these circumstances, international sanctions are likely to be renewed in January. Russia recently stepped up support for the government in the Syrian conflict which may not help in this context as it threatens to thwart western attempts to halt the IS surge.

Meanwhile, the internal political situation in Russia is stable. This helps to cope with the current recession, which is now estimated to be a bit milder than we expected previously: a 3.8% GDP contraction in 2015 (a 4.1% GDP contraction was estimated in May 2015). 2016 growth is expected to be nearly flat. The state supports firms and directs them if needed. Firms simply often impose wage cuts rather than mass redundancies to cope with demand decline. Potential social unrest, especially in single firm cities, can thus be avoided. That is a wise strategy as private consumption is forced to take a severe hit, by about 10% in 2015 and another 2% in 2016. September 2016 parliamentary elections will be tightly managed and will most likely keep the current government in control. Opposition, if any, is weak.

The recession of this year is driven by the low oil prices. Russia is following OPEC's footsteps, trying to counter the low prices by turning the tap to the maximum in order to maintain market share. Indeed, despite the price fall to a below USD 50 per barrel for Brent, Russian oil production has been kept at the level of about 10.6 million barrels a day through 2015. The continued oil price slump during the summer has clearly not helped. The rouble was again sent on a downward path versus the US dollar, pushing up inflation to record levels of 16% in May. That in turn put a dent in consumption as wages did not keep up. Inflation is expected to slow to around 8% in 2016, as oil prices are expected to climb gradually. This will help Russian GDP as well.

Underlying problems will not be helped, however, future growth opportunities remain limited. As we have mentioned in previous Economic Outlooks, the business climate is plagued by uncertainty regarding property rights, a weak transport infrastructure and lack of competition in goods and services markets. That is an underlying deterrent for investments, badly needed to modernise the energy sector and help diversify the economy. But investment has been low and under continuous pressure since the 2008 crisis. This is now exacerbated by the international sanctions that aim to prevent technology transfers and financing to Russian firms, especially in the energy and defense sectors. Russia still needs to find a way to cope with this to avoid long-term decline.

3.5 Russia: Fixed investment

Source: IHS

Despite the recession and, at best, lacklustre medium-term growth prospects, Russian macro fundamentals look reasonably solid. The floating rouble helps to

maintain the external balance. Indeed, for 2015, a current account surplus of 3.6% is expected as it is anticipated that imports will contract sharply by almost 30% and that exports will grow by only 2%. Foreign debt and government debt are both low. For 2016 a current account surplus is expected as well. Macro policy seems relatively accurate, as the IMF confirms.[18] The central bank uses monetary policy room if possible and has now brought back the benchmark rate to 11% from 17.5% during the late 2014 crisis. The government clearly indicated its intention to provide capital or foreign exchange support to firms and banks. It is using the Reserve and Wealth Funds to smooth the decline in government expenditures as well. Erosion of international reserves has halted. According to the IMF, reserves are currently sufficient. At this stage, Russia appears to be coping relatively well with the recession.

Still, Russian corporate foreign debt is, related to exports, one of the highest in the emerging economies, as presented in Chapter 1. This is compounded not only by high interest rates, pressure on capital flows and the rouble, but also international sanctions that severely hinder foreign (re)finance. Therefore, despite the relatively deep coffers of the Russian state, Russian foreign corporate debt is indeed an issue to be watched carefully.

CIS: victims of circumstance

The economic crisis in Ukraine seems to have finally stabilised but it remains very difficult. Consumer spending and private investment have dropped while external demand for Ukrainian exports has declined due to the recession in Russia and low global oil prices. The economy is expected to contract 10.8% in 2015. A slight recovery from a very low base is expected in 2016, but Ukraine's outlook is mired by downside risks. A re-escalation of the conflict with Russia, global financial market volatility and a decline in popular support for the reforming government would have devastating effects on this vulnerable country.

Overall, most CIS countries have been severely affected by the drop in oil prices and the recession in Russia. This is especially true for the region's energy exporters (Azerbaijan, Kazakhstan, Turkmenistan and Uzbekistan). Pressure from rouble depreciation, as well as low oil prices, have forced national currencies to be devalued in several countries like Azerbaijan and Kazakhstan. While these devaluations are often painful adjustments, there is a trend away from fixed exchange rate regimes toward allowing currencies to float more freely against the US dollar. This will protect these economies' international reserves and also help them to absorb external shocks more smoothly in the future. The recession in Russia has also weighed on the outlook for the region's energy importers (Armenia, Georgia, Kyrgyz Republic and Tajikistan). A more challenging labour market and a weaker rouble in Russia are weakening remittances which are an important source for consumption and economic growth across many CIS economies.

Turkey: unstable politics, rebalancing slowing

Credit risks in Turkey remain elevated. Economic developments were better than expected in the first half of 2015, but increased domestic political instability since then is weighing negatively on Turkey's already mixed prospects. A drop in confidence is counterbalancing positive effects on domestic demand from low oil prices and is adding to its already high vulnerability to a normalisation of US monetary policy and shifts in market sentiment. Turkey is one of the most exposed economies to such shocks, due to its high stock of portfolio inflows, relatively low buffers and persistently high external financing needs. The latter limits the ability of the exchange rate as a shock absorber and has raised concerns about private sector creditworthiness, considering rapidly rising external debt. Sound government finances and a healthy banking sector remain risk mitigating factors.

Political risks have increased significantly in the past few months following an inconclusive election of June 7 in which the ruling AKP lost its parliamentary majority after 12 years of single-party government. However, in a surprising victory, the AKP regained its majority in legislative elections on November 1. While this reduces political uncertainty by re-establishing the dominance of the AKP at least until the next presidential election in 2019, other developments continue to heighten political risk. These are the breakdown of the peace process with the Kurdish militant PKK group and the involvement of Turkey in the conflict against IS in neighbouring Syria following a deadly attack of IS in the south of the country.

[18] IMF. Russian Federation. Staff report for the article IV consultation. July 2015.

