Confidence to be bold

Economic Research Department
Global Economic Outlook

June 2018

EULER HERMES
Our knowledge serving your success

Allianz

GLOBAL GROWTH: HEALTHY ALBEIT LESS SYNCHRONIZED

Global GDP growth forecasts (%)

	2016	2017	2018		2019	
			Latest forecast	Revision (pps)	Latest forecast	Revision (pps)
World GDP growth	**2.6**	**3.2**	**3.3**	=	**3.1**	=
United States	1.5	2.3	2.9	=	2.4	=
Latin America	**-0.9**	**1.2**	**2.0**	**-0.3**	**2.4**	**-0.4**
Brazil	-3.5	1.0	1.9	**-0.6**	2.5	**-0.5**
United Kingdom	1.9	1.7	1.4	**-0.1**	1.3	**0.1**
Eurozone members	**1.7**	**2.6**	**2.1**	**-0.2**	**1.9**	**-0.1**
Germany	1.9	2.5	2.2	**-0.3**	1.9	=
France	1.1	2.3	1.8	**-0.3**	2.0	**0.1**
Italy	1.0	1.6	1.2	**-0.2**	0.8	**-0.4**
Spain	3.3	3.1	2.7	**0.2**	2.4	**0.1**
Russia	-0.2	1.5	1.8	**-0.1**	1.8	=
Turkey	3.2	7.4	3.7	**-0.9**	3.0	**-1.0**
Asia	**5.0**	**5.2**	**5.1**	**0.1**	**4.9**	=
China	6.7	6.9	6.6	**0.1**	6.3	**0.1**
Japan	1.0	1.7	1.2	=	1.0	=
India	7.1	6.7	7.3	=	7.3	=
Middle East	**4.3**	**1.3**	**2.4**	**-0.3**	**2.5**	**-0.5**
Saudi Arabia	1.7	-0.7	1.7	=	2.0	=
Africa	**1.3**	**3.2**	**3.7**	**0.1**	**3.8**	**0.1**
South Africa	0.6	1.3	2.0	=	2.5	=

** Weights in global GDP at market price, 2017*

NB: The revisions refer to the changes in our forecasts since the last quarter
Fiscal year for India

Sources: IHS. Euler Hermes. Allianz Research

1. World GDP growth remains on a solid footing albeit being less synchronized
Three shocks since Q1: stronger than expected yields, higher commodity prices and higher (geo)political risk

- i. The growth peak seems behind us
- ii. Diverging growth engines as:
  - i. Political risk is expected to persist
  - ii. The Fed will continue pushing global rates higher
  - iii. Effects from old fiscal stimulus measures start to fade away (China, Japan, US) but new one kicks-in (Europe)
  - iv. Multi-speed normalization of monetary policies will diverge the trend in financial conditions
  - v. FDI flows soften amid higher protectionism

2. The markets are likely to increasingly sanction the weakest in the loop: Stress for currencies in the some of the vulnerable emerging markets: Turkey and Argentina

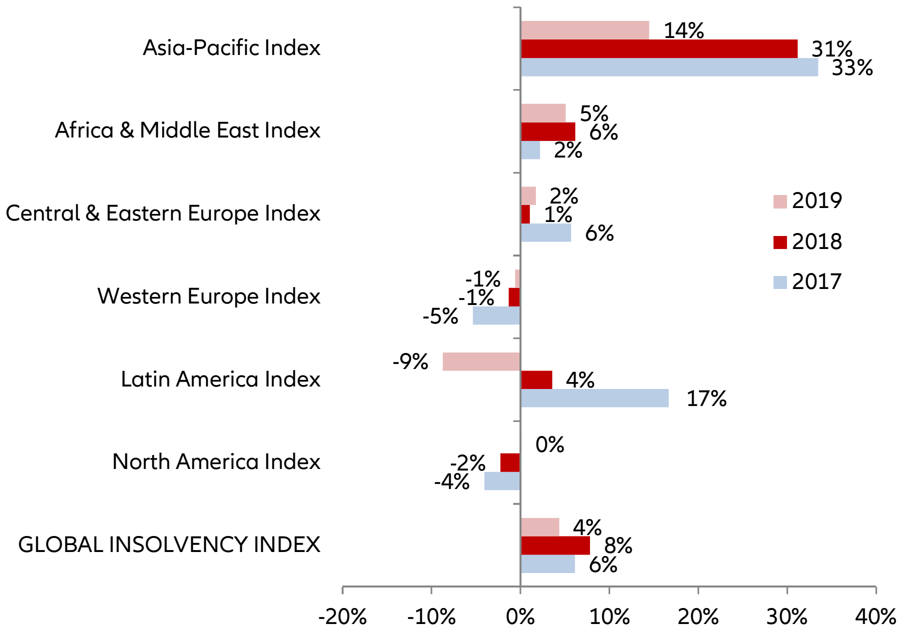
3. Brent oil prices at 72 USD/bbl in 2018 and 69 USD/bbl in 2019. Spot price mid-June 2018 at 75 USD/bbl.

4. A temporary surge in **inflation** expected in Q3 18 on the back of higher oil prices and depreciating currencies.

5. USD to further appreciate in the next 6 months (+4.5%). EUR/USD: 1.10 at end-2018; 1.17 at end-2019.

GLOBAL INSOLVENCIES DIVERGING REGIONAL FORECASTS

EH Global and Regional Insolvency Indices (yearly change in %)



Sources: National statistics, Euler Hermes, Allianz Research

Insolvency Heat Map 2018

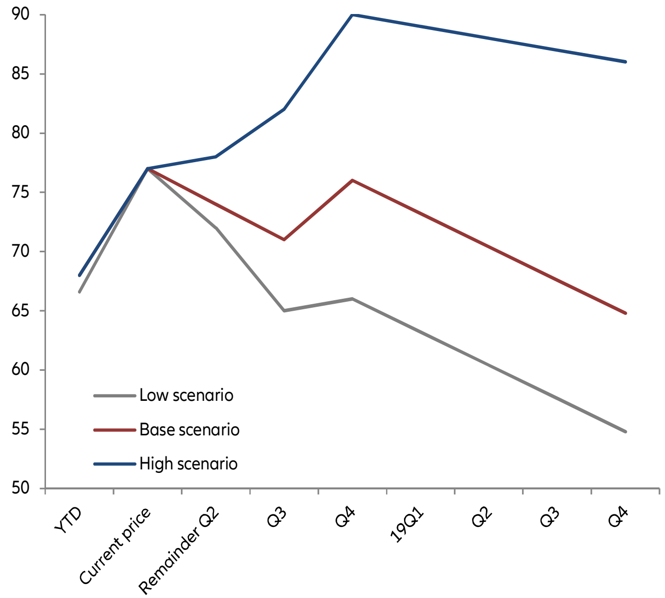
	Very low level (more than 10% below the 2003-2007 level)	**Low level** (between 0% and 10% below the 2003-2007 level)	**High level** (between 1% and 10% above the 2003-2007 level)	**Very high level** (more than 10% above the 2003-2007 level)
Strongly deteriorating strictly more than +5%	Romania (+12%)	Poland (+10%)	Finland (+6%)	Slovakia (+80%) * China (+50%) Luxembourg (+12%) Denmark (+11%) Colombia (+8%) * Morocco (+8%) Chile (+7%)
Deteriorating or stable +0% to +5%	UK (+5%) Taiwan (+5%) New Zealand (+2%) Austria (+2%) Canada (0%) Japan (+0%) Russia (0%)	Sweden (+2%) Singapore (+0%) Estonia (0%)	Switzerland (+1%)	Turkey (+5%) Norway (+5%) Australia (+3%) Belgium (+3%) Spain (0%)
Improving -5% to -1%	South Africa (-1%) Latvia (-2%) US (-2%) Brazil (-3%) Germany (-4%) The Netherlands (-5%) South Korea (-5%) Hong-Kong (-5%)		Bulgaria (-5%)	
Strongly improving strictly more than -5%	Greece (-9%)	Czech Rep (-17%) *	Italy (-6%) France (-7%)	Hungary (-7%) Ireland (-10%) Portugal (-10%) Lithuania (-18%)

