FLYING HIGH IN 2018

The World Economy This Year: Robust Growth, a Decline in Insolvencies, Major Failures Rise

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The beginning of the year is the best time to reflect on what took place the past year and prepare for the future. Here are 5 lessons from 2017 and 5 big ticket items for 2018.

First, what did we learn in 2017?

The entire world grew in sync and rejuvenated global trade. 2017 was marked by a rare synchronization of economic cycles across the US, Europe and China, pushing the world economy above 3% growth for the first time in 7 years. Global trade accelerated to 4.3%, in spite of the protectionist rhetoric.

Where did inflation go? The absence of inflation in a late and favorable phase of the global cycle puzzled central bankers across the world. New technologies and consumer habits cannot explain it all.

Heightened political risk is not enough to derail it all. The uncanny presidency of Donald Trump and tensions in the Korean Peninsula and in the Gulf did not prevent financial markets and multinationals from having a great year.

One-size-fits-all economic policy is over. Solo moves by the United States including on taxes, along with atypical policy-making (entrepreneurial states, heterodox monetary policies e.g.) from China to Turkey and Russia, confirm that the Washington Consensus is over.

There is still a lot of cash available. 7 trillion dollars on corporate balance sheets alone to be exact. This unprecedented amount of wealth – and it is true for households too – could still be put to use.

What should we expect in 2018?

The world economy could be even stronger. The US and the emerging world (outside China) should accelerate. China will continue to surprise, and Europe should be strengthened by an institutional breakthrough.

Financial conditions to remain supportive. Though all central banks will continue to unwind, tighten and enact further macro prudential policies, the private sector should continue to benefit from the credit cycle. Even with a bit more inflation (and moderate second round effects on wages), a weak dollar is a big plus.

Political turbulences should continue. From South America, through Thailand, Malaysia, and to Italy and Russia, this will be another busy year, especially as the UK and the US can surprise any minute.

Mind the disappointment factor. The biggest risk is to be disappointed, especially for financial markets, in a context of stretched valuations and market complacency. Policy blind spots (US debt, Europe’s tight window for action, China’s soft landing) combined with too much confidence could end up in higher volatility.

Brace yourselves: it might not be a walk in the park. The almost certain deceleration of the US and the subsequent release of pressure points (multiple bubble-like phenomena in financial markets, shadow banking risks, large countries avoiding structural reforms) are among the reasons for caution – and a correction.

Enjoy another year of audacity and successes, but don’t forget to fasten your seat belt!
World GDP growth in 2018
(Euler Hermes forecast)

3.2%
Let the beat go on

Everything comes to those who wait. Ten years after the worst financial crisis since 1929, growth has finally recovered in 2017. This year should see similar growth and comparable drivers.

So what’s the difference? At the beginning of 2018, we all know (corporates, households, governments) that this year will be about good growth, again the best performance since 2011 to +3.2%.

This is a key change from one year ago when the news was all about policy nudges and the glass ceiling limiting growth levels.

Why such a recovery? A pessimist would say this is because we experienced no global shocks over the last two years despite the risky accumulation of debt over the last decade – when economic performance was overall mediocre.

In some ways this is true. Insolvencies, for example, have risen among big corporates which benefitted the most from Central Banks asset purchases (see page 7 for a special focus on insolvencies).

An optimist could claim that things are radically different from 2016. Growth is above trend in three key ways: trade, investment and a growing number of Emerging Markets are now overachievers.

But, as the risk appetite is mapping up in the real economy and policy is pushing to go one bridge further, beware that things do not go one bridge too far.

Trade and growth live together

Trade growth was back in 2017, with many one-off aspects driven by a price recovery fueled by the oil price rebound, but also some volume growth acceleration.

This virtuous circle had positive spillovers on GDP growth in the most open economies in Asia as well as in Eastern Europe.

In 2018, world trade is set to grow faster than GDP for a second consecutive year, a return to a pattern unseen since 2011. In volume terms, trade should rise by +3.9% compared to +3.2% for GDP growth.

Why the comeback? Troublemakers turned into cycle makers again. This is particularly true for China, since growth increased in 2017 to +6.9% (from +6.7% in 2016), the first such acceleration since 2010. What about imports? These grew by +7.2% in volume terms. This added demand for other Asian economies, as well as commodity exporters in the region, in Latin America and in Africa. As a result, highly open economies were among the best growth performers.

This momentum might ease in 2018. But open economies will keep their lead vis-a-vis countries with comparable income levels. South Korea is forecast to grow by +3% while France should advance by +1.9%. Poland should post +3.7% while Russia is estimated to expand by +1.9%. And Spain with +2.4% should perform better than Italy with a mere +1.3%.

Investment in Advanced Economies: Let’s go party

The Eurozone and Japan got back to higher growth in 2017, much like the US and China had done earlier. That was one (small) step for them, one giant leap for the World Economy. Growth across all key economies means fewer issues of slack - a measure of the quantity of unemployed resources - or high inventories.

