

FIGURE  
OF THE WEEK

30%

Approx. vol. of  
world shipping  
passing through  
Bab-el-Mandeb  
Strait

## In the Headlines



### Italy: Tackling NPLs will free up new (cheaper) bank credit

On Monday, the government and leading banks reached an agreement on bad debts. With EUR360bn in outstanding non-performing assets and with 60% of this representing non-performing loans (NPLs), bank balance sheets are overburdened. A fund of at least EUR5bn will help banks unload bad loans from their balance sheets and thereby relieve pressure on their capital requirements, reassure investors and resume lending in the country. The fund should function as a vehicle held by private investors and managed by a private entity that will buy junior tranches of bad loans (the most risky) from the most fragile banks as a replacement for raising equity capital in the market. This fund is a further step in reforming the banking sector and supplements recent agreements on bank mergers. However, the fund's size remains limited and could be increased. The banking system is highly fragmented, preventing full transmission to the real economy of ECB monetary policy measures. As a result, since the end of 2013, interest rates on bank loans to SMEs have disconnected from those in Spain and remain 90bps above their Spanish counterparts (2.8%) and below those in Germany.



### China: Stabilising? Or getting stronger?

Exports were up +11.5 y/y in March, following a fall of -25.4% in February, and business confidence improved. Positive official PMI data were followed by an improvement in the Caixin/Markit Services PMI to 52.2, supported by rising new orders. Moreover, a rebound in producer prices (-4.3% y/y in March after -4.9% in February) and improving consumer prices suggest that deflationary forces are receding. In terms of financing, there are signs of stabilisation, with increased foreign reserves (+USD10.3bn in March) and less volatility in both the currency and equity markets. As a result, Q1 GDP will probably indicate some resilience, with growth in the target range of +6.5% to +7%. The authorities will keep their easing stance to reinforce these current trends. Cyclical measures will include further injection of liquidity in domestic markets and increased public spending and, structurally, it is likely that the business tax will be replaced by VAT on construction, real estate and financial and consumer services, which will result in a tax cut of at least RMB500bn. EH expects GDP growth will slow to +6.5% in 2016.



### UK: Manufacturing needs more time to bottom out

Manufacturing production fell by -1.1% m/m in February, the largest contraction since May 2014. Business confidence has been soft since November 2015, while capacity utilisation at 79.7% has weakened since mid-2015 and is the lowest since Q3 2013 and below the long-term average. The contraction in manufacturing suggests that GDP growth will slow further; +0.4% q/q in Q1 from +0.6% in Q4 2015 and +0.5% on average last year. The recent depreciation of the GBP will assist company competitiveness in the coming quarters, but soft global demand and fears of a Brexit are likely to remain a drag on the economy in H1. While we expect a *Bremain* (70% probability) post 23 June, we estimate that, in the event of a *Brexit*, the total export loss in the case of a Free Trade Agreement (FTA) with the EU could be around GBP9bn and nearer to GBP30bn if no FTA is signed. The dependency on the European market is significant for exporters (50% of total UK exports compared with 6% of total exports for the EU) notably for sectors including chemicals, machinery & equipment and automobiles.



### Angola: Take Effect?

Technical assistance from the IMF (see also [WERO 16 March 2016](#)) may now be supplemented by a financial facility as the Fund announced that it will discuss with Luanda a potential three-year (perhaps USD1.5bn) Extended Fund Facility (EFF). The latter, if agreed, will provide balance of payments support and assist an economic reform strategy designed to combat structural impediments and promote growth. An EFF programme comes with conditionality, the prospect of which probably made Angola initially reluctant to approach the IMF, although a facility of USD1.9bn was granted in 2009 and fully drawn down by March 2012. The EFF should assist debt sustainability in the short term. EH expects GDP growth will be capped at around +3% in 2016 and 2017, compared with an annual average +7% in 2000-2015 (and +12.5% in 2004-2008). The slowdown will reduce commercial prospects, particularly in the private sector, and Angola will remain a challenging business environment. EH also expects other Sub-Saharan African countries will seek IMF support.

# Countries in Focus

## Americas



### Peru: Political uncertainty ahead

Last Sunday's elections revived social divides. The Maoist insurgency perpetrated an attack on the eve of the elections in which Keiko Fujimori, the daughter of former president Alberto Fujimori (1990-2000) who had violently repressed this very insurgency and is now in jail, won the most votes in the first round, with 39.5%. Demonstrations have been mounting over her candidacy and the period leading to the runoff in June could be marked by strong protests. Her biggest rival, Pedro Kuczynski, a right-wing ex-Finance Minister perceived by investors as more pro-business, gathered 22% of the vote and looks likely to prevail in the second round. Security is the key issue in the campaign, along with economic growth in a still-deeply unequal country. Peru has yet to return to its +5% long-term average GDP growth, but it expanded by +3.3% in 2015 and should record a slight acceleration in 2016, to +3.5%, mainly driven by dynamic domestic demand and public support.