(*) Historical data are not fully consistent because of changes in law or national figures
Sources: National statistics, Euler Hermes, Allianz Research

We expect our Global Insolvency Index to remain oriented on the upside for a second consecutive year in a row in 2018 (to +8% from +6% in 2017) and to keep on increasing in 2019 (+4%). However, this global trend will reflect different trends by regions and countries: the decrease in insolvencies to loose momentum in North America and Western Europe, but to soften faster in Western Europe than in the US ; the improvement in Latam to be more obvious in 2019 than in 2018; the surge in insolvencies to continue in China, notably re 'zombie companies, and to boost the regional overall figures; the quasi-stabilization in Central and Eastern Europe to mask an increase in Poland and Turkey.

OIL PRICES TO DECLINE TO 69 USD/BBL IN 2019

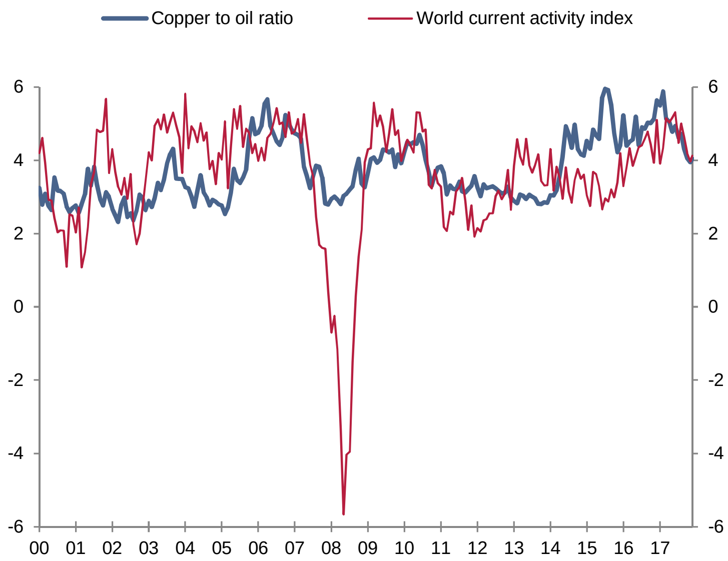
Oil forecasts



Sources: IHS, Bloomberg. Allianz Research

We expect oil prices to be broadly stable until the end of 2018 and decline thereafter on the back of abundant supply absorbing net losses linked to Venezuela and Iran situation

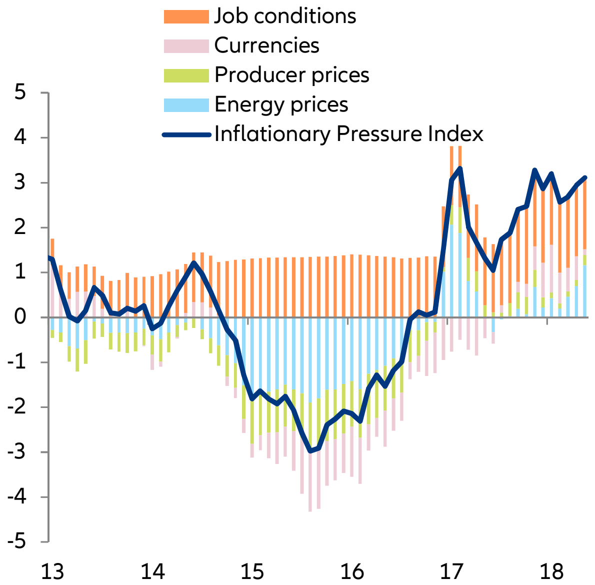
Copper to oil ratio vs world current activity index (y/y, %)



Sources: IHS, Bloomberg. Allianz Research

The copper to oil ratio is a good advanced indicator of global activity. Our 2019 GDP growth scenario suggests that the market will anticipate a deceleration of global demand and therefore exert downward pressures on oil prices

Global Inflationary pressure index

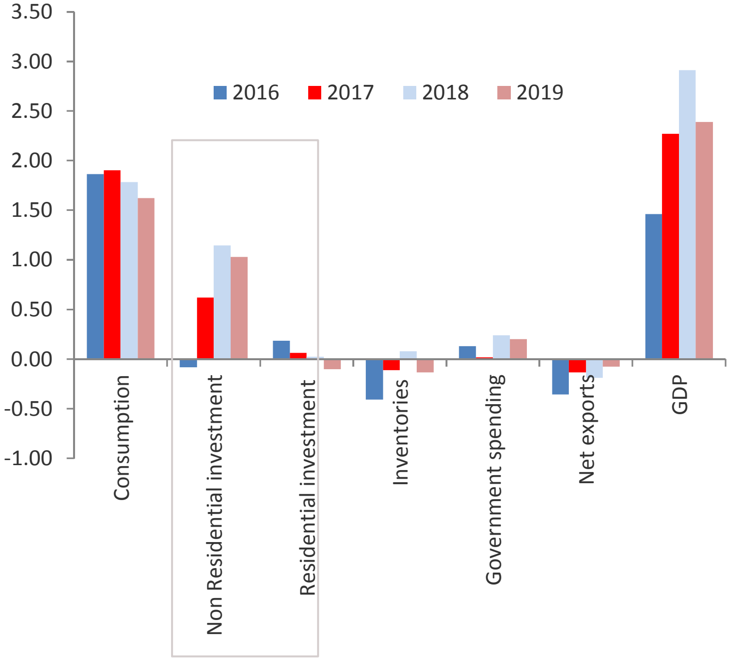


Sources: IHS, Bloomberg. Allianz Research

Our global inflationary pressure index suggests that the upcoming surge of global inflation should be temporary as the contribution of energy prices is significant

US: CLOSER TO OVERHEATING DUE TO FISCAL STIMULUS

Contribution to US GDP growth (%, y/y)



Sources : Euler Hermes, Allianz Research

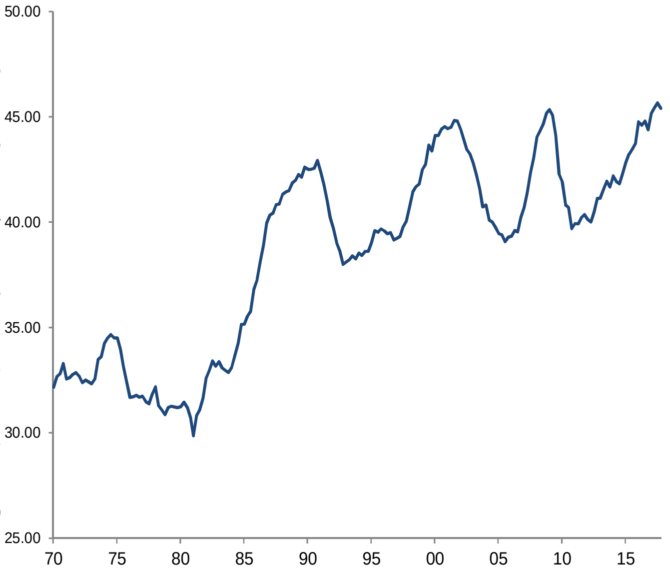
US GDP growth is expected at 2.4% y/y in 2019 compared with 2.9% y/y in 2018. Higher rates will weigh on consumption and residential investment at a 2-year horizon