Table 3.5 Key data Turkey

	2014	2015f	2016f
Real GDP growth (%)	2.9	2.9	2.8
Inflation (%)	8.9	7.6	7.3
Private sector credit growth (%)	18.0	20.0	20
Current account (% GDP)	-5.8	-5.0	-5.2
Portfolio investments stock (% reserves)	151.0	164.0	171
Gross external debt (% GDP)	53.7	58.3	61.9
Net external debt (% XGS)	107.6	125.9	133.4462
External financing need (% reserves)	200.4	170.0	185

Sources: Consensus Economics, Atradius, IFS, IIF, Fitch

Annual real GDP growth was stronger than expected in the first half of this year at 3.1% as domestic demand was boosted by low oil prices and front loading spending ahead of the elections. But momentum slowed in the summer due to recent political uncertainty which exacerbated concerns about the independence of the central bank. This resulted in further currency depreciation and a sharp drop in business and consumer confidence. The lira has lost some 20% of its value vis-à-vis the USD over the course of this year.

A weaker exchange rate and low oil prices (Turkey is a net-importer of oil) have contributed to a narrowing of the current account deficit. The improvement was less than expected and has recently stalled. This is due to falling export demand from the oil producers Russia and Iraq, Turkey's second and third largest export markets.
Large external financing needs and relatively high dollarisation in the Turkish banking system, expose Turkey to exchange rate risk and a Fed rate rise. These risks are most imminent in the corporate sector, as the banking system is healthy and well-hedged. Non-financial corporate debt in Turkey has risen from 25% of GDP end-2007 to almost 57% of GDP in the first quarter of 2015. Although the level is still modest, this is one of the strongest increases among emerging markets. A third of the debt is financed externally, with the share of foreign currency debt being even higher due to dollarisation. Although the Turkish central bank has recently taken measures to reduce dollarisation of domestic lending, this will not address the vulnerability to refinancing and exchange rate risk in the short to medium term. So far, corporates have good access to international capital markets with rollover rates of corporate external debt remaining above 100% and maturities being lengthened. Additionally, non-performing foreign currency loans to corporates from local banks are low at 0.9% end-June, much below the NPL ratio on loans in lira of 3.2%. Most at risk are smaller sized firms.

MENA: pushing through

The intensified security situation and spill-over from the region's conflicts in Syria, Iraq and Yemen are having a negative impact on confidence in the region and constraining economic growth. The collapse in the oil price is thereby hurting the oil-exporting countries in the region. However, ample financial buffers and low public debt are helping these countries to weather the lower oil prices. For instance, high investments in infrastructure are keeping economic growth in Saudi Arabia and the UAE relatively high. Overall, economic growth for the oil exporting countries is expected to slow to 1.8% this year, but to recover to 3.8% next year in line with a higher oil price. Economic growth in the oil-importing countries is forecast to accelerate to 3.9% this year from 2.9% in 2014. In Egypt and Morocco especially, economic growth is picking up through higher domestic demand and exports are benefiting from the gradual recovery in the euro area. The lower oil price is easing the fiscal and external vulnerabilities of the oil importing countries.

Table 3.6 Real GDP growth (%) – MENA

	2014	2015f	2016f
Egypt	2.2	4.3	3.7
Morocco	2.4	4.7	4.0
Qatar	4.0	3.9	4.1
Saudi Arabia	3.6	3.0	3.1
Tunisia	2.3	1.3	3.1
UAE	4.6	3.2	3.2

Source: IHS

Sub-Saharan Africa: facing headwinds

This region has especially been affected by the economic slowdown in China and lower commodity prices. China is one of the largest trading partners for Sub-Saharan countries and most countries are exporting commodities. Oil is the most important commodity, but in the past years the export of metals

have risen sharply in several countries in this region. The lower oil price is having a major impact on the economies of Nigeria and Angola. Growth figures in these countries are much lower than in the previous year and their external finances have deteriorated resulting in depreciating currencies. For the region as a whole economic growth is expected to decelerate to 3.5% this year from 5% in 2014.

Table 3.7 Real GDP growth (%) – Sub-Saharan Africa

	2014	2015f	2016f
Ghana	4.0	3.0	6.0
Kenya	5.3	5.9	6.1
Nigeria	6.2	2.2	2.0
South Africa	1.5	1.5	1.6

Source: IHS

Nigeria: uncertainty rising

The oil price decline is not the only one having a negative impact on the Nigerian economy. Political uncertainty is also affecting confidence. President Buhari won the presidential elections in March and has still not appointed a cabinet. The public and investors are waiting for some clarity regarding its (economic) policies. The country faces major challenges in a low oil price environment. It needs to improve its business environment, tackle corruption, improve the security situation and raise the living standards to increase economic growth in the medium term. The lack of confidence in combination with the low oil price and the expected Fed interest rate increase are keeping the naira under pressure. A further depreciation is therefore expected.

South Africa: external and internal vulnerabilities

The economy of South Africa is expected to show meagre growth figures this and next year. This year economic growth of 1.4% is expected and next year 1.3%. Inadequate infrastructure, especially electricity shortages, skill shortages in labour and persistent strikes along with weak investor confidence are constraining economic growth. Next to those internal factors, weaker external demand and low commodity prices are contributing to the weak GDP growth. The rand is expected to remain volatile due to the large deficit on the current account, which is mainly being financed by short-term debt and foreign participation in the bond and equity market. Therefore, South Africa is also vulnerable toa Fed interest rate increase.

4. Implications for the insolvency environment

Insolvency environment in advanced economies improving

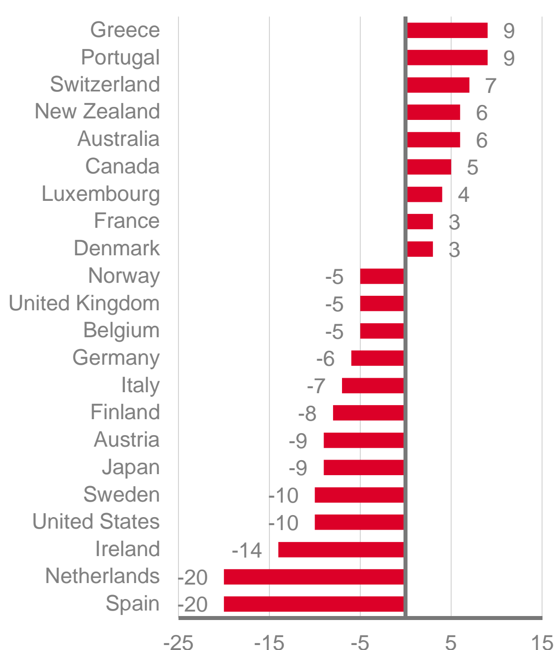
Due to the economic recovery in the advanced economies, we expect a decline in insolvencies in most advanced countries in 2016. However, in Europe the number of insolvencies still remains higher than the pre-2007 crisis level.

