Press release

Euler Hermes: Global growth hits 2016 hard patch; 70% of world economy to remain subdued

PARIS – 18 APRIL 2016 - The global economy's growth will be weaker in 2016 with only a +2.5% rise in GDP (2015: 2.6%), according to Euler Hermes, the worldwide leader in trade credit insurance. In its updated risk analysis for Q1 2016, the company notes that subpar global growth, still below +3% for the 6th consecutive year, will affect a majority of countries – both advanced economies and emerging markets.

"More than 70% of the world's economy will slow or be in recession in 2016," said Ludovic Subran, chief economist at Euler Hermes. "China, Saudi Arabia, Turkey, the U.S. and the UK will register lackluster growth. Argentina, Brazil and Russia will remain in negative territory."

The main culprits are dubbed 'The Five FLOPS of the Global Economy':

1. Trade flows are anemic. Global trade is set to contract again in 2016, with a 2% decrease in value after a fall of -10% in 2015. The number and record-value of cross border mergers and acquisitions year to date suggest investment flows may be picking up modestly. Yet capital flows remain wobbly.

   "Today *the* issue the world economy faces is the rise and fall of capital flows, which wreaks havoc on currencies and emerging market companies," said Subran.

2. Liquidity, already abundant, should grow by +6% this year, while monetary policies are less divergent then before. Impact on the real economy remains limited, creating a major issue for sectors impacted by high debt levels and anemic turnover, such as commodities and machinery.

   "These liquidity pockets remain local, in Europe for instance, in contrast with emerging markets where liquidity is scarce, particularly related to extending credit to companies," noted Subran.

   As a result, 2016 will see the return of non-payment risk. After six consecutive years of decline, global corporate insolvencies should increase by +2%, mainly due to emerging country turmoil.

3. Oil is either too costly, or too cheap. With oil prices set to remain low for longer, negative effects are appearing. Countries with revenues heavily reliant on oil exports are also often those that spent lavishly when barrel prices were at record levels. The list includes Arab states of the Persian Gulf and Saudi Arabia, as well as Angola, Azerbaijan, Equatorial Guinea, Gabon and Venezuela. Social tensions could escalate if these governments push forward further subsidy cuts or tax hikes in order to compensate for the loss in revenues.

4. Public policies are too hesitant and lack coordination – preventing a much-needed strong stimulus to investment. While rigorous fiscal consolidation and debt elimination haunt European economies less than previously, the pace is not fast enough to spur growth. In parallel, emerging markets are feeling the impact of austerity measures aimed at decreasing public deficits. Even if in some countries such as China, Turkey or India, sustained high public expenditure contributes to growth and rising debt, the private sector is spared from reducing its debt burden.

5. Surprises have become more frequent over the last few years. Euler Hermes identified several possible and potentially disruptive shocks.

   - Capital controls have already been introduced in many countries to curb currency volatility and capital flight. Governments have therefore created downward pressure on trade, payments and dividend repatriation. Egypt is a relevant recent example.
   - Secondly, the political calendar is crowded with sensitive elections and referendums, including the U.S. and the UK. Commenting on the risk posed by Brexit, Ana Boata, Europe economist at Euler Hermes noted: "We believe a Brexit could be costly for the UK. Export losses of up to 30 billion pounds and almost 200 billion in investments are at stake. In Europe, Ireland will be the country most impacted. Germany and the Netherlands could also suffer significantly because of their high exports to the UK."
   - Finally, the risk of an escalating conflict in the Middle-East remains high. A flare-up could create regional repercussions, and hurt investor appetite.

The global economic deterioration, coupled with increased geopolitical tensions, generated changes in Euler Hermes' Country Risk Ratings at the end of Q1 2016, with a focus on emerging markets. The company's Economic Research department announced six downgrades - Brazil, Hong Kong, Macao, Singapore, South Africa and Taiwan - and four upgrades: Argentina, Croatia, the Dominican Republic and Greece. Exposure to Chinese risk, reliance on commodities and current account weakness are common denominators of country risk in 2016 – and influenced all six downgrades.

Asian hubs: when a giant sneezes, the neighborhood gets a cold
Heightened short-term risk in Hong Kong, Macao, Singapore and Taiwan translated into downgraded risk ratings. The Asian hubs will be affected in 2016 by lower global trade overall and, more importantly, by China's refocus from manufacturing to services and the related slowdown. Subran observed that "a loss of export opportunities should result in an economic slowdown for these countries: Hong-Kong and Singapore should grow modestly (+2%), and Taiwan by only +0.7%."