US unemployed to jobs openings ratio

Sources : Euler Hermes, Allianz Research

Amid a favorable investment cycle, demand for jobs is strong. For the first time since 1970s the number of US job offers is above the number of unemployed people, meaning that this unemployment is frictional only

US corporate debt (as % of GDP)

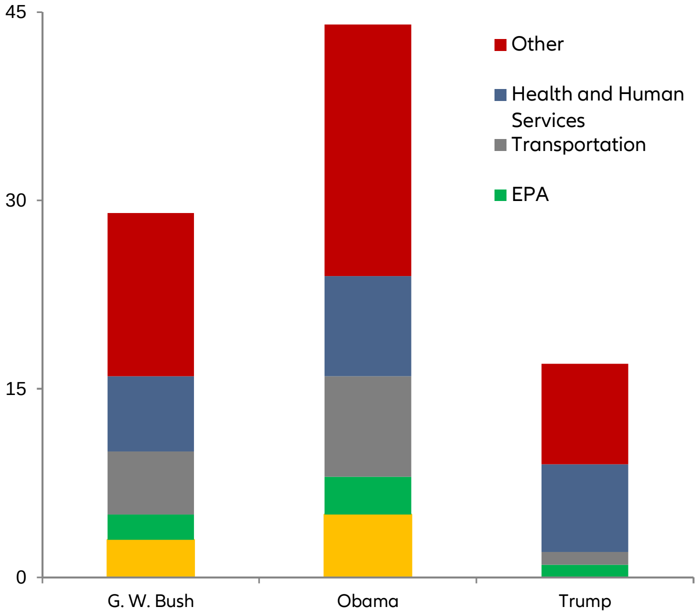


Sources : Euler Hermes, Allianz Research

US non-financial corporate sector is already stretched in terms of debt, suggesting an elevated sensitiveness to any shock on interest rates

US: FINANCIAL DE-REGULATION TO INCREASE RISK

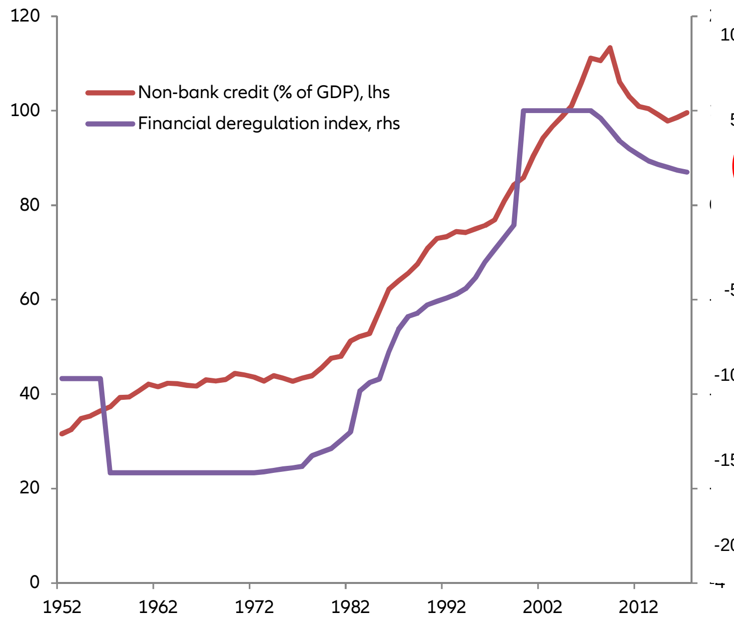
Significant rules within 1 year of Presidency



Sources : Euler Hermes, Allianz Research

President Trump issued four Executive Orders (EOs) in 2017 directing federal agencies to repeal two regulations for every new regulation

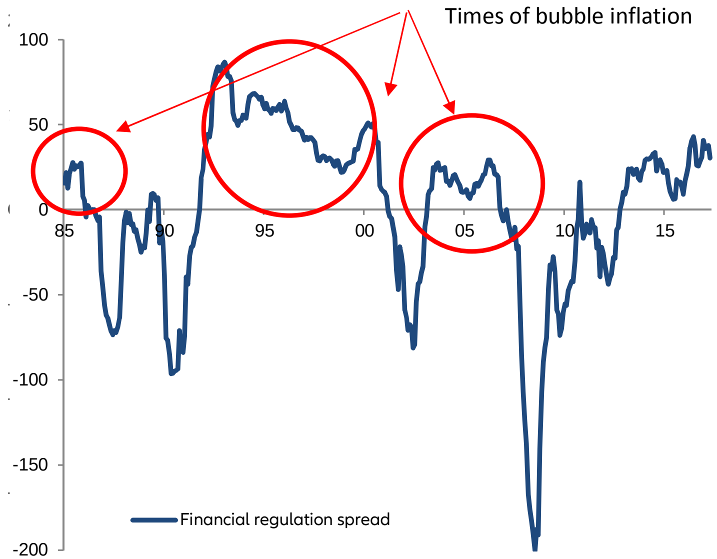
US de-regulation and shadow banking



Sources : Euler Hermes, Allianz Research

US ongoing de-regulation move is expected to free up USD 60bn per year of new credit. Past de-regulation moves have contributed to inflate the size of shadow banking, which is much less regulated and controlled

US financial de-regulation– US total deregulation

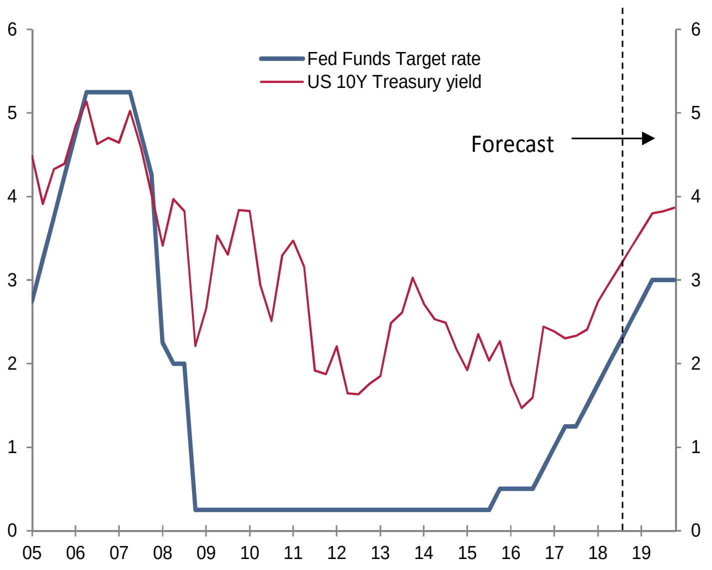


Sources : Euler Hermes, Allianz Research

Financial de-regulation inflates bubbles. This time, small banks (and therefore SMEs depending on their financing) heavily exposed to commercial real estate, are particularly exposed

