Press release

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Euler Hermes global economic outlook: "Hot, bright and soft spots - Who could make or break global growth?"

World GDP growth is set to recover (+2.9% in 2014) but the pace of the recovery remains slow (below 3% for the third year in a row) and downside risks prevail.

PARIS – 14 MAY 2014 – According to Euler Hermes' latest global economic outlook, advanced economies are picking up speed with an expected growth of +2.0% in 2014, the fastest since 2010.

The UK (+2.4%) and eurozone members (+1.0%) continue to improve, while the U.S. (+2.8%) was slightly held back by an extremely severe winter. Abenomics still creates steady growth in Japan (+1.2%), though more efforts are needed to keep the engine running. Emerging economies remain the primary contributors to global growth (+4.3% in 2014), but expectations have dampened following the sharp revision of Russia's growth prospects as well as slowing growth outlooks for Brazil, South Africa and Turkey.

Has the game changed?

Of the "10 Game Changers for 2014 Global Growth" introduced earlier this year, three have since become pivotal:
(1) disinflation in the advanced economies;
(2) the fragility of the emerging economies, and
(3) old and new (geo-)political risk in 2014, especially in the emerging economies.

Diverging fates in the emerging economies: 'Fragile 10' became the 'Improving 4', the 'Precarious 5' and Argentina

As emphasized late last year, the ability of emerging economies to weather financial tensions largely depends on their financial fundamentals. National authorities need to be responsive and flexible in creating compensating policies. At the beginning of 2014, Euler Hermes classified emerging countries against two criteria:

- their fragility related to the U.S.'s quantitative easing (QE) tapering, and
- their dependency on exports to China, i.e., countries that could be hit by a slowdown in China's GDP growth and the transformation of its economic model.

The resulting list of 10 most vulnerable countries in the short-term, the 'Fragile 10' , includes Argentina, Brazil, Chile, Colombia, India, Indonesia, Mexico, the Philippines, South Africa and Turkey.

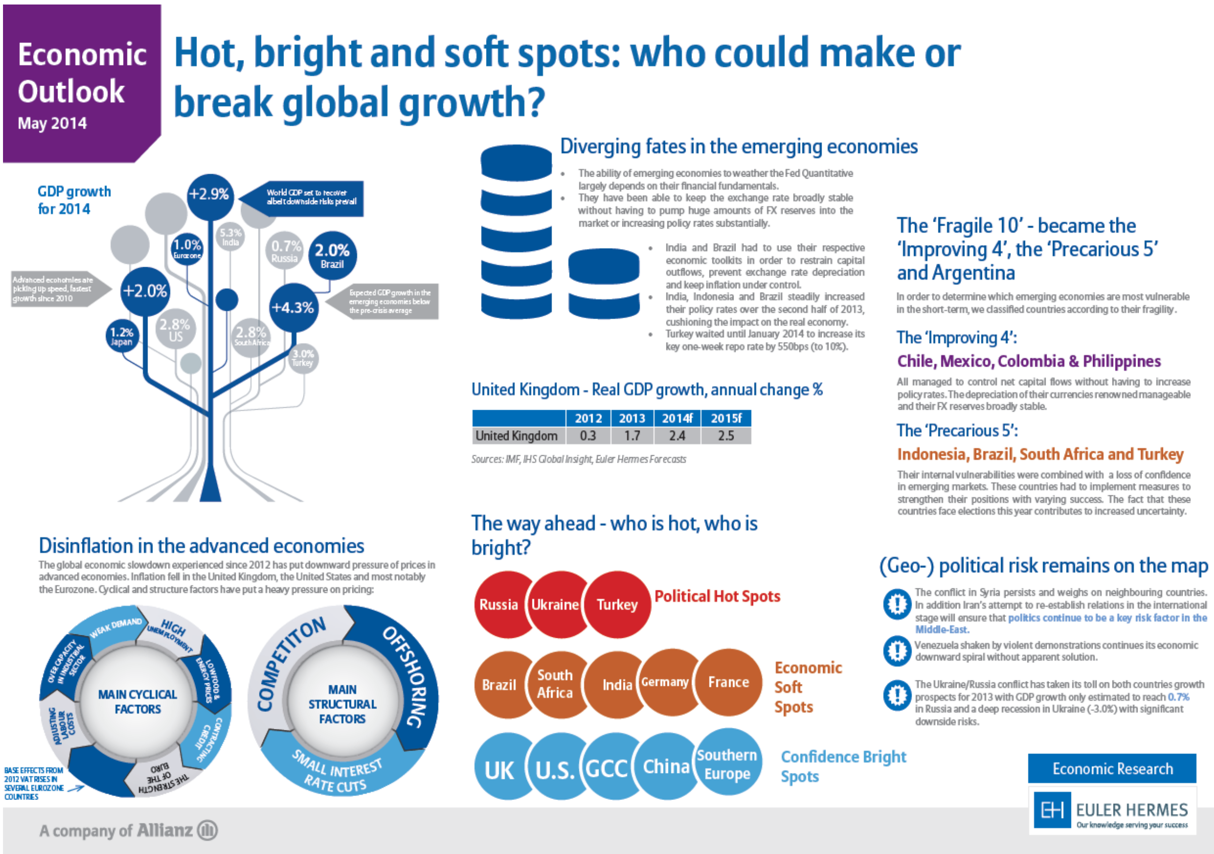
Since then, the quality of economic policy and authorities' responsiveness to the QE tapering program and rising (geo)-political risks in recent months reveal that some countries are in better shape to weather storms than others. They constitute the 'Improving 4' (Chile, Colombia, Mexico and the Philippines), the 'Precarious 5' (Brazil, India, Indonesia, South Africa and Turkey) and Argentina.