Brazil: Beaten and bruised
After stagnation in 2014 and recession in 2015 (-3.8%) – the economy's worst performance in 25 years – Brazilian GDP could contract a further -3.5% in 2016. Inflation is slowing but should remain at a high level in 2016 (above +8%), affecting private consumption (-4% in 2015). Non-payment risk continues to increase sharply: after a +25% increase in 2015, corporate insolvencies are expected to rise by +22% in 2016.

South Africa: Cloudy rainbow
In South Africa, persistent structural rigidities creating employee/employer relations conflicts, combined with power outages, are clouding the business climate. Political difficulties and lower revenues from commodities - which account for 14% of the country's GDP – are creating economic deceleration. Growth in 2016 is forecast at only +1%. Drought is aggravating the scenario, weakening the agricultural sector and forcing the country to import more food products.

The four upgraded country risk ratings reflect improved public policies and their positive impacts on companies.

Argentina: New government, new path
A five-pronged initiative was proposed to put the economy back on track and spur economic growth by 2017 (+0.6%). It includes an easing in capital controls, better access to international capital markets following a favorable resolution of the conflict with external "holdout" creditors, responsible economic policies with clear objectives and an overhaul of the national statistics institute.

Greece: Eased capital outflows
In 2015, despite the recession (-0.3%, four big Greek banks were recapitalized, and capital controls were eased. Companies can now make payments abroad worth € 250K per day per company. Growth prospects should begin to improve in the second half of 2016 due to a further easing of capital controls and to potential measures to improve debt sustainability which could be taken by the European Commission, ECB and the IMF, depending on results of the ongoing review.

Croatia: Dynamism is back
After six consecutive years of annual GDP contraction, the economy returned to growth in 2015, due to a moderate recovery in domestic demand. Euler Hermes expects the recovery to gradually gain momentum, resulting in growth of about +1.8% in 2016 and +2% in 2017. Levels will however remain well below the 2008 peak. Improved economic policies are key to further progress.

Dominican Republic: Steady as she goes
Even with the economy slowing, it remains solid: GDP should rise by +4.9% in 2016. Macroeconomic fundamentals were reinforced recently, with an improved business climate, reduced fiscal deficit (-6.8% of GDP in 2012 vs -0.6% in 2015) and limits on external debt (-2% of GDP in 2015). The country is a good example of an economy that benefits from both U.S. resilience and lower energy prices.

Grade changes table: 10 changes in country risk ratings in Q1 2016

Upgraded Countries	Downgraded Countries
Dominican Republic C2 › B2	Singapore AA1 › AA2
Croatia C4 › C3	Hong Kong A1 › A2
Greece C4 › C3	Taiwan A1 › A2
Argentina D4 › C4	Macau A1 › BB2
	South Africa BB2 › B2
	Brazil B3 › C3

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Euler Hermes Country Risk Methodology Summary

The evaluation of overall country risk is the combination of the Medium-Term Rating (Country Grade) and the Short-Term Rating (Country Risk Level).

The Medium-Term Rating (Country Grade) measures economic imbalances, the quality of the business climate, and the likelihood of political hazards. It uses a six-level scale from AA to D, in which AA is the lowest risk level and D is the highest risk level. The Medium-Term Rating is the combination of three scores:

• The Macroeconomic Rating (ME) is based on analysis of the structure of the economy, budgetary and monetary policy, indebtedness, the external balance, the stability of the banking system and the capacity to respond effectively to (emerging) weaknesses;

• The Structural Business Environment Rating (SBE) measures the perceptions of the regulatory and legal framework, control of corruption and relative ease of doing business; and

• The Political Risk Rating (P), which is based on the analysis of mechanisms for transferring and concentration of power, the effectiveness of policy-making, the independence of institutions, social cohesion and international relations.

The Short-Term Rating (Country Risk Level) identifies more immediate threats by focusing on the direction of economic output in the next 6-12 months and those macroeconomic indicators that can signal imminent financial crisis as a result of a disruption to financing flows. It is measured on a four-level scale from 1 to 4, in which 1 is the lowest risk level and 4 is the highest risk level. The four levels of risk are also labeled low, medium, sensitive or high in the Euler Hermes country risk map. The Short-Term Rating is the combination of two indicators:

• The Financial Flows Indicator (FFI), a measure of short-term financing risks for an economy that can impact payments of trade receivables between companies; and

• The Cyclical Risk Indicator (CRI) which measures the short-term disruptions in demand. It includes Euler Hermes macroeconomic and insolvency forecasts.

Together, these five risk dimensions constitute Euler Hermes' country risk methodology to assess the risk of non-payment by a company in a given country – a factor useful to businesses in their strategic decision-making.

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