Insolvencies expected to go down further in 2016

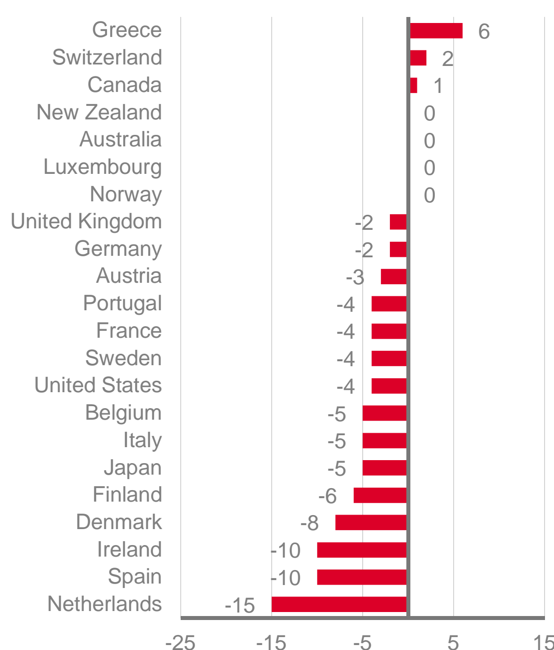
With the Atradius insolvency forecast model being predominantly dependent on business cycle movements, and further recovery in most advanced economies, the insolvency forecast outlook warrants improvement for most of the 22 advanced countries that we track. In Table 4.1 and 4.2, the forecasts for insolvencies growth in 2015 and 2016 are given.

In 2016, we expect the most improvement in the Netherlands, Spain and Ireland. For the Netherlands, this follows a record high level of insolvencies in 2013 and is grounded in the expectation of robust economic growth over the coming period. For many eurozone countries, for instance France and Italy, the decline is expected to be modest. In Germany, where economic growth is stagnating, insolvencies are not expected to decline much at all.

Although the US and UK economies are among the fastest growing advanced economies, only a small further decline in insolvencies is expected in 2016. Likewise, in Japan, we expect the rate of decline in insolvencies to slow down to about half that of 2015 despite the anticipated acceleration in economic growth.



Source: Atradius Economic Research



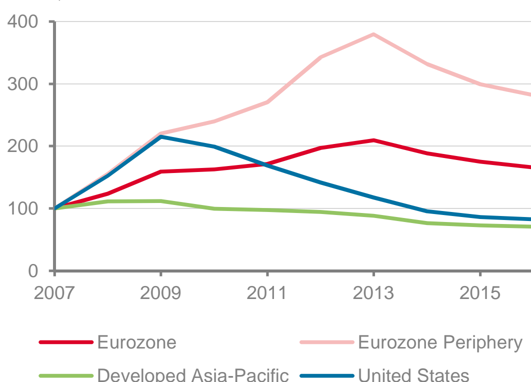
Source: Atradius Economic Research

Insolvencies are not expected to decline everywhere. We anticipate an increase in insolvencies next year for Greece, Switzerland, and Canada, and no improvement in New Zealand, Luxembourg, Australia and Norway. The Greek economy still suffers from debt sustainability and economic distress, with expected contraction of the economy in 2015 and 2016. Greece's poor overall outlook stands alone this time in the eurozone and insolvencies are expected to increase 9% in 2015 and another 6% in 2016. Switzerland's economy is struggling after the change in policy of the Swiss national bank in January 2015. The expected moderate growth in 2016 slows the Swiss insolvency growth however, and its economy is expected to pick up steam later that year.

Level of insolvencies remains high

With this overall improved picture for next year, one should remain aware of the legacy of the crisis. The level of insolvencies in the eurozone remains high and still hasn't reached the pre-crisis level of 2007. Table 4.3 shows how insolvencies have developed since 2007 (2007=100). The eurozone periphery In particular has suffered from the severe increase registered in the period 2007-2013. For these countries, the number of insolvencies in 2016 will still be at, on average, three times the level of 2007. A similar, but less severe picture, can be seen for the euzozone as a whole. While the 2016 insolvency level is declining, it is still forecast to be 66% higher than the 2007 level. Meanwhile, in the US, UK and developed Asia-Pacific, the recovery was initiated earlier on and the insolevency level is expected to be around the 2007 level.

4.3 Insolvency developments
Index, 2007 = 100

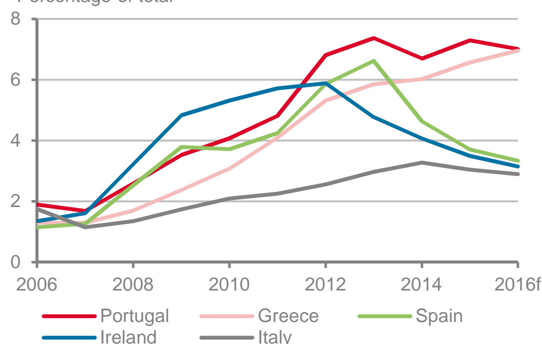


Source: Atradius Economic Research

Insolvency rates in eurozone periphery indicate split

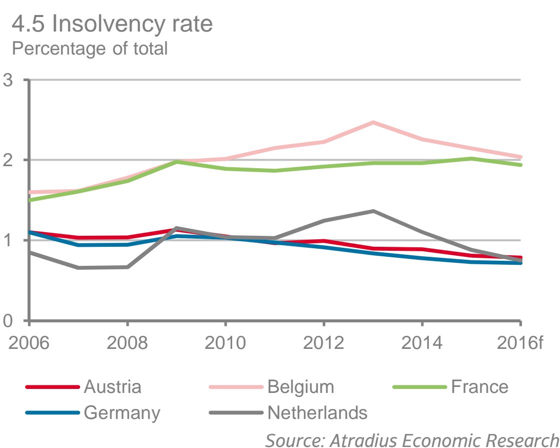
Within the eurozone periphery (Ireland, Portugal, Spain, Italy and Greece) all countries have seen strong growth in insolvencies in the period after 2007. Ireland and Spain have seen a resaonably good recovery since 2012/2013. In Portugal the number of insolvencies stabilized at the higher level. In Greece, the insolvency rate continues to rise. The volatility of the insolvency rate in Italy was relatively low, with the rate increasing steadily, until 2014. In 2015, Atradius expects a slight recovery for Italy. In 2016, the insolvency rate is expected to be the higest in Portugal and Greece, reaching almost twice the rate of Spain, Ireland and Italy.