The way ahead – who is hot, who is bright?

The new Euler Hermes global economic report has identified a range of hot spots, soft spots and bright spots that are likely to impact global confidence in the short-term:

- **Political Hot Spots:** Russia, Ukraine and, to a lesser extent, Turkey remain political hot spots due to (geo)-political risks weighing on their economies and potentially creating negative spillover effects
- **Economic Soft Spots:** Brazil, South Africa and, to a lesser extent, India are economic soft spots, having to adjust to a world where emerging markets are no longer investors' darlings purely by definition. Also in this group are France, which needs to rethink its business model, and Germany, which could be challenged by prevailing eurozone deflationary pressures as well as the strong euro.
- **Confidence Bright Spots**: The U.S. and the UK are confidence bright spots, as growth has gained traction. Southern Europe shows signs of improving economic prospects and confidence after

several years of painful adjustments and austerity. China is also a member of the group despite challenges related to the changed business model, as there are positive signs of a successful transition.



Political hot spots

Ukraine and Russia: The domestic political crisis escalated into a serious conflict between the Ukraine and Russia after the latter annexed the Crimea, taking a toll on the economies of the two affected countries but a negligible impact on Europe so far. Russian GDP growth is expected to slow to 0.7% and the Ukraine is likely to experience a deep recession (-3%) in 2014. Significant downside risks prevail.

Turkey: Economic output proved resilient in 2013 despite political and global financial market turbulence. Domestic demand was the sole growth driver, with private consumption expanding by 4.6%, public consumption by 5.9% and fixed investment by 4.3%. In 2014, domestic demand is expected to moderate as a result of monetary tightening and Turkish lira (TRY) depreciation. As a result, 2014 GDP growth is expected to slow to 3%.

Economic soft spots

France and Germany: After France failed to meet its initial fiscal deficit target of -3% of GDP in 2013, a new French prime minister in 2014 announced a slew of reforms aimed at bolstering business competitiveness and household purchasing power. These measures are unlikely to lead to a quick lowering of the fiscal deficit (Euler Hermes forecasts: -3.9% in 2014 and -3.3% in 2015) but will support other eurozone countries via higher imports. In contrast to France, Germany's economic model is that of a thrifty and export-driven industrial powerhouse, as evidenced by its large current account surplus. Still, recent PMI export orders data, and Bundesbank data, indicate a possible decline in momentum. Germany's export sector is facing headwinds both from within the eurozone (deflationary pressures) and from abroad (renewed competition from Japan and the U.S., whose main export sectors overlap with those of Germany).

Brazil: Past experience shows that organizing major sporting events does not always have a positive impact on the host country's economy. Even if Brazil could be an exception, as it is hosting three sporting mega-events in a row, Euler Hermes expects a negligible impact on short- and medium-term growth. The slowdown in the Brazilian economy is mainly due to structural weaknesses that will not be offset by the sporting events. While domestic demand has benefited in recent years from a combination of demand-supporting fiscal policy, low unemployment, increases in real wages and massive foreign capital inflows, investment has remained low. There is now a mismatch between dynamic domestic demand and weak national supply. Deep structural reforms are needed to cope with the local industry's lack of competitiveness, infrastructure shortcomings and a weak business environment. Growth is expected to remain low at 2.0% in 2014 and 2.5% in 2015, well below the 5% annual pre-crisis pace.