This is because there are no remaining major weaknesses when it comes to demand drivers. Definitely, the risk of deflation is over.

The usual (missing) link between unemployment and wage inflation should make a comeback, but not in the immediate future.

This means that corporates are benefiting from growing turnovers (+4.4% y/y in Italy in Q3) without one per one pass-through to wages. Goodbye balance sheet recession, hello balance sheet reflation, and supportive low credit costs.
As a result, after a long period of underinvestment, 2018 will be the second year in a row to see above trend investment growth. Corporate investment, for example, will grow by +4.7% in the US. A catch-up effect is a pervasive driver. This is particularly true in France where the “lost decade” of corporate investment means a EUR 40 bn gap that will be hard to close.

Yet booming growth can help to lower or eliminate slack. Capacity utilization rates returned to pre-crisis levels (87.2% in Germany and 85.4% in France during Q4). As household investment is also facing a good year in 2018 (e.g. +3.6% in Germany), the story holds for private investment as a whole and is supportive for related sectors (particularly capital goods and metals).

### Table 1 Growth forecasts

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Weights in global GDP at market price, 2016

NB: The revisions refer to the changes in our forecasts since the last quarter

Sources: National sources, Euler Hermes, Allianz Research
Emerging Markets: Let me play among the stars

2017 was a year of recovery in Emerging Markets (EM), after recessions in Brazil, Russia, South Africa and Nigeria. 2018 should demonstrate growth in a wider range of EMs.

External conditions eased substantially. Commodity prices increased and still-low interest rates in advanced economies pushed capital flows to high yielders. Net capital flows to EMs rose to USD 300 bn in 2017, the best level since 2012 (before the Fed tapering).

This figure excludes China, but even it saw a reversal to inflows during the year.

Optimistic expectations still hold for 2018, since domestic credit conditions recently further improved as a result of lowering interest rates. Moreover, this recovery is not only about financial conditions. Our EM aggregate manufacturing PMI rose to 52.2 in December 2017, the highest figure since April 2012.

What about the EM consumer? He is also back in a wide range of economies, from Brazil to Russia, and from Poland to South Africa, adding to positive figures in countries where they never weakened (e.g. in Vietnam or in China). On aggregate, Emerging Markets’ growth (excl. China) will accelerate in 2018 to +3.7% from +3.3% in 2017 (and +2.5% in 2016).

Upside down: Are we about to stock new imbalances?

The duration of the current growth cycle is a key question. It’s true that the level of spared capacities decreased, but the main economies are not already overheating, thus growth can continue in 2018 without a major risk of overproduction.

Yet some existing factors may trigger excesses in this early phase of the cycle. The first is the kind of financing that fuels growth. The credit intensity of growth is strong or has increased in key economies. In China, 3 units of debt are needed to generate one unit of GDP (twice the 2011 level). In France, 4.3 units of debt are now needed (instead of 3.4), with a bias toward big corporations.

Great expectations may also trigger overoptimistic valuations. The US stock market capitalization has reached a new high in 2017, above 140% of nominal GDP. As the fiscal package was finally adopted, we revise our growth forecast up to +2.6% in 2018.

But in a late phase of the US growth cycle such a fiscal stimulus may trigger more inflation acceleration than currently expected. This could precipitate more Fed tightening and a growth impact in 2019/20: not exactly what is in current market valuations.
Global decline in insolvencies amid regional divergence

After seven consecutive years of substantial declines in worldwide insolvencies the improvement halted in 2017 (+1%).

This key forecast is based on the latest estimates of the Euler Hermes Global Insolvency Index. The index covers 43 countries totaling 83% of global GDP.

In 2018, failures should post a moderate decrease (-1%). This would be supported by the economic momentum but limited by the return of cost pressures and monetary tightening. Insolvencies will thus remain -4.5% below pre-crisis level (2003-2007 average).

Yet, this overall picture is driven by four disparate regional trends, in themselves driven by the largest countries.

Western Europe: The British exception

In Western Europe, the economic recovery and the supportive monetary conditions will continue to drive down the number of insolvencies (-3% after -6% in 2017), for the 5th consecutive year.

Yet they will remain above pre-crisis levels in 1 out of 2 countries. The sharpest declines should occur in countries that were still registering a high level of insolvencies in 2017 (compare to pre-crisis level), such as Italy (-10% in 2018), France (-7%), Portugal (-7%), Ireland (-4%) and Norway (-3%).

Countries with an already low volume of insolvencies at the end of 2017 should register a slower decline in 2018. This is the case for the Netherlands (-5%), Germany (-4%), Austria (-2%) and Finland (-2%). In Belgium (-5%), the rebound seen in 2017 was a one-off. It was driven to a large extent by insolvencies in Brussels, notably in the Hospitality and Restaurants industry, following the terror attacks.

The UK will be the main exception with a sizable increase (+8%) due to Brexit uncertainties.

US: Back to pre-crisis levels

After eight years of a steady fall, we anticipate a slower decrease in insolvencies in North America in 2018 (-2%). Insolvencies should plateau in Canada after reaching a record low in 2017. The US has a robust economic outlook for 2018, bolstered by the expected fiscal easing. This should support another decrease in insolvencies (-2%) to the lowest since 2006. Yet the improvement will be tempered by the gradual tightening of interest rates, input and labor cost pressures, business demography dynamics - and lagging effects of the natural disasters that hit the country in late 2017.
A persistent rise in Asia, notably China, and Africa

In Asia, economic growth is to remain firm, supported by improved prospects for trade and investment. Yet the region suffers from the side effects of the growth ‘normalization’ in China. Economic and monetary measures enacted to reduce financial risk, overcapacities and capital flows and to support the rebalancing and upgrading of the economy create turbulences for specific sectors and companies.

In 2018, insolvencies will continue to rise in China (+10%) - after a significant pick-up in 2017 (+35%) - and in Taiwan (+5% after +17%). Failure levels are estimated to remain almost unchanged in Japan and Hong-Kong (+1% after +0% for both countries).

The declining trend is set to be over in Singapore (+0%) Australia (+0%), South Korea (+0%) and New Zealand (+2%) where they reached low levels in 2017. Thus the regional insolvency index will increase further in 2018 (+6%), albeit at a slower pace (+14% in 2017). Still, it will remain below its 2008 peak.

In Africa, the regional rise in insolvencies (+6%) emanates from two major economies. Morocco with +8% after +12% in 2017; and the softening improvement in South Africa -3% in 2018 after -10% in the previous year.

A trend reversal in Brazil, but not for Latin America as a whole

We expect insolvencies in Latin America to stabilize in 2018 (+0%). This should take place after six consecutive years of rise and a sharp rise in 2017 (+17%) which led to a record high. In Brazil, the number of insolvencies should start to decline in 2018 (-7% after +5% in 2017), thanks to the easing of financial conditions and the acceleration of the economic recovery.

For the same reasons, the trend reversal initiated in Colombia in 2017 (-6%) remains on track for 2018 (-3%). But in Chile bankruptcies will stay on the upside (+5%), still boosted by the new procedures in place since 2014 with the new Insolvency Law.

Central and Eastern Europe improves again, after a tough 2017

The bounce-back seen in 2017 (+4%) was driven by two factors. First, the difficulties that companies faced in major countries such as Russia, Turkey and Poland as well as in Romania, due to VAT issues;

Second, the change in the Insolvency Law in Slovakia where failures skyrocketed by +78% (including sole proprietorship). In 2018, the region should return to the positive trend of a decline in insolvencies as seen in the 2014-16 period with a -4% decline.

Maxime Lemerle

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**Chart 1:** Euler Hermes Global Insolvency Index (yearly change in %)

- **Asia-Pacific Index:** +14% (2018), +14% (2017), +14% (2016)
- **Africa & Middle East Index:** +19% (2018), +19% (2017), +19% (2016)
- **Central & Eastern Europe Index:** +4% (2018), +4% (2017), +4% (2016)
- **Western Europe Index:** -6% (2018), -6% (2017), -6% (2016)
- **Latin America Index:** +47% (2018), +47% (2017), +47% (2016)
- **North America Index:** -4% (2018), -4% (2017), -4% (2016)
- **Global Insolvency Index:** -4% (2018), -4% (2017), -4% (2016)

Source: Euler Hermes
Major Failures

Big, ugly and more frequent

Retail in Europe and the US in focus

While the total number of insolvencies is set to decline in 2018, the improvement will not be spread evenly. 2017 figures on major insolvencies – namely for companies with more than EUR 50 million in turnover – show the extent of the gap. Major failures increased every quarter last year. The number for the full year - 57 additional cases – meant that 321 companies went bust in 2017. Their cumulative turnover stood at EUR104bn. This is a EUR10bn hike compare to 2016.

Western Europe (up 42 cases to 138) and Asia (+17 to 63) are leading the climb. In terms of sectors, Services in Central and Eastern Europe, Retail in North America, Construction and Agrifood in Western Europe all sustained more than 20 major failures. Energy was the main sector that saw a decline in major failures, despite some big-ticket cases in North America and Europe.

![Chart 2 Euler Hermes Global and Regional Insolvency Indices in 2018 (yearly change in %)](chart)

- **Strongly deteriorating**
  - Strictly more than +5%
  - UK (+8%)
  - Romania (+7%)
  - China (+10%)
  - Morocco (+8%)

- **Deteriorating**
  - +1% to +5%
  - Taiwan (+5%)
  - New Zealand (+2%)
  - Japan (+1%)
  - Hong-Kong (+1%)
  - Poland (+5%)
  - Slovakia (+3%)
  - Sweden (+2%)
  - Singapore (+5%)
  - Chile (+5%)

- **Stable or improving**
  - -5% to 0%
  - Canada (0%)
  - Estonia (0%)
  - Russia (0%)
  - South Korea (0%)
  - US (-2%)
  - Austria (-2%)
  - South Africa (-3%)
  - Germany (-4%)
  - The Netherlands (-5%)
  - Latvia (-5%)
  - Finland (-2%)
  - Bulgaria (-5%)
  - Switzerland (0%)
  - Spain (0%)
  - Australia (0%)
  - Norway (-3%)
  - Colombia (-3%)
  - Luxembourg (-4%)
  - Ireland (-4%)
  - Turkey (-4%)
  - Belgium (-5%)
  - Lithuania (-5%)

- **Strongly improving**
  - Strictly more than -5%
  - Brazil (-7%)
  - Greece (-10%)
  - France (-7%)
  - Italy (-10%)
  - Portugal (-7%)
  - Czech Rep (-7%)
  - Denmark (-9%)
  - Hungary (-12%)

Source: Euler Hermes
**NORTH AMERICA**

**THE US: FIT FOR A MARATHON**

The American economy is set to benefit in 2018 from one of its longest cycles of expansion amid a favorable policy-mix

**US economy to be more balanced**

The US economy registered a stronger than expected level of growth in Q3 17 at 3.2% (q/q annualized). This happened on the back of higher contribution of net exports and investment, while consumption decelerated a bit after a remarkable period of stability.

This configuration is promising, as it taps into more diversified sources of growth.

Thus, we see a more versatile allocation of the benefits of what is now the second longest cycle of expansion.

A better balance of different contributors to growth will be the key theme for 2018. We expect the US economy to accelerate and grow by 2.6% y/y against 2.3% y/y in 2017.

Household consumption will climb broadly at the same pace as in 2017 at 2.6% y/y amid steady progress on the job front and higher wages.

These would be counterbalanced by higher inflation and weaker growth in consumer credit.

Investment will register the most significant improvement thanks to the boost provided by the Tax Cuts and Jobs Act (TCJA).

Non residential investment will reach 5% on a y/y basis in 2018 compared with 4.4% y/y in 2017.

Residential investment is also expected to accelerate albeit in a more muted manner as TCJA is not really judged as being supportive of the housing market.

**TCJA to further tighten job market**

A late positioning in the cycle, limited redistribution effects (wealthy households are expected to benefit the most from individual tax cuts), a limited impact of tax repatriation initiative and the priority given to reducing taxes on corporate profits suggest a limited multiplier effect of the TCJA.

In our view, the most significant effect of the Act, beside the temporary boost to growth (estimated at +0.5% in 2018), should appear in the job market.

This would take place via higher wages expected at 3% y/y on average in 2018 against 2.5% y/y in 2017, as unemployment will decline to 3.5% (from 4.1% today.)

**The Fed to hike 3 times in 2018**

Despite a lower degree of slack in the economy, the Fed won’t be in a hurry to hike the Fed Funds Target rate.

CPI inflation is estimated to rise by a mere 2.2% y/y in 2018 compared to 2.1% y/y in 2017.

We expect three hikes in 2018 with the first move to take place in March.
The Federal Reserve will see significant personnel changes in 2018 as Jerome Powell replaces Janet Yellen, Randall Quarles replaces Daniel Tarullo as supervisory chief, and New York Fed President William Dudley is to retire in mid-2018. Then there are still two vacant positions. These moves will incentivize the Fed to establish its credibility by sticking to the well-communicated plan of three hikes in 2018.

The stock market, already overstretched in terms of valuation, would thus not face any surprises from the Fed’s side.

**Canada : Solid but risky**

The Canadian economy was among the strongest in the developed world in 2017, with GDP growth of about 3.1%. However, base effects will cause the economy to slow in 2018 and return to grow closer to its sustainable potential at 2.3%.

The white-hot labor market will underpin that growth. Unemployment is at a record low 5.7%, and the economy added a total of 159,000 jobs in November and December, at three times the rate of the U.S. The recent rise in oil prices will serve as another boost at least in Q1.

The Bank of Canada has responded, raising the policy overnight rate twice in less than two months in 2017, once so far in 2018, and probably twice more in 2018, helping keep inflation under 2%.

However two serious risks remain. Negotiations over NAFTA, which are due to end in Q1, have been contentious.

A collapse of NAFTA, which once seemed unlikely, has now evolved into a possibility.

If it were to happen, the Canadian economy would suffer massive damage. In addition, the housing market continues to pose a risk, as government measures to slow bubble-like price increases have caused sharp swings in activity.

Prices fell 7% in Toronto in just four months. Unit sales nationwide fell 10% between Q1 and Q3, but have recovered significantly since then.

Overall 2018 looks to be a strong year, but the risks are high.

Dan North, Alexis Garatti
**WESTERN EUROPE**

**SWAY WITH ME**

The upswing surprised in 2017, and the economy is off to a flying start in 2018

**Cruising mode activated**

We expect the Euro zone to grow by +2.2% y/y in 2018 compared to +2.4% y/y in 2017.