4.4 Insolvency rate
Percentage of total



Source: Atradius Economic Research

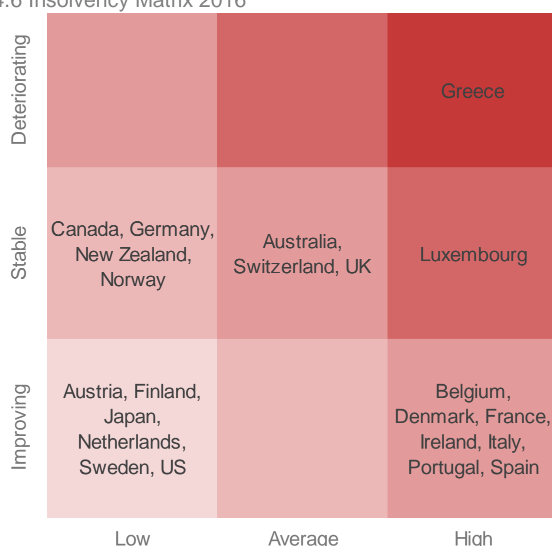
Western European countries show a lower insolvency rate with less volatility on average. Also within the Western European markets, there is a clear split between France and Belgium, on the one hand with a high insolvency rate and Austria, Germany and the Netherlands which show a lower insolveny rate. The insolvency rate in Belgium and France is around 2% and at a higher level than in 2007. Austria, Germany and the Netherlands have an insolvency rate between 0.7% and 0.8%, and are back on or below their pre-crisis level.



Source: Atradius Economic Research

Insolvencies: level and trend

A schematic overview of the insolvency situation in advanced markets is illustrated in the 4.6 Insolvency Matrix. All countries expected to see deterioration in their insolvency environment in 2016 are to be found in the top segment of the grid. Greece is the only country in which insolvencies are expected to increase by more than 2% in 2016. The majority of countries included in our forecasts are expected to display improving insolvency developments (i.e. a drop in insolvency of more than 2%).



Source: Atradius Economic Research

The horizontal axis in the Insolvency Matrix depicts the absolute level of insolvencies – whether the frequency of insolvencies in a country is assessed as low, average or high – in a cross-country comparative context. As such, all countries perceived to be markets with comparatively high insolvency frequencies are to be found in the right-hand segment. Except for Greece and Luxembourg, all countries with a relative high insolvency level are expected to experience an improvement in insolvency levels in 2016: Belgium, Denmark, France, Ireland, Italy, Portugal, and Spain.

Emerging market insolvencies

We also applied our insolvency forecast model to the emerging markets. Because the model has been built on data from advanced countries, forecasts may be somewhat off the mark; for the emerging markets, Atradius therefore only provides a general direction of the expected insolvency developments.

In general, conditions in many emerging markets have deteriorated. Commodity exporters suffer from lower natural resource prices, while the slowdown in China negatively impacts trade and finances in many markets. In addition, many emerging markets struggle with the expected rise in US interest rates and the stronger US dollar. The stagnation of economic growth in the BRIC countries, except for India, is expected to have consequences for the number of insolvencies. India is the only country maintaining its accelarated economic growth and insolvencies are expected to decline this year and in 2016. With China's economy slowing down, insolvencies are expected to increase substantially in 2015 and 2016. Companies face a change in funding conditions and in the structure of the economy as it rebalances towards more services and consumption. This will inevitably lead to shrinking business opportunities in some sectors, and insolvencies, with possibilities opening up in other sectors. Russia and Brazil are both forecast to see a significant increase in insolvencies this year, as financial conditions tighten and their economies contract. Their insolvency rates are forecast to increase further next year as they are expected to only gradually move out of recession.

Table 4.1 Insolvency growth

	2015f	2016f
China	Strong increase	Strong increase
Brazil	Strong increase	Increase
Russia	Strong increase	Increase
India	Decrease	Decrease

Source: Atradius Economic Research

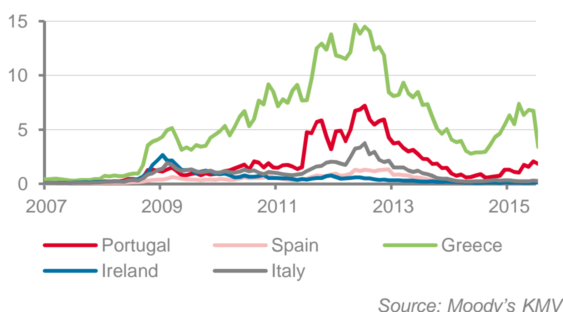
Credit risk developments for large firms

The credit risk for large firms in the eurozone periphery shows a two-fold picture. On the one hand, the expected default frequencies (EDFs)[19] of Spain, Ireland, and Italy have converged at a lower level after a period of high EDF during the financial crisis. However, default levels are still at a higher level than in 2007. On the other hand, EDF volatilities in Greece and Portugal are still high. During the latest Greek debt crisis, its EDF suffered a strong increase, but after that, the EDF showed a remarkable recovery.

Stabilisation of credit risk for large firms in Western European countries is evident as the EDFs have converged and have lost much volatility. The EDFs are back to pre-crisis levels. In addition, the EDF figures are flattered by the expansionary monetary policy of the European Central Bank (ECB), which has pushed up equity prices and lowered financial market risk premia. As this latter effect can be seen as temporary, with the end of the expansion period, EDF figures and volatility could rise again.

4.7 Median EDF - Eurozone periphery

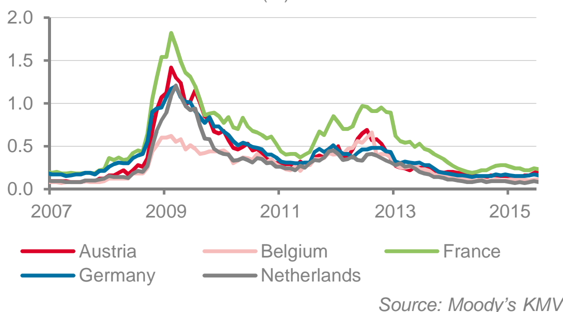
Default risk 12 months ahead (%)



Source: Moody's KMV

4.8 Median EDF - Eurozone

Default risk 12 months ahead (%)



Source: Moody's KMV

[19] The expected default frequency (EDF) tracks default risk among stock-listed companies. Combining balance sheet and stock market information for a particular firm, yields a 1-year default forecast. The median EDF, as referred to in the charts below, represents the 50th percentile in the total country aggregate of firms.

Credit conditions loosened for advanced, but tightened for emerging economies

According to the October 2015 bank lending survey of the ECB, improvements in lending conditions continue to support the growth of lending in the eurozone, particularly for enterprises. The third quarter of 2015 brought further easing of credit standards on loans for businesses, with a decrease of 4%, following a decrease of 3% in the second quarter. For the fourth quarter, the net easing is expected to continue (6% decrease).

According to IIF's 2015 Q2 survey, bank lending conditions in emerging markets, except for Eastern Europe, have been tightened further in the second quarter this year. The main cause of the tightening was deteriorating supply side conditions for new loans, due to renewed volatility in the financial markets of emerging markets since May this year. Overall bank lending conditions have tightened in Asia, Latin America and Sub-Saharan Africa. Also, for the first time since the fourth quarter of 2012, the conditions were tightened in the MENA region. Only in Eastern Europe have the bank conditions eased, after a tightening in the first quarter.

Two-sided picture

The picture is two-sided, with the slowdown of the emerging markets on the one hand and the recovery of the advanced economies on the other hand. The insolvency forecast is positive for most advanced economies, especially for some countries where the number of insolvencies rose rapidly after the financial crisis like in the Netherlands, Spain and Ireland. Along with the good insolvency outlook, the credit risk outlook for large firms is improving and credit conditions are easing. However, the insolvency level in Europe is still substantially higher than before the financial crisis and the higher level of credit risk in the eurozone periphery seems to become structural.

For the emerging markets, the business and insolvency environment has become more challenging and is expected to remain so in 2016. The slowdown in China, the change in US monetary policy and low commodity prices will hit individual companies that are exposed to these risks hard. Many emerging markets may therefore face a rise in insolvencies in 2015 and 2016.

Appendix I: Recent publications

Economic research notes and reports published since January 2015

The slowdown in world trade: temporary or permanent?, October

China stock market crunch should not be overestimated, September

Brexit: top 5 countries and sectors at risk, September

Insolvency Forecasts, August

Russia update: economic and industry outlook, July

Economic Outlook: navigating a new world, May

Iran: potential opportunities and risks, April

Cheap oil: the new normal, April

Weakening euro's effect on the UK market, March

Insolvency Forecasts, February

Most vulnerable countries to Chinese economic downturn, February

Russia update – Lower oil price will take its toll, February

Ending the Swiss franc ceiling, January

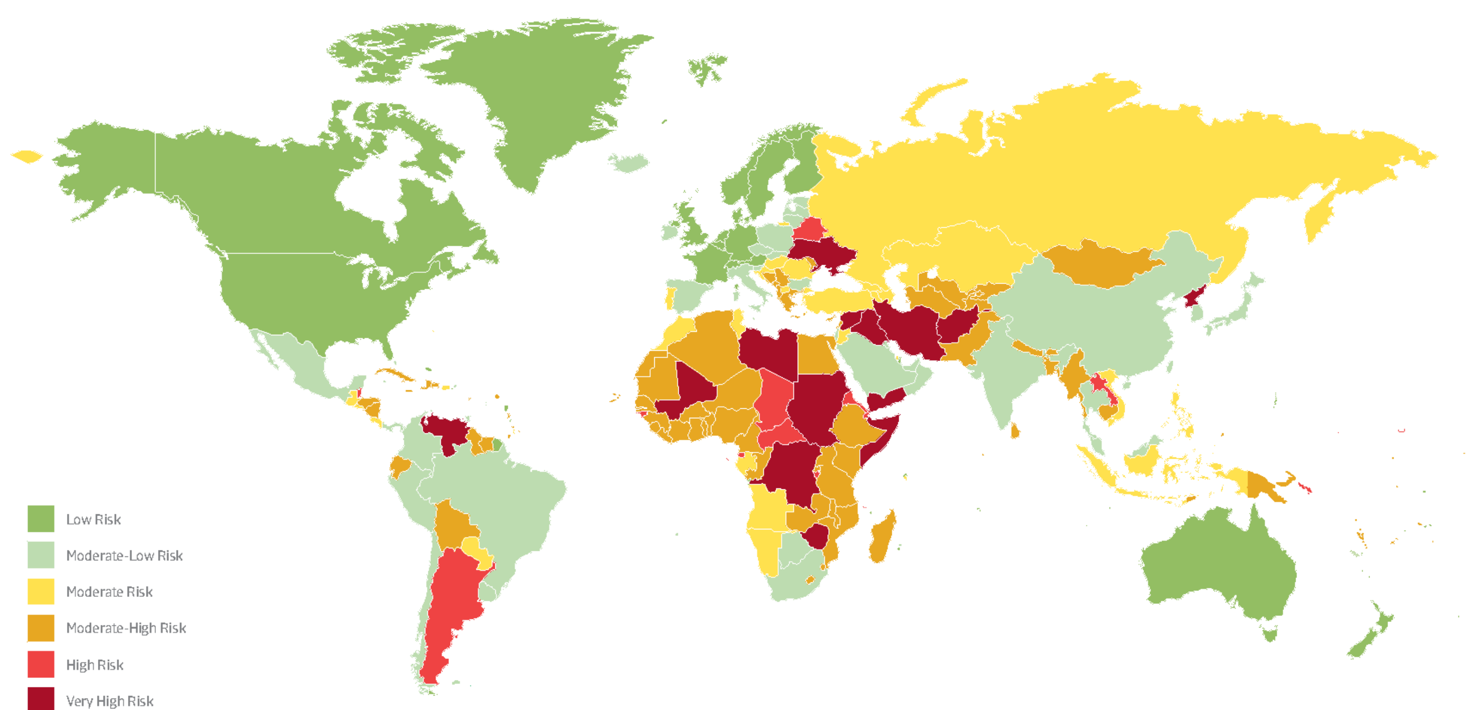
The benefits of a falling euro, January

Impact of a Greek euro exit, January

Lithuania joins the euro, January

Please visit www.atradius.com for an overview of all Atradius Economic Research publications.

Appendix II: Atradius Risk Map



The Atradius Risk Map gives an overview of the level of risk associated with countries worldwide. This map has been created by the Economic Research team and drawn from a range of sources. This map is provided for information purposes only and is not intended as a recommendation as to particular transactions, investments or strategies in any way to any reader. The Atradius Risk Map is updated every month. For the latest version of the map and further information, please visit www.atradius.com/riskmap.

Appendix III: Forecast tables

Table A1: Macroeconomic headline figures - Developed markets

	GDP growth (% change p.a.)			Inflation (% change p.a.)			Budget balance (% of GDP)			Current account (% of GDP)			Export growth (% change p.a.)		
	2014	2015	2016	2014	2015	2016	2014	2015	2016	2014	2015	2016	2014	2015	2016
Australia	2.7	2.0	2.0	2.5	1.7	2.4	-2.5	-2.5	-2.0	-3.0	-3.8	-3.6	6.7	5.4	3.8
Austria	0.4	0.7	1.7	1.6	1.0	1.7	-2.7	-1.8	-1.4	2.0	2.6	3.2	2.1	0.6	3.7
Belgium	1.1	1.3	1.7	0.3	0.4	0.8	-3.2	-2.6	-2.3	1.1	1.2	0.6	3.8	3.9	5.1
Canada	2.4	1.0	1.8	1.9	1.1	2.0	-1.6	-1.9	-1.3	-2.1	-3.4	-2.8	5.4	2.1	2.3
Denmark	1.1	1.7	1.9	0.6	0.5	1.0	1.2	-1.6	-1.4	6.3	5.6	5.4	2.6	1.9	4.1
Finland	-0.4	-0.1	1.0	0.5	0.1	1.1	-3.3	-2.8	-3.3	-1.1	-0.7	0.4	-0.7	0.0	2.3
France	0.2	1.1	1.3	0.6	0.1	1.1	-4.0	-3.7	-3.3	-0.9	-0.6	-0.8	2.4	6.4	3.3
Germany	1.6	1.7	2.1	1.0	-0.2	1.0	0.3	0.6	0.3	7.6	8.5	7.8	3.9	5.2	3.9
Greece	0.7	-1.3	-1.8	0.5	0.0	1.0	-3.5	-3.0	-2.7	0.9	0.9	1.8	8.7	-3.3	-2.0
Ireland	5.2	6.1	4.0	0.9	0.3	1.5	-4.1	-2.3	-1.9	6.1	4.4	4.6	12.1	11.7	3.8
Italy	-0.4	0.7	0.9	-1.3	-1.9	0.5	-3.0	-2.8	-2.5	2.1	2.4	1.8	2.4	3.8	2.2
Japan	-0.1	0.5	1.0	0.2	-0.2	1.0	-4.9	-5.9	-6.0	0.6	2.9	2.4	8.4	2.8	1.9
Luxembourg	4.1	2.8	3.4	0.2	0.1	0.7	0.6	0.2	0.1	5.5	4.5	4.1	6.8	5.1	3.7
Netherlands	1.0	2.1	1.7	2.7	0.8	0.5	-2.3	-1.7	-1.3	10.8	10.3	9.4	4.0	4.8	4.6
New Zealand	3.3	2.2	1.9	0.6	0.6	1.9	-1.8	-0.8	-0.1	-3.1	-3.2	-3.5	3.3	5.3	1.0
Norway	2.2	0.8	0.6	1.0	0.6	1.3	9.1	6.5	6.3	8.5	7.0	8.5	2.6	0.8	1.8
Portugal	0.9	1.7	1.8	1.2	0.6	2.1	-4.5	-3.0	-2.6	0.6	1.5	1.1	3.3	5.4	2.9
Spain	1.4	3.2	2.6	2.0	2.0	2.0	-5.8	-4.7	-3.4	0.7	1.4	1.3	4.2	4.6	4.7
Sweden	2.4	3.0	2.3	-0.3	0.5	0.9	-1.9	-1.0	-0.5	6.1	5.8	5.6	3.7	3.1	3.0
Switzerland	1.9	1.0	1.2	-0.1	-0.5	0.9	-0.1	-0.5	-0.3	7.1	10.0	9.3	3.5	-0.6	3.3
United Kingdom	2.9	2.4	2.4	-0.2	0.0	0.9	-5.2	-3.7	-2.7	-5.1	-4.3	-3.9	1.8	3.4	3.9
United States	2.4	2.5	2.9	0.0	-1.2	-0.5	-3.8	-3.4	-3.6	-2.2	-2.4	-2.2	3.4	1.7	3.4
Eurozone	0.9	1.6	1.7	1.5	0.1	1.2	-2.5	-2.1	-1.8	3.4	3.8	3.4	3.9	4.9	3.8
European Union	1.4	1.9	2.0	1.6	0.0	1.8	-2.9	-2.3	-2.0	1.9	2.2	1.9	3.9	4.7	3.9

Source: IHS

Note: IHS forecasts for 2015 and 2016. These forecast values are provided as an indication of direction, representative of one vendor's view only. The values in the table may therefore differ from the Consensus values quoted throughout the report.

Table A2: Macroeconomic indicators - Developed markets

	Private cons. (% change p.a.)			Fixed investment (% change p.a.)			Government cons. (% change p.a.)			Retail sales (% change p.a.)			Industrial prod. (% change p.a.)		
	2014	2015	2016	2014	2015	2016	2014	2015	2016	2014	2015	2016	2014	2015	2016
Australia	2.4	2.5	2.7	-2.1	-2.8	-1.4	2.0	2.1	0.5	2.8	2.3	3.0	4.6	1.5	2.2
Austria	0.1	0.3	1.2	-0.1	-0.6	2.9	0.8	1.1	1.1	-0.5	-0.1	1.9	-0.3	1.2	2.4
Belgium	0.9	2.1	1.7	5.1	2.0	-0.1	1.0	0.3	0.5	0.0	0.8	1.7	0.9	0.3	2.0
Canada	2.7	2.0	2.2	0.2	-2.7	-0.4	0.2	0.7	1.8	2.6	1.1	1.2	4.1	-0.9	0.1
Denmark	0.8	2.0	1.4	4.0	0.9	4.5	0.2	1.6	1.5	-0.4	0.9	0.8	1.0	1.9	1.8
Finland	0.5	0.7	0.7	-3.3	-2.8	1.4	-0.2	-0.1	0.2	-2.0	-0.9	4.3	-2.0	-2.8	1.0
France	0.7	1.6	1.4	-1.2	-0.5	1.7	1.5	1.6	1.2	0.8	2.8	1.4	-1.1	0.8	0.9
Germany	1.0	1.9	1.9	3.5	2.4	3.1	1.7	1.9	1.3	1.0	2.6	0.8	1.5	1.5	2.5
Greece	1.4	-0.2	-2.6	2.9	-10.4	-9.5	-0.8	3.3	0.1	0.2	-0.9	-1.8	-1.9	-2.0	-2.7
Ireland	2.0	3.1	3.4	14.0	16.6	3.0	4.5	3.0	3.0	3.9	6.8	7.9	20.9	14.9	0.5
Italy	0.3	0.6	1.0	-3.2	0.7	1.0	-1.0	0.1	0.3	-1.4	0.8	1.3	-0.5	1.0	1.5
Japan	-1.3	-0.7	1.4	2.5	0.5	2.6	0.2	0.9	-0.1	-1.0	-1.3	2.4	2.1	-1.0	0.8
Luxembourg	3.8	0.3	3.5	14.3	-2.0	7.5	0.2	4.5	1.5	7.9	-9.8	1.6	5.7	1.3	3.4
Netherlands	0.0	1.9	1.4	3.5	9.3	2.7	0.3	0.2	1.9	-0.5	1.2	0.7	-2.9	-0.5	2.0
New Zealand	3.2	2.7	3.0	8.8	2.2	0.3	3.4	2.5	1.2	2.7	3.4	1.8	2.6	0.0	1.7
Norway	2.0	2.4	1.7	0.7	-4.6	-2.8	2.7	2.1	3.3	1.4	1.0	0.8	3.5	0.3	0.9
Portugal	2.2	2.1	1.3	2.5	5.5	3.1	-0.3	-0.6	0.7	-1.1	0.6	1.2	1.6	2.3	2.5
Spain	2.4	3.6	2.6	3.4	5.7	3.9	0.1	1.1	-0.4	0.6	2.0	2.2	1.2	2.6	2.0
Sweden	2.3	2.0	1.8	7.7	4.8	3.7	1.8	1.6	1.4	2.9	4.3	2.7	-1.7	2.7	3.3
Switzerland	1.3	1.1	1.3	2.1	1.4	2.0	1.3	2.5	1.1	0.1	-1.4	1.7	1.4	-0.8	1.7
United Kingdom	2.6	3.0	2.9	7.5	4.0	4.8	1.9	1.8	0.3	1.7	1.5	2.8	1.4	1.2	1.4
United States	2.7	3.2	3.3	4.1	4.3	6.4	-0.5	0.3	0.5	2.2	2.3	3.3	3.7	1.3	2.0
Eurozone	1.0	1.7	1.6	1.4	2.2	2.3	0.8	1.2	1.0	-	-	-	0.5	1.4	1.8
European Union	1.4	2.1	2.0	2.7	2.7	2.9	1.1	1.4	0.9	-	-	-	0.8	1.6	2.0

Source: IHS

Note: IHS forecasts for 2015 and 2016. These forecast values are provided as an indication of direction, representative of one vendor's view only. The values in the table may therefore differ from the Consensus values quoted throughout the report.

Table A3: Macroeconomic headline figures - Emerging markets

	GDP growth (% change p.a.)			Inflation (% change p.a.)			Current account (% of GDP)			Private cons. (% change p.a.)			Export growth (% change p.a.)		
	2014	2015	2016	2014	2015	2016	2014	2015	2016	2014	2015	2016	2014	2015	2016
Asia Pacific	6.0	5.4	5.5	3.0	2.2	3.0	2.0	3.6	3.3	5.2	5.1	5.2	4.0	2.4	4.8
ASEAN	4.4	4.2	4.1	4.1	2.9	3.3	3.2	4.4	4.0	4.5	4.9	4.6	3.4	1.8	3.5
China	7.3	6.5	6.3	2.0	1.7	2.6	2.1	4.2	4.3	6.8	6.3	6.0	5.9	3.5	6.1
Hong Kong	2.5	2.2	2.5	4.4	2.7	3.3	1.8	3.5	3.2	3.2	3.6	2.7	0.8	-0.6	1.5
Taiwan	3.8	1.9	2.5	1.2	-0.3	0.9	12.4	13.8	14.7	3.0	2.9	2.8	5.9	-0.1	1.7
India	7.3	7.4	7.5	6.8	4.9	5.6	-1.5	-0.8	-2.3	6.3	6.8	7.4	-0.6	2.1	6.7
Singapore	2.9	1.6	2.0	1.0	-0.3	1.6	19.1	25.5	23.6	2.5	4.2	2.9	2.1	1.8	1.8
Latin America	0.8	-1.3	-0.5	10.6	15.0	17.4	-3.4	-3.4	-2.7	1.2	-1.4	0.0	-1.3	1.4	1.0
Argentina	0.5	1.6	0.6	21.4	16.3	22.9	-1.0	-1.6	-2.2	-0.5	-0.1	0.7	-7.5	-2.4	-1.9
Brazil	0.2	-3.0	-1.9	6.3	8.8	6.2	-4.4	-3.8	-2.7	0.9	-3.4	-1.7	-1.0	8.3	2.0
Mexico	2.1	2.2	2.3	4.0	2.8	3.1	-1.9	-2.2	-0.7	2.0	2.7	2.1	7.3	7.6	4.8
CIS	0.9	-3.0	0.0	8.1	15.6	10.0	2.0	3.5	1.4	0.9	-4.6	0.6	-2.1	-4.4	2.2
Czech Republic	2.0	3.9	2.8	0.4	0.4	1.5	0.6	0.2	-0.6	1.5	2.9	2.9	8.9	6.2	4.5
Hungary	3.5	2.7	2.5	-0.2	-0.2	1.1	2.3	3.8	3.2	1.5	2.8	2.7	8.7	7.7	4.9
Poland	3.4	3.5	3.8	-0.1	-0.8	1.0	-2.0	-1.0	-2.1	3.0	3.2	3.8	5.6	5.4	5.1
Russia	0.6	-4.2	-0.8	7.8	15.8	10.5	3.0	6.1	3.0	1.3	-7.0	-0.9	0.5	-0.1	-1.7
Turkey	2.9	2.3	3.0	8.9	7.7	7.7	-5.8	-5.6	-5.4	1.4	3.3	2.9	6.9	-0.6	2.2
Africa	3.3	2.9	3.3	6.9	7.2	7.2	-4.7	-5.3	-4.4	4.6	2.3	3.6	-0.5	4.2	4.5
South Africa	1.5	1.5	1.6	6.1	4.7	6.2	-5.4	-4.4	-4.6	1.4	1.7	1.8	2.6	10.6	7.1
MENA	2.2	2.5	3.1	5.2	4.6	4.8	7.1	-0.5	0.3	4.0	3.7	3.9	2.8	3.8	4.8
BRIC	5.4	4.3	5.1	3.9	4.3	3.9	0.9	2.9	2.6	4.7	3.0	4.4	3.7	3.2	5.1
World	2.7	2.5	3.0	2.9	2.4	3.2	-	-	-	2.5	2.5	2.9	3.6	3.0	3.9

Source: IHS

Note: IHS forecasts for 2015 and 2016. These forecast values are provided as an indication of direction, representative of one vendor's view only. The values in the table may therefore differ from the Consensus values quoted throughout the report.

Table A4: Insolvency growth (% per annum)

	2007	2008	2009	2010	2011	2012	2013	2014	2015f	2016f
Australia	-4	18	3	-1	5	1	4	-22	6	0
Austria	-6	0	9	-8	-8	3	-10	-1	-9	-3
Belgium	1	10	11	2	7	4	11	-9	-5	-5
Canada	-7	-2	-12	-20	-11	-12	-2	-2	5	1
Denmark	21	54	54	13	-15	0	-10	-20	3	-8
Finland	-1	16	25	-13	3	0	11	-11	-8	-6
France	7	8	14	-5	-1	3	2	0	3	-4
Germany	-15	0	12	-2	-6	-6	-8	-7	-6	-2
Greece	0	30	40	30	33	30	10	3	9	6
Ireland	19	100	50	10	7	3	-19	-15	-14	-10
Italy	-35	18	29	21	8	14	16	10	-7	-5
Japan	6	11	-1	-14	-4	-5	-11	-10	-9	-5
Luxembourg	5	-13	17	33	5	8	2	-20	4	0
Netherlands	-23	1	73	-10	-1	21	10	-19	-20	-15
New Zealand	-5	-35	45	-6	-12	-8	-13	-7	6	0
Norway	-6	28	38	-12	-2	-12	20	-5	-5	0
Portugal	-12	54	36	16	18	42	8	-9	9	-4
Spain	10	100	50	-2	14	38	13	-30	-20	-10
Sweden	-5	7	20	-4	-4	7	5	-7	-10	-4
Switzerland	-5	-2	24	20	7	3	-5	-7	7	2
United Kingdom	-5	24	23	-16	5	-4	-7	-6	-5	-2
United States	2	52	41	-7	-15	-16	-17	-19	-10	-4

Sources: National bureaus, Atradius Economic Research

Table A5: Insolvency level, index

	2007	2008	2009	2010	2011	2012	2013	2014	2015f	2016f
Australia	100	118	121	120	126	127	133	104	110	110
Austria	100	100	110	101	93	96	87	86	78	76
Belgium	100	110	123	125	133	138	153	140	133	126
Canada	100	98	86	69	62	54	54	52	55	55
Denmark	100	154	238	269	228	227	204	163	168	155
Finland	100	116	145	127	131	131	145	129	119	112
France	100	108	123	118	116	119	122	122	126	121
Germany	100	100	112	110	103	97	89	83	78	76
Greece	100	130	182	237	315	409	450	463	505	536
Ireland	100	200	300	330	354	365	296	252	217	195
Italy	100	118	151	183	197	223	259	285	265	252
Japan	100	111	110	95	90	86	77	69	63	60
Luxembourg	100	87	102	135	141	152	155	124	128	128
Netherlands	100	101	175	158	156	189	207	167	134	114
New Zealand	100	65	94	89	78	72	63	58	62	62
Norway	100	128	176	156	153	134	161	152	145	145
Portugal	100	154	210	242	286	405	438	398	434	417
Spain	100	200	300	293	335	463	523	366	293	263
Sweden	100	107	128	123	117	126	133	123	111	106
Switzerland	100	98	121	145	154	159	150	140	149	152
United Kingdom	100	124	153	128	135	129	120	112	106	104
United States	100	152	215	199	169	142	117	95	86	82

Sources: National bureaus, Atradius Economic Research

Don't overcomplicate your decision about whether to use credit insurance

SHOULD I INSURE MY RECEIVABLES?

Is credit insurance too expensive?

Do I have a lot of bad debts?

Would credit insurance administration be time consuming?

I've been doing business with my customers for years. how well do I really know them?

Does credit insurance cost less than my bad debt expenses?

Have I experienced any payment defaults over the past 3 years?

Credit insurance and collections administration can be directly integrated into my own, limiting my administration workload

NO

YES

NO

YES

Can I grow my business more effectively if I have external credit management support?

YES

Do I spend a lot of time monitoring the creditworthiness of my customers?

NO

NO

How much more revenue do I need to recover a bad receivable loss?

A long business relationship does not ensure my buyers' future success or that they will let me know that things are going poorly

Do I really want to bear the risk of payment default?

Additionally, our relationship could cloud my objectivity

NO

At a 10% margin I will have to sell 9x the amount of the unpaid invoice just to recover the loss. Is €3 per €1.000 of revenue expensive compared to this?

YES

YES

Don't insure receivables

I'd rather do my own thing

Are there products that will improve my credit management while limiting my insurance expense?

NO

Insure receivables

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