India: The Indian economy underperformed during the past two years with GDP growth below +5% on average, compared with a +7% growth potential. Output expansion was dampened by weak domestic demand. High inflation continued to erode purchasing power, restraining private consumption growth. Investment slowed, caused by tightening financing conditions and limited demand. Net exports deteriorated on the back of an elevated import bill caused by high commodity prices (oil and gold represent 34% and 8% of imports respectively) and weaker-than-expected economic performance by India's main partners, the U.S. and China. Since mid-2013, India has been on financial market and investor radar due to deteriorating economic prospects and high fiscal and current account deficits. Structural weaknesses need to be tackled further, but some steps in the right direction have been already taken. Financial stability (and therefore the reduction in short-term capital inflows) is one of the key priorities of new Central Bank Governor Rajan, and the current government initiated reforms to encourage foreign investment in key sectors.

South Africa: GDP growth will remain lackluster: +2.8% in 2014 and +3.5% in 2015, with downside risks. Monetary policy remains tight to protect the rand and international reserves, gold prices are weak and fraught labor relations restrict output growth in some key sectors, particularly platinum mining. Structural rigidities remain a source of concern, including high unemployment, large income inequalities, weak service delivery, troubled industrial relations and fiscal and current account deficits.

Confidence bright spots

United States: Much of the U.S. experienced record winter cold and snow, causing a significant drag on the economy. GDP expanded by only 0.1% quarterly, annualized in Q1 2014. However, the difficult winter also set the stage for a spring rebound in economic activity, which will help boost Q2 GDP and is likely to push full-year 2014 GDP growth to 2.8% -- still below trend, but better than 1.9% in 2013. Manufacturing seems poised for a strong recovery as unit labor costs continue to fall; manufacturing employment has risen for seven consecutive months. The Federal Reserve is likely to completely terminate its quantitative easing program by the end of 2014, but remain highly accommodative due to a significant amount of liquid excess reserves that can be deployed into the economy.

China: Chinese GDP growth proved resilient in 2013, rising at a similar rate as the previous year (+7.7%). In 2014, the economy is projected to decelerate to +7.5%, linked to the ongoing economic transformation to a domestic demand-driven GDP growth .The transition has begun and positive signs are already appearing. First, the government moved from a strict growth-targeting framework to a more balanced one, aiming simultaneously at job creation, price stability and economic growth. Secondly, there is some evidence of a rising consumer market with strong fundamentals. Thirdly, the normalization of financing conditions is ongoing, following improvements in credit quality with a deceleration in non-bank and off-balance-sheet financing. Continued support to domestic consumption through bank lending and job creation, and further investments in knowledge and high value-added industries, would boost long-term growth.

Southern Europe and the UK: After several years of painful adjustments and deep financial and sovereign crises, Southern European countries are finally returning to positive growth, mainly thanks to a pick-up in exports linked to competitiveness gains. Combined with ongoing fiscal adjustments, structural reforms and reduced investor appetite for emerging markets, this has triggered a broad return in confidence and therefore a rise in portfolio inflows and foreign direct investments. That said, short-term volatility cannot be ruled out as substantial fragilities remain. Unemployment remains at very high levels, the banking sector is still cleaning up balance sheets and long-lasting low inflation could hurt the recovery. In the UK, domestic demand will remain the main driver of GDP growth (+2.4%) due to an increasingly business-friendly environment.

Gulf Cooperation Council (GCC): The GCC countries account for over 29% of global oil reserves and over 23% of gas reserves. Output from the hydrocarbon sector was a key growth driver from 2011 to date, when benchmark oil prices were USD 100/barrel, or higher. With a combined population of only 49 million, oil export revenues have continued to build strong foreign exchange reserves and financial asset accumulation in Sovereign Wealth Funds (estimated at USD 2,250bn). Such reserves enable GCC countries to boost domestic demand through state spending on infrastructure projects and social spending. Trade opportunities with the GCC are therefore likely to remain relatively buoyant, particularly given the improved business climate in recent years. GCC GDP growth is likely to expand by rates at or above the regional average (+3.6% in 2014).

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