US: FED GOES FASTER IN TIGHTENING

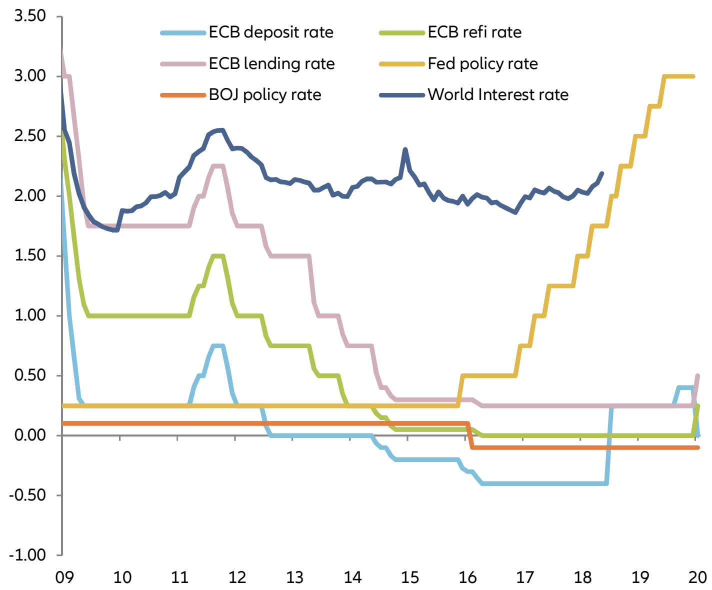
US 10Y Treasury yield (%)



Sources : Euler Hermes, Allianz Research

The Fed is expected to hike twice in 2H18 and 2019. The US 10-yr Treasury yield should reach a level of 3.8% at the end of 2019 based on a progressive tightening of the monetary policy and increasing public deficit

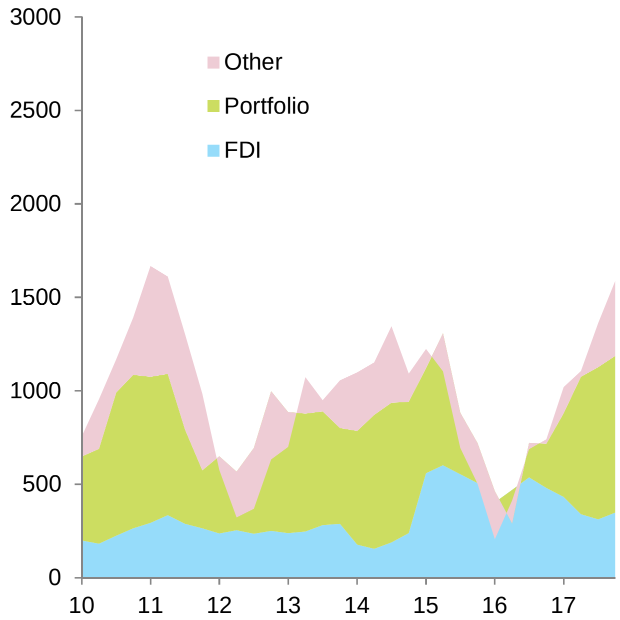
Key interest rates



Sources : Euler Hermes, Allianz Research

The US monetary policy will remain expansionary in 2018 but turn restrictive in 2019. This tightening of the monetary policy will have notable effects on foreign economies

Capital inflows into the US (USD bn)



Sources: IHS Global Insight. Allianz Research

Capital flow back to the US. Yet beware of their nature

PROTECTIONISM: BETWEEN TRADE GAMES AND TRADE FEUD

Current US tariff **3.5%**

Trade game (55%)

- Negligible on global trade (>4% volume)
- US real GDP growth cut by -0.1pp; negligible impact on US inflation
- US current account deficit: -0.6pp to -3.0% of GDP
- US fiscal deficit: -1.1pp to -4.5% of GDP in 2019
- Europe's ongoing recovery not impacted
- China remains on soft landing trajectory

Milestone
USD50bn of Chinese imported products at 25% tariffs & 25% import tariffs on steel imported products & 10% import tariffs on aluminum imported products

4.0%

Trade feud (40%)

- Global trade slows down (-2pp)
- US growth cut by -0.5pp
- US inflation durably up by +0.1 pp
- US CA deficit: -0.9pp to -3.3% of GDP(*)
- US fiscal deficit: -1.6pp to -5.0% of GDP
- Europe growth cut by -0.6pp
- China growth cut by -0.3pp, CNY depreciation similar to 2015 (-10%)

Milestone
USD50bn of Chinese imported products at 25% tariffs & USD200bn of Chinese imported products at +10% import tariffs

4.5%

or

USD200bn of US automotive imports targeted by +25% import tariffs in addition to the USD50bn of Chinese imports and USD10bn of steel and aluminum

6.0%

Trade War (5%)

- Global trade contracts (-6pp from +4%)
- US growth cut by -1.7pp
- US inflation durably up by +0.4pp
- US CA deficit: +0.7pp to -1.7% of GDP (*)
- US fiscal deficit: -4.6pp to -8.0% of GDP
- Europe growth cut by -1.9pp
- China growth cut by -1pp only on the back of stabilizing policies; CNY depreciation (-20%)
- EM broad recession

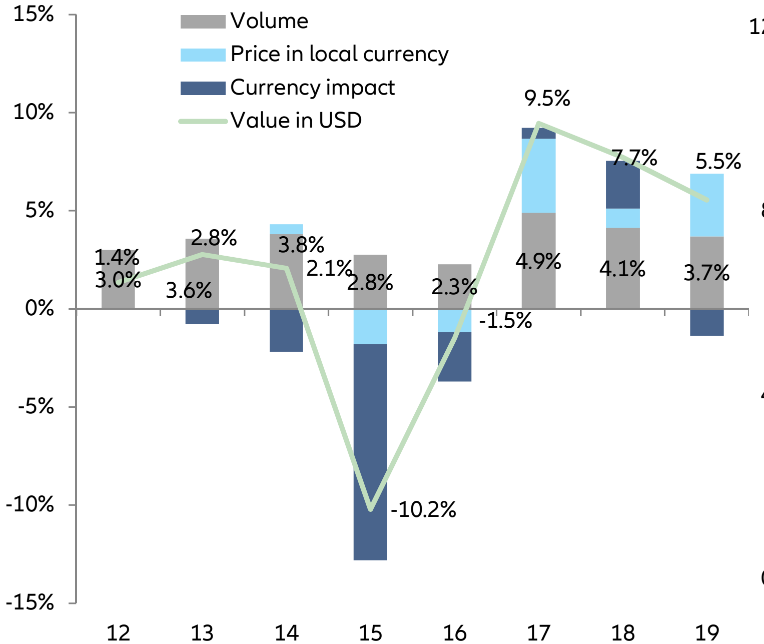
Milestone:
USD500bn of Chinese products targeted by the US by +25% import tariffs & USD200bn of US automotive imports targeted by +25% import tariffs

11.2%

Source: Euler Hermes scenarios

GLOBAL TRADE: NO REGIME-CHANGE DESPITE RISKS

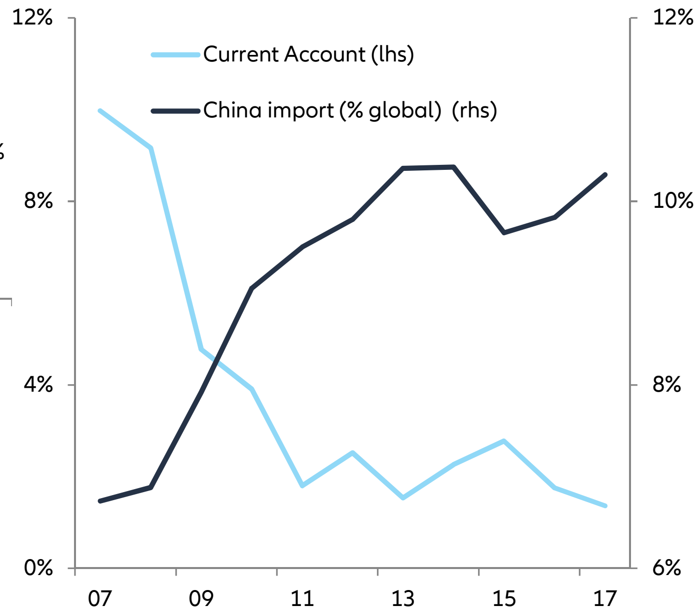
Global trade of goods and services



Sources: IHS, Datastream, Allianz Research

Global trade is expected to decelerate to 4.1% in volume in 2018 and to 3.7% in 2019, but to grow at a healthy pace

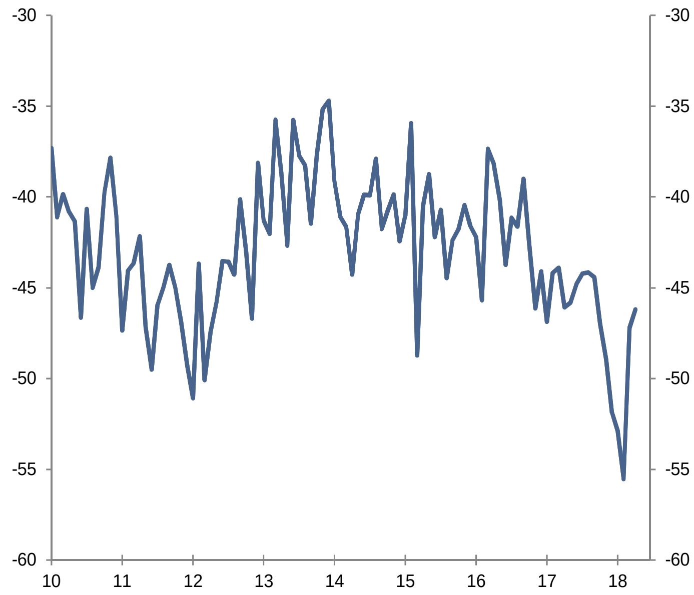
China current account and China imports



Sources: IHS, Datastream, Allianz Research

China tends to absorb a growing share of world demand despite its domestic deceleration via an increasing opening of its market

US trade deficit (USD bn)

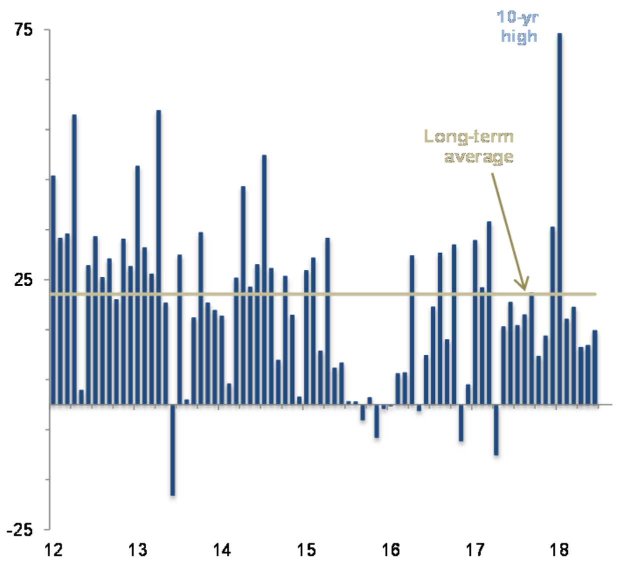


Sources: IHS, Datastream, Allianz Research

Front-loading strategies have been clearly at work before the implementation of tariffs in the US explaining the deepening of deficit

MARKETS SANCTIONED EMERGING MARKETS

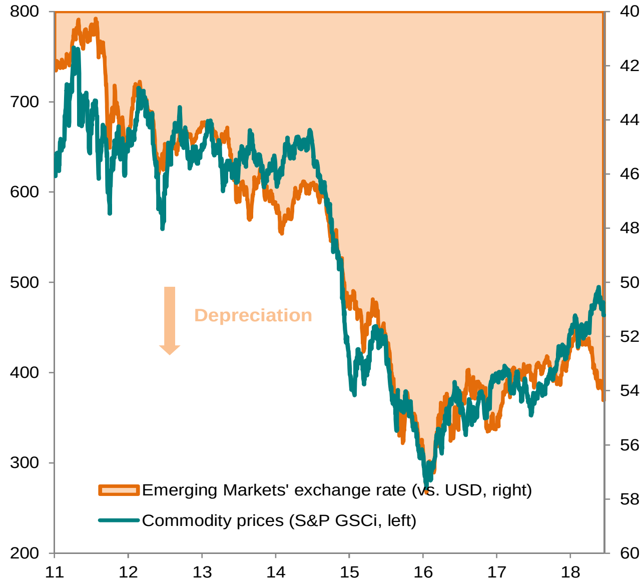
Capital flows to Emerging Markets (USD bn)



Sources: IHS Global Insight. Allianz Research

Diversion: What goes to the US (more short-term capital flows), no longer goes to the Emerging Markets (EM). Capital flows to EMs went below historical average from February (after a record level in January)

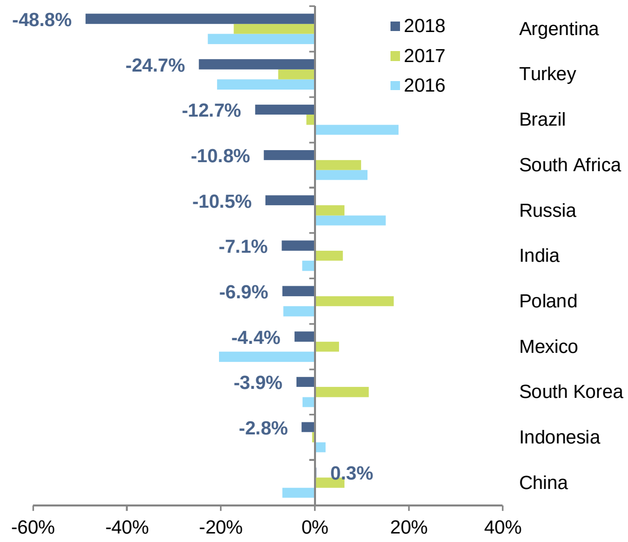
Commodity prices vs. EM exchange rate



Sources: Bloomberg. Allianz Research

Disruption: EM Exchange rates and commodity prices show the same kind of disconnect than during the US Fed tapering aftermath. EM exchange rates and commodity prices should converge in the medium-run

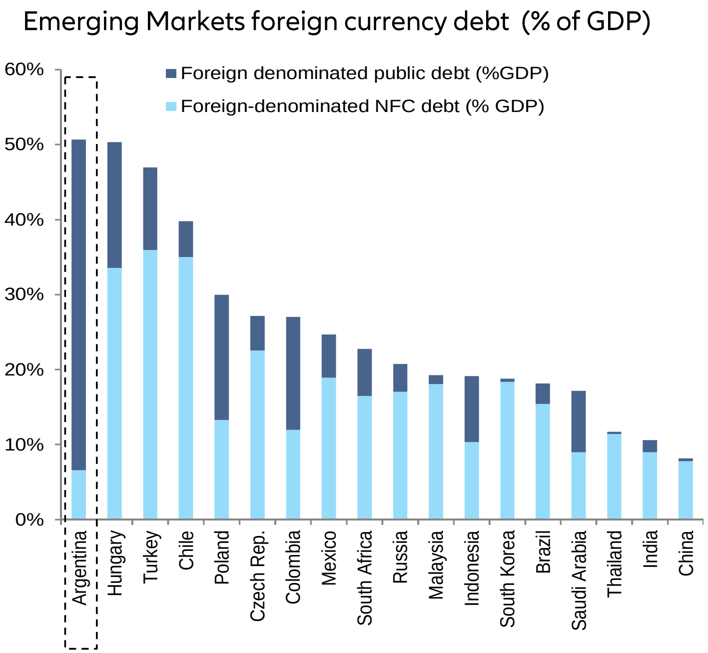
Emerging market currencies change in %



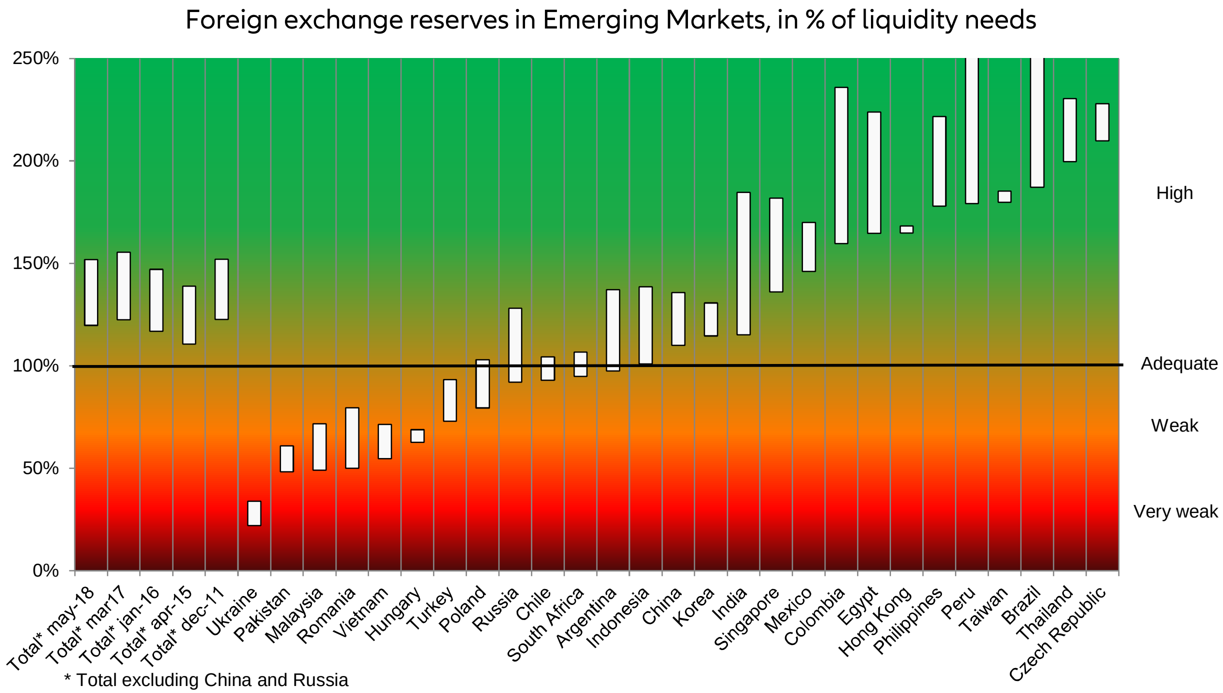
Sources: Bloomberg. Allianz Research

Divergence: Countries with wider current account deficits (Argentina and Turkey) have suffered the most. Second-round effects should trigger more depreciation in China, but in a benign way (-2%). USD is expected to appreciate by +4% against most currencies over the 6 coming months

EMERGING MARKETS: WHO'S NEXT?



Sources: IHS, Euler Hermes, Allianz Research



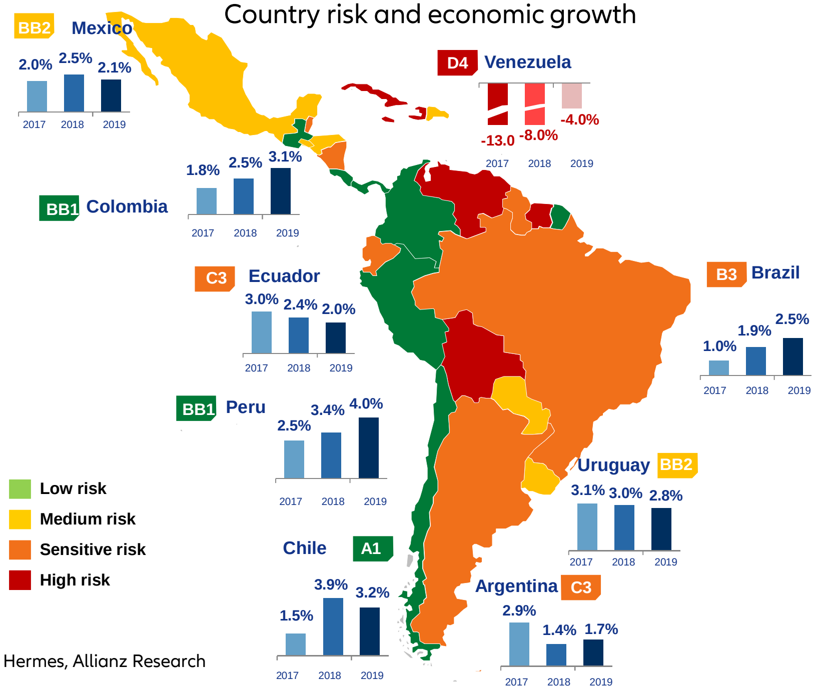
Sources: IHS, Bloomberg. Allianz Research

Refinancing needs: **Argentina** is topping foreign currency denominated (FCD) public debt ranking and the announced USD 50bn IMF program tackled it through direct fiscal support. **Turkey** shows the highest FCD corporate debt, but **Hungary** and **Chile** are not far

Liquidity gaps: Weak foreign reserve levels expose countries to the risk of sudden disruptions. The usual suspects are there: **Ukraine**, **Pakistan**. Other economies like **Hungary**, **Poland** and **Turkey** are also in the vulnerability area. The dilemma is depreciation pressures vs. monetary policy tightening in overheating economies or with a maturing cycle

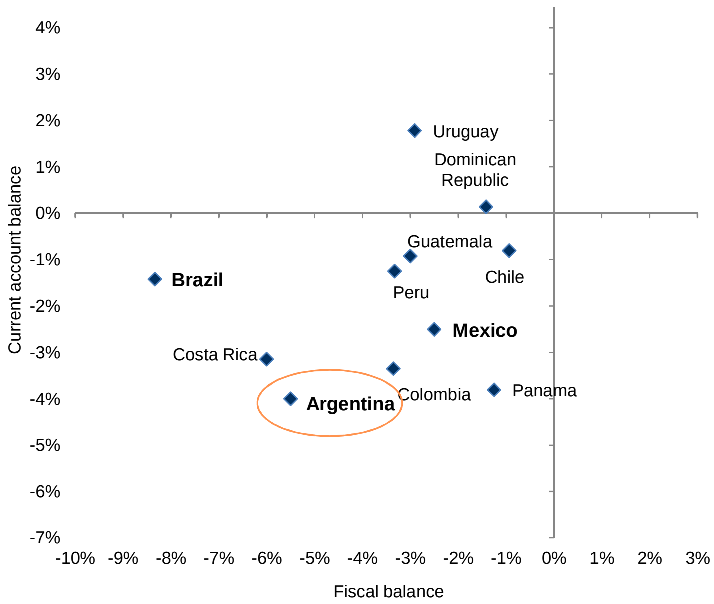
LATIN AMERICA: VOLATILITY & DOWNGRADED OUTLOOK

Country risk and economic growth



Sources: IMF, Euler Hermes, Allianz Research

Fiscal and current account balances (% of GDP)



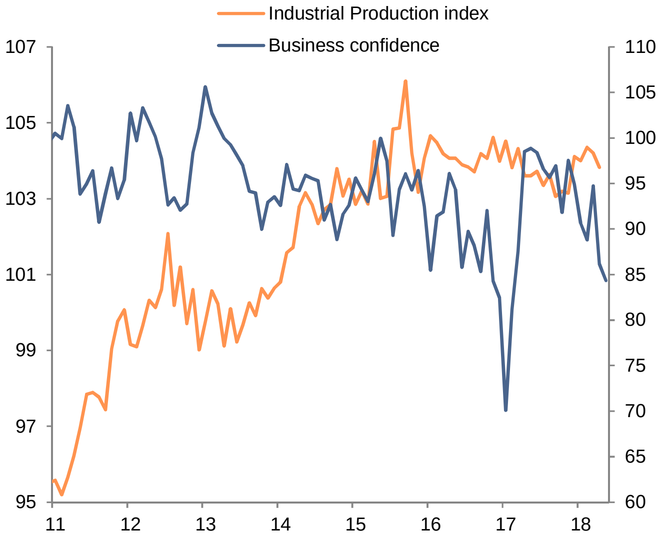
Sources: IHS, Euler Hermes, Allianz Research

- **Downside revision of regional growth** by -0.36pp to **+2.0% in 2018** (after +1.2% in 2017) and by -0.4pp to **+2.4% in 2019**
- Due to downside revisions in Brazil and Argentina despite acceleration in Chile and Colombia **(desynchronization)**

- **Argentina, case in point:** twin deficits and high inflation; Now **under control**: (i) IMF USD 50bn stand-by arrangement to increase reserve adequacy and help provide for the country's financing needs; (ii) Argentina back in the MSCI emerging markets index, which rewards Macri's reforms
- Tight fiscal consolidation (achieve primary balance by 2020), persistent inflation (> 25%), less favorable global and local financial conditions and heightened political uncertainty should **slow growth**

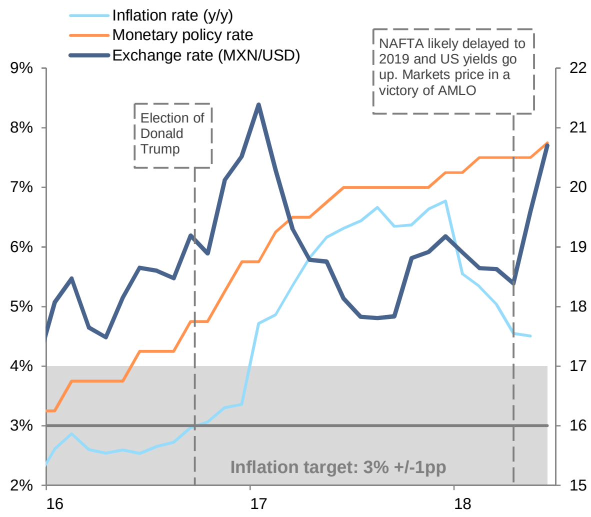
LATIN AMERICA: MEXICO AND BRAZIL UNDER THE RADAR

Mexico: Industrial Production Index and business confidence



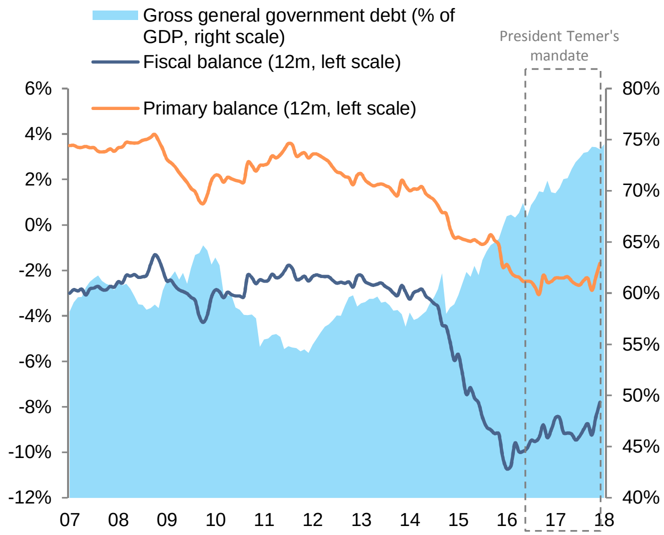
Sources: IHS, Euler Hermes, Allianz Research

Mexico: exchange rate, inflation and central bank policy rate



Sources: IHS, Euler Hermes, Allianz Research

Brazil: public debt, fiscal and primary balance (% GDP)



Sources: IHS, Euler Hermes, Allianz Research

- **Resilient 2018**: no more slack in the economy: wage growth has accelerated, unemployment has reached lows (3.40%)
- **Industrial production still at a high level** thanks to US cycle, but confidence starts receding

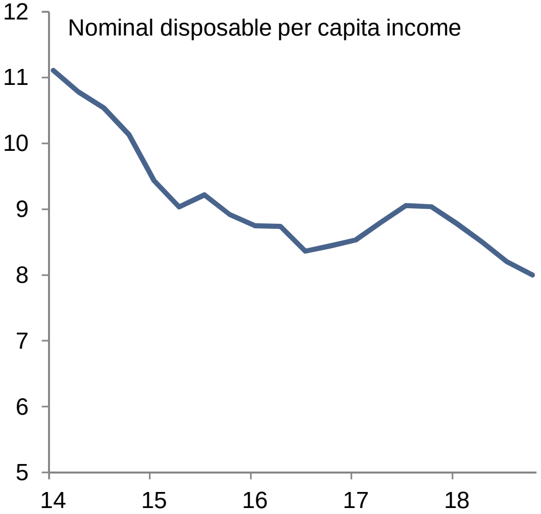
- **Volatility** continues**,** but **sound policy management** helps (rates up at 7.75%)
- Left-wing candidate expected to win, but fiscal slippage to be institutionally constrained. **Main risk for 2019: mind NAFTA** & **energy sector** where reforms could be unwound

- Brazil **recovery took a hit**, **public finances are weak**. But Brazil should prove **resilient to volatility in 2018** thanks to strong external position and central bank buffers (20 months of import cover)
- **Policy uncertainty remains**: we should monitor official campaign this summer

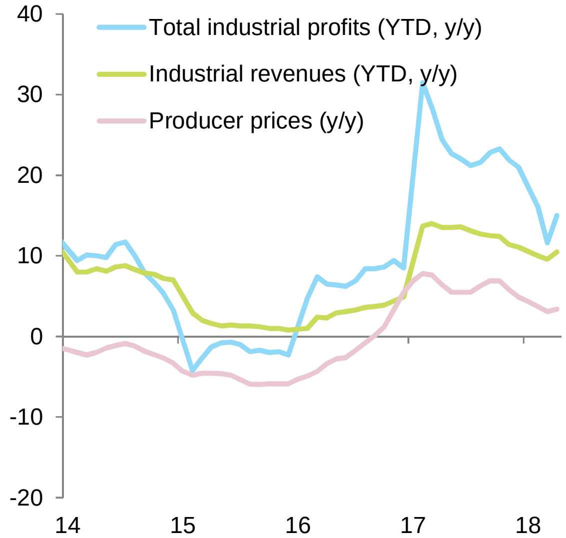
CHINA: A MULTIFACETED STRATEGY IN RESPONSE TO THE US

Economic patriotism	• Anti–US campaign and boycott of US products (as done with South Korea), tighter regulation at the borders and different treatment for US corporates
Diplomatic retaliations	• Partnership against US strategy to increase (with Asian markets such as Japan and South Korea, with the EU) • Potential leverage on Korean Peninsula issue
Protectionism on services	• Measures to reduce trade deficit in services to be considered. First in line would be financial services.
Mild RMB depreciation with RMB per USD kept below 6.9	• Currency depreciation to be used carefully to keep national purchasing power in check. • Marginal depreciation expected with RMB/USD at 6.6 in H2 2018 (-4% from H1) and 6.7 in 2019
Threats on US Treasuries	• Threats (some turbulences) but no significant sell off is expected

CHINA: THE ECONOMY WOULD BE ABLE TO MAINTAIN A GROWTH AROUND +6.5%



Sources: IHS, Allianz Research



Sources: IHS, Allianz Research

Policy tracker

		2017	2018	2019
Fiscal policy	Gen. Gov. Net lending (% GDP)	-3.9	-4.0	-4.2
Monetary Policy	Benchmark lending rate (eop)	4.35	4.35	4.60
	7 days - Reverse Repo (eop)	2.50	2.60	2.70
	M2 growth	9.7	8.7	8.7
	Reserve requirement ratios*	16.5	15.5	15.5
	RMB per USD (average)	6.8	6.6	6.7
	RMB per USD (eop)	6.5	6.7	6.7
Capital account liberalization progress	Inward	Modest	Significant	Significant
	Outward	Neutral	Modest	Modest

* For large banks
Sources: IMF, Allianz Research

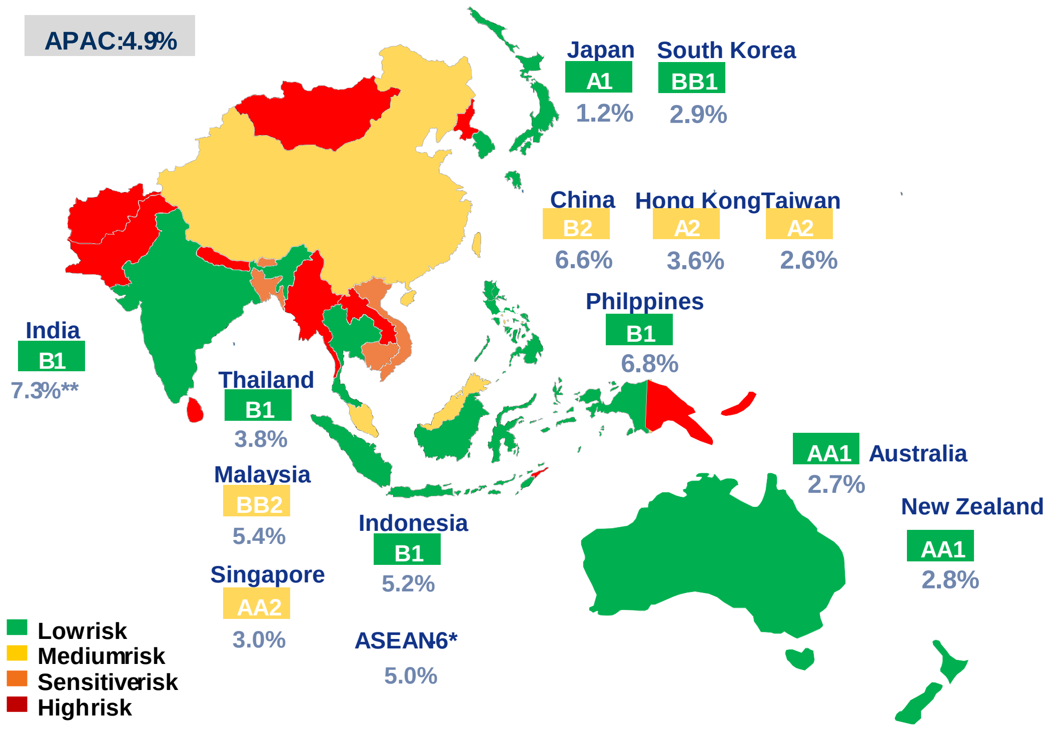
Households: solid income growth (8%+) will continue to support private consumption

Corporates: strong balance sheet will act as a buffer for debt repayments and tighter financing conditions

Policymakers to adopt a defensive strategy :

- Fiscal support to increase
- Central bank to keep liquidity in-check (RRR cut) but maintain deleveraging efforts through regulation
- Capital liberalization progress to be maintained but with further moves on inflows (financial opening)

ASIA: A SHELTER IN THE STORM OF EMERGING?



Sources: IHS, Allianz Research

Activity - Economic growth is set to slow to +4.9% in 2018 (revised up from +4.8%) and +4.8% in 2019 as China's soft landing continues, Japan's fiscal stimulus effects fade away. Emerging ASEAN to maintain firm growth rate supported by strong domestic demand solid export growth

Financing conditions - Financing conditions tighten to reduce debt (China, e.g.), because of inflation (South Korea, Malaysia, Philippines, e.g.) and to reduce pressure on the currency (India, Indonesia).

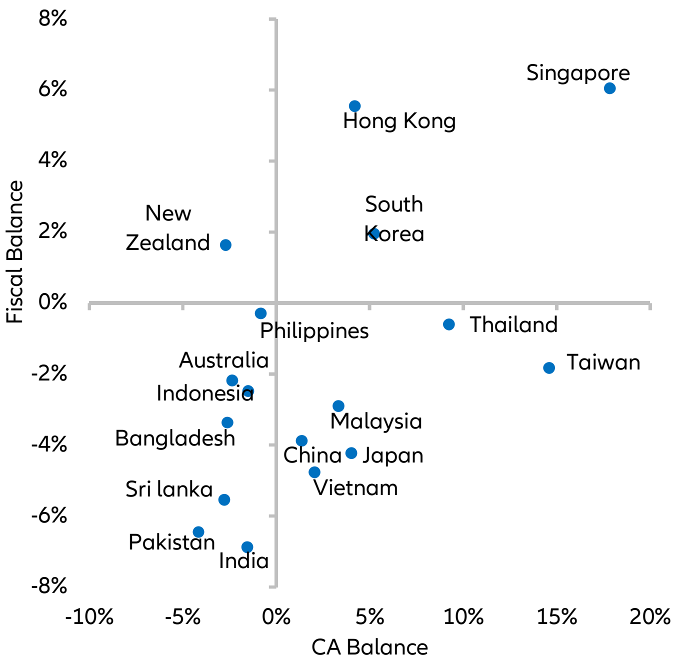
Inflation – Upward pressures to increase especially from the second half of the year as a result of (i) currency depreciation, (ii) oil prices, and (iii) tight(er) job markets.

Countries vulnerabilities check-up. Risk on growth is limited in large economies thanks to solid buffers, high in frontier markets more vulnerable.

- *Currency risk* - Twin deficits countries to remain under pressure (India, Indonesia). Risk of policy mistakes in Malaysia and Philippines is also under watch.
- *Confidence and risk on growth* – This concerns frontier and twin deficits markets such as Sri Lanka and Pakistan as buffers to keep growth in check are really thin.

ASIA: CURRENCY TURBULENCES BUT LIMITED IMPACT ON GROWTH

Current account balance vs fiscal balance