This slight deceleration will mainly be explained by a lower contribution of external trade (exports will grow by +4.5% y/y in 2018 against +4.7% y/y in 2017) and a slightly lower growth of investment (+3.8% y/y in 2018, -0.2pp from 2017).

The current expansion cycle of the euro-area should last for at least 2 more years due to (i) accommodative credit conditions, (ii) a high synchronization of national cycles, and (iii) a persistently high level of external demand.

We expect household consumption to be stable in 2018 and expand by +1.8% y/y on the back of favorable credit condition and steady decline of unemployment.

Investment will remain the main driver of this improvement as it will continue growing at a strong pace of +3.8% y/y in 2018 compared with +4.0% y/y in 2017.

As a common feature with 2017, this dynamism of investment will lead to significantly gains in terms of jobs creation.

We expect Euro zone’s unemployment rate to decline by 0.7 pp in 2018 to 8.4% on average.

Net external demand should contribute slightly less to growth as we expect exports (+4.4% y/y in 2018 versus +4.7% y/y in 2017) to decelerate at a quicker pace compared with imports (+4.5% y/y in 2018 versus +4.6% y/y in 2017).

Government spending is expected to accelerate from +1.1% y/y in 2017 to +1.3% y/y in 2018 on the back in particular of higher public expenditures in Germany.

**Smooth operator**

Several contradictory factors fuel uncertainty on the CPI inflation scenario as the recent appreciation of the EUR (+14% y/y versus USD in 2017) depresses the price of imported goods, but oil prices have markedly increased to USD 70 per barrel, while wage growth remains contained for now.

All in all, we expect an increase of CPI inflation to +1.6% y/y in 2018 against +1.5% y/y in 2017.

The ECB has extended its quantitative easing program until at least the end of September 2018, but reduced its monthly net asset purchases to EUR30bn (-30bn), starting in January 2018. Currently at EUR4471bn, the size of ECB’s balance sheet will continue increasing until September.

Thereafter, the ECB is likely to cease its securities purchase program and envisage rate hikes from early 2019 only despite clear and tangible signs of macroeconomic improvement.

**5 pilots**

**France:** The catch up effect holds on. After a lost decade, 2017 was the full-speed growth year I (+1.8%) and 2018 is set to be year II (+1.9%). Private sector investment is expected to be the main trigger of growth acceleration.

Business confidence and capacity utilization rates recently returned to pre-crisis highs. Inflation should accelerate from +1% y/y in 2017 to +1.6% y/y in 2018, driven by increasing fuel taxes and more pressure on core prices alongside higher capacity utilization rate.

**Spain:** 2017 put the finishing touches to Spain’s “Remontada” as nominal GDP surpassed its pre-2008 crisis level.

In 2018, a deceleration from +3.1% y/y to +2.4% y/y of real GDP growth is in sight. Inflation (+1.5% y/y in 2018) should take a toll on purchasing power, as wages struggle to keep pace despite employment gains.

Risks related to the Catalonia crisis will nurture uncertainty and weigh on investment, which is expected to grow by +3.2% y/y against +4.8% y/y in 2017.

**Germany:** the boom goes on and we expect real GDP to steadily grow by +2.5% y/y in 2018 (the same as in 2017).

A slowdown in private consumption (+1.5% y/y in 2018) should be offset by an acceleration of investment (+5.1% in 2018) amid steady contribution of net exports.

In parallel, a slightly lower contribution of net exports should be compensated by an acceleration of public spending.
**Italy:** Real GDP growth is expected at +1.3% y/y in 2018 after 1.6% in 2017.

Economic performance positively surprised thanks to a strengthening of domestic demand and continued strong external performance.

Nonetheless, more reforms are still required to tackle structural weaknesses. Progress at this level won’t be easy to achieve, with general election coming in March 2018.

**UK:** Brexit-induced downshift is becoming increasingly more visible.

The outlook for private consumption is grim (forecast at +0.9% in 2018, -0.6pp from 2017) as UK consumers’ confidence is declining against the double-whammy blow of high inflation and sluggish wage growth.

Moreover, the sterling depreciation hasn’t triggered higher exports as of now. The economy should decline to a mere +1.0% in 2018, after +1.7% in 2017.

**Table 1** Real GDP growth forecasts

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Sources: IHS, Euler Hermes
Fast (growth) and cautious (optimism)

In 2018, the outlook for Asia-Pacific could be summarized in two words “fast” and “cautious”. First, “fast” stands for the still strong real economic growth the region is expected to record this year. Real GDP growth is set to rise by +4.8%, a pace slightly slower than last year (+5%), but still strong compared to the global average and other regions, supported by improved exports prospects and solid domestic demand.

“Cautious” qualifies our optimism. Economic activity has returned to a healthy growth pace with (i) both domestic demand and exports moving in sync, (ii) the manufacturing sector out of deflation.

Yet, challenges to sustainable expansion remain elevated. One, financing conditions are expected to tighten. We expect monetary authorities in the region to shift gradually from an easing to a tightening cycle as (i) inflation picks up and (ii) the reduction of financial risks (high leverage, housing risk, e.g.) becomes the priority. Two, trade related risks do exist with rising protectionist measures from the US against China. Three, on the micro-side, corporate risk remains an issue with a continued rise of corporate bankruptcies (+6% in 2018 from +14% in 2017) led by China (+10%).

China: slower but firm

In China, real economic growth is set to slow to +6.4% (from +6.9% in 2017). Economic growth continues to rise at a solid pace, yet a certain number of indicators point to slower momentum in 2018. On the demand side, retail sales growth moderated and investment remained weak in Q4 2017. In terms of prices, manufacturing reflation start to lose some speed (producer prices up 4.9% y/y in December, down from +5.8% in November). On financing, outstanding loans growth decelerated (12.7% y/y from +13.3% in November). Looking at advanced indicators, business surveys indicate solid expansion in services, fragile growth in the manufacturing sector due to slower growth in both output and new orders. Our view is that authorities’ moves to improve growth quality (financial and property market tightening, cut in overcapacity e.g.) have started to dent growth and slower momentum could be expected going forward. On the upside, we expect domestic consumption to remain resilient underpinned by a favourable fiscal policy, solid labour market and rising per capital income.

Japan: still above potential

In Japan, real economic growth is set to slow in 2018 due to the unwinding of the 2017 fiscal stimulus. Yet economic growth is likely to stay above potential thanks to solid export growth and a positive investment cycle. Investment is underpinned by high corporate profit margins and still favourable financing conditions. Consumption appears to have regained some strength at the end of 2017. Further improvement could be expected if spring negotiation were to allow a pickup in wages as the government has proposed a new tax credit for companies that raise hourly wages. On the monetary policy front, we expect the BoJ to stick to its target for the 10-year JGB yield (“around zero percent”) for the time being. With a tight labour market and gradually rising inflation, the BoJ might, however, begin to signal a more flexible approach to the 2% price stability target later this year.

Emerging ASEAN and India: a higher growth regime

In Emerging ASEAN, economic growth is expected to remain firm with stronger expansion in Vietnam (+6.7% in 2018), Philippines (+6.8%) and Indonesia (+5.3%); above trend growth in Malaysia (+5%) and Thailand (+3.6%). Vietnam, Philippines and Indonesia are expected to benefit from a strong rise in exports thanks to solid competitive advantages (low labour costs). Domestic consumption would remain solid sustained by a strong labour market and rising wages.

Higher demand, rising risk appetite and a gradual rise in foreign direct investment may act as a driver for a positive investment cycle. In Malaysia and Thailand, growth pace would be above trend. Yet we expect a slight deceleration owing to more modest investment cycle: in Thailand due to persisting political uncertainties during a potential election year; in Malaysia as monetary policy tighten and fiscal consolidation continues.
In India, growth is set to accelerate to +7.3% in FY2018-19 (from +6.5% in FY2017-18) as the impacts of demonetization and the GST implementation fade away. Strong car sales point to strong growth in private consumption. Industrial production growth picks up speed as both external demand and domestic demand move in sync. Investment shows signs of strengths supported by rising FDI inflows, strong corporates and investor's confidence and a gradual rise in bank credit. With bank’s ability to lend set to improve next year on the back of government recapitalization (+USD32bn), credit growth could improve further and support growth.

Mahamoud Islam

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NB: data for India are in fiscal year

Sources: IHS, Euler Hermes
Boas Vibrações? (“Good Vibes”)

Latin Americans can breathe a sigh of relief - at least for now. After two years of recession, in 2015 (-0.2%) and 2016 (-1.2%) we estimate 2017 GDP growth at +1.4% and expect it to accelerate to +2.4% in 2018.

The buds of recovery have started to blossom with higher commodity prices (the S&P GSCI index was up 13% in 2017) and the Brazilian return to growth with +1.1% in 2017 and +2.5% in 2018 (forecast). These should further fuel the regional acceleration.

South American countries’ growth rates are converging again. Moreover, the improved macroeconomic environment has seen a less steep rise in the number of business insolvencies in 2017 with +17%, after +47% in 2016. The number of failures should stabilize in 2018 (+0%) for the first time in six years. Yet the busy political calendar could prevent the region from thriving at its pre-recession average growth rate (+3.5% from 2005 to 2014).

Buckle up! For a (modest) acceleration

We estimate the three major economies - Brazil, Mexico and Argentina - will contribute to 70% of the region’s growth in 2018. Export gains over four quarters reached USD +29.4bn in Mexico in Q3 2017 and USD +24.5bn in Brazil.

The recovery should now shift to the consumer. Retail sales have shown dynamism especially in Brazil where they posted their highest y/y growth in November since February 2014 (+5.1%). Besides, Euler Hermes upgraded two Brazilian consumer-related sectors in Q4 2017: Automotive and Agrifood. This bodes well for internal demand.

The upswing will be supported by (i) the trend reversal in unemployment in Brazil (12% in November 2017 down from 13.7% in March); (ii) accommodative monetary policies (post-disinflation in 2015-16), although the easing trend will likely slow down. Inflation is expected to ease to +5.7% in 2018 on average in Brazil, Mexico, Argentina, Chile, Colombia and Peru, after +7.4% in 2017. For the first time in four years, financial conditions are improving.

Beware of turbulences

If it were only for its external financing position, Latin America would be in for a safe ride, with comfortable foreign exchange reserves and more balanced external accounts as a result of strict adjustments. Yet 2018 could be the year of political turbulences.

Two major presidential elections are on the radar: Mexico (July) and Brazil (October). The Mexican anti-establishment candidate is gaining ground. It leverages nationalism as a response to the US’s tough foreign policy stance and the rejection of the center-right party’s hegemony. The Brazilian race has never been so open.

The possibility of a return to power of economic populism in both countries poses a risk to the reform momentum and hence to the business climate and public finances. On top of that, the volatility stemming from the North American Free Trade Agreement (NAFTA) negotiations could rein in economic outcomes, although the new treaty would not come into effect before 2019.
The Emerging Europe region as a whole is forecast to grow by +3% in 2018, following a strong +3.7% in 2017.

Central Europe: Strong, balanced growth
Notably the 11 EU member states in the region will continue to perform well. These economies have been on a path of strong recovery since 2014, somewhat earlier than Western Europe, thanks to strengthening domestic demand which has put growth on a more balanced footing. Private consumption is forecast to remain a key growth driver in 2018, supported by strong wage growth, low interest rates and still moderate inflation.

Fixed investment growth rebounded in 2017, thanks to better absorption of EU funds, and should remain robust in 2018 though the rate of increase will be somewhat lower due to base effects. In Romania and Poland, substantial procyclical fiscal stimulus boosted growth in 2017, raising some concern of potential overheating and rising inflationary pressures.

Indeed, inflation rose to 3.3% at end-2017 in Romania, prompting a timid 25bp policy rate hike to 2.0% by the Central Bank.

Elsewhere in Central Europe, inflation also rose markedly in 2017 but leveled off within the respective central banks’ inflation target ranges by year-end.

We expect average inflation rates between 2% and 3% in 2018 in these economies and a rate above 3% in Romania. The Czech Republic started the monetary tightening cycle in the region with two hikes in H2 2017 and we expect the other countries to follow with 1-2 hikes this year.

External trade activity will remain robust in 2018, with export growth benefiting from the ongoing Eurozone recovery and import growth from the sound domestic demand.

Turkey: Normalization in 2018
Following the extraordinarily rapid growth in 2017, thanks to strong fiscal stimulus channeled to households and investment as well as rebounding exports, we expect a slowdown of GDP growth to +4% in 2018.

This could be due in part to the waning impact of both the one-off fiscal measures and the exports rebound. Inflation is forecast to ease from the 14-year high of 13% in November 2017 to a still elevated average 9% in 2018.

Russia: Low growth, low inflation
We project a gradual acceleration of GDP growth to +1.9% in 2018, on the back of recovering consumption and investment, and political continuity beyond the presidential election in March.

The pick-up will be supported by low inflation (forecast at an average 3.6% in 2018) and declining interest rates as well as one-off factors such as pre-election spending and the 2018 FIFA World Cup.

Manfred Stamer
Economic outlook to improve gradually as oil prices pick up, but rising political risks pose substantial downside risks

GCC: Moderate recovery in 2018

In 2017, growth in the Gulf Cooperation Council (GCC) region decelerated to an estimated +0.4% (from +2.4% in 2016). This was mainly due to a reduction in oil production following the November 2016 agreement by OPEC members and other major oil producers (such as Russia) to cut output in order to stabilize then falling oil prices. For example, oil extraction in Saudi Arabia which accounts for almost half of GCC GDP dropped by -3.5% in 2017, dragging the whole economy into recession (-0.7%) even though the non-oil sector grew by +1%.

Meanwhile, the oil production cuts have been extended until the end of 2018 but not deepened. Hence oil output in the GCC should stabilize this year, allowing for a gradual recovery of the oil sector as prices will be higher than last year—Euler Hermes forecasts an average USD62/bbl of benchmark Brent in 2018, up from USD55/bbl in 2017. The non-oil sector is expected to continue to expand moderately as ongoing fiscal austerity measures will retard a significant strengthening. Overall, we forecast a modest recovery of growth to +2.2% in the GCC region in 2018.

The long announced introduction of a 5% VAT across the GCC at the start of 2018 was implemented only in Saudi Arabia and the UAE, for now. This should speed up inflation to an average 4% or so in 2018.

The rest of the GCC states are understood to have deferred VAT implementation, perhaps until 2019. Huge SWFs in the larger GCC economies still provide for solid country risk profiles. However, Bahrain ran out of reserves in late 2017 and reportedly asked GCC allies for financial support. Meanwhile, Qatar appears to weather the political tensions with other Arab states as GDP growth rebounded to +1.9% y/y in Q3 2017. We forecast growth of +2.5% in 2018.

Iran: Political risks cloud economic outlook

The economy is recovering from years of tough economic sanctions. We forecast +4% real GDP growth in 2018. However, rising political tensions in the country (as strong growth since the lifting of sanctions in 2016 has not yet translated into better living standards), mounting regional geopolitical risks and potential new U.S. sanctions pose considerable downside risks. Inflation remains elevated and is forecast to average 10% in 2018.

Israel: Robust outlook

Real GDP growth is projected to pick up to +3.6% in 2018 (from +3% in 2017), supported by accommodative monetary and fiscal policies that will boost private consumption and investment. And the improving global economy should sustain sound export expansion. Inflation is expected to pick up to an average 1% in 2018.

Manfred Stamer
AFRICA
COUNTRY ROADS

Growth is gradually recovering and should reach +3.5% in 2018. Yet growth divergence across regions will remain fairly strong

Growth: Meet me halfway

In 2018, African economies will continue to exhibit salient divergences. On average, growth is on a higher path, accelerating to +3.5% in 2018 (from +3.2% in 2017), but will stay well below pre-crisis levels (+5% in 2012). The continent will prove resilient on key positive long-term economic developments: investment in infrastructure and the industrial revolution will together continue to fuel economic growth.

These positive developments are particularly prominent in East African economies, bringing stability to their high growth rates (+6.6% in 2018). Other economies in Southern Africa (e.g. Zambia) or in West Africa (e.g. Côte d’Ivoire or Ghana) are also benefitting from this virtuous circle. Increases in the capital stock fuel agricultural productivity and the development of low value-added manufacturing sectors (textile) or consumer-related ones (car plants). As a result, despite low agricultural prices, output growth is protecting farmers’ incomes.

But not all African economies will grow this year. Financing issues (low levels of foreign reserves, high external deficits and debt levels) will continue to weigh on the outlook in Central Africa (+1.5%), in Angola (+1%) or in Tunisia (+2.5%). Moreover, these countries will still be exposed to exchange rate depreciation pressures.

The Fantastic Four in different shapes

Egypt should be among the best performers in 2018, growing by +5%. Key reforms implemented from November 2016 (flexible exchange rate, partial unwinding of capital controls and subsidies cuts) are delivering fast, with a positive impact on growth. In 2018, the rapid decrease of inflation to +12% from +29.5% in 2017 will help.

In 2017, Nigeria emerged from a long lasting recession and an exchange rate crisis. Better business environment and the recovery of oil prices should stimulate growth: we expect it to accelerate to +2.5% in 2018 from +0.8% in 2017. However, inflation persistence at +12.9% in 2018 may well trigger new depreciation pressures on the Naira.

In 2017, South Africa posted below 2% growth for a fourth consecutive year, putting public debt on a rising trend (53% of GDP in 2017, compared to 41% in 2012). 2018 should be about growth recovery (+1.4% up from +0.8% in 2017), as lower inflation (+5% in 2018) will help.

Morocco will probably grow slower in 2018 (+3%). Indeed, growth in 2017 (+3.8%) benefitted from one-off effects of an agricultural crops recovery. Overall, growth in the manufacturing sector will be quite stable. The country adopted a more flexible exchange rate regime in January, a welcome move in order to reach new export destinations.

Stéphane Colliac

Growth forecasts per region, in %

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<td>4.5</td>
</tr>
</tbody>
</table>

*Egypt is included in Africa; Lybia excluded from regional average

Sources: IMF, Euler Hermes, forecasts
CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

The statements contained herein may include prospects, statements of future expectations and other forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties. Actual results, performance or events may differ materially from those expressed or implied in such forward-looking statements.

Such deviations may arise due to, without limitation, (i) changes of the general economic conditions and competitive situation, particularly in the Allianz Group's core business and core markets, (ii) performance of financial markets (particularly market volatility, liquidity and credit events), (iii) frequency and severity of insured loss events, including from natural catastrophes, and the development of loss expenses, (iv) mortality and morbidity levels and trends, (v) persistency levels, (vi) particularly in the banking business, the extent of credit defaults, (vii) interest rate levels, (viii) currency exchange rates including the euro/US-dollar exchange rate, (ix) changes in laws and regulations, including tax regulations, (x) the impact of acquisitions, including related integration issues, and reorganization measures, and (xi) general competitive factors, in each case on a local, regional, national and/or global basis. Many of these factors may be more likely to occur, or more pronounced, as a result of terrorist activities and their consequences.

NO DUTY TO UPDATE

The company assumes no obligation to update any information or forward-looking statement contained herein, save for any information required to be disclosed by law.