## Europe



### Switzerland: Exports will increase by +CHF2.5bn in 2016

The outlook for exporters will gradually improve this year, after total exports declined by -CHF5.5bn last year, which was largely a result of CHF appreciation following the removal of the CHF:EUR cap in January 2015 but also due to rising export risks in emerging markets (including currency turbulence and political risks). The latter are expected to continue this year. Nonetheless, 2016 is likely to see a moderate recovery in total exports, which are forecast to increase by +CHF2.5bn, making up for nearly half of the losses in 2015. Notably, exports to the Eurozone (+CHF2.1bn) will rebound as the one-off negative impact of the lifting of the exchange rate cap has faded. Euler Hermes expects further export gains coming from China and Hong Kong (+CHF0.5bn) and the U.S. (+CHF0.4bn) while exports to the UK will decrease by -CHF0.2bn as a result of the markedly weakened GBP (for further details on the export outlook and export risks see our [Economic Insight Switzerland April 2016](#)).

## Africa & Middle East



### Djibouti: Jib sailing?

Incumbent President Omar Guelleh won a convincing mandate for a fourth term in office in elections held on 8 April. This was widely expected, although the country rarely hits the headlines. However, in this small (population <1mn) and mostly arid country, China is building its first permanent overseas base and some reports suggest that Djibouti represents a superpower hotspot because it already hosts military bases for the U.S. and France and operational stations for Japanese and EU anti-piracy forces. Unlike elsewhere in Africa, China is not seeking commodities – natural resources are very limited – but use of the country's strategic location, which overlooks the Bab-el-Mandeb Strait linking the Gulf of Aden and the Red Sea and therefore of the Indian Ocean and the Suez Canal. Ongoing infrastructure projects include new ports, airports, a railway and pipelines. China's presence will boost construction and associated projects, although expect very competitive bidding for any opportunities arising.

## Asia Pacific



### Taiwan: Navigating troubled waters

USD-denominated nominal exports contracted for the 14th consecutive month in March (-11.4% y/y) with a broad-based decline in demand from China and Hong Kong (a combined -14.2% y/y) and the U.S. (-8.5% y/y). Activity statistics continue to show signs of domestic weakness, with lower industrial production and continuing wholesale price deflation. More positively, household fundamentals are proving resilient as incomes and labour markets are still firm. Looking ahead, private surveys send mixed signals. First, the Nikkei manufacturing PMI was at 51.1 in March. However, declining new order sub-components still call for caution. Second, consumption remains at a low level (81.3) suggesting weak growth in household expenditure in the short term. Policymakers are taking aggressive measures to support growth (including policy interest rate cuts) but the pass through to the economy will probably take some time. GDP growth is expected to be limited to +1.5% in 2016.



## What to watch

- April 14 – UK BoE interest rate decision
- April 14 – South Africa February mining output
- April 15 – UK official designation of Brexit campaigners
- April 17 – Brazil lower house vote on impeachment
- April 17 – Israel Q4 2015 GDP
- April 20 – UK February unemployment
- April 20 – South Africa March CPI
- April 20 – Israel March leading 'S' indicator

### DISCLAIMER

These assessments are, as always, subject to the disclaimer provided below.

This material is published by Euler Hermes SA, a Company of Allianz, for information purposes only and should not be regarded as providing any specific advice. Recipients should make their own independent evaluation of this information and no action should be taken, solely relying on it. This material should not be reproduced or disclosed without our consent. It is not intended for distribution in any jurisdiction in which this would be prohibited. Whilst this information is believed to be reliable, it has not been independently verified by Euler Hermes and Euler Hermes makes no representation or warranty (express or implied) of any kind, as regards the accuracy or completeness of this information, nor does it accept any responsibility or liability for any loss or damage arising in any way from any use made of or reliance placed on, this information. Unless otherwise stated, any views, forecasts, or estimates are solely those of the Euler Hermes Economics Department, as of this date and are subject to change without notice. Euler Hermes SA is authorised and regulated by the Financial Markets Authority of France.

© Copyright 2016 Euler Hermes. All rights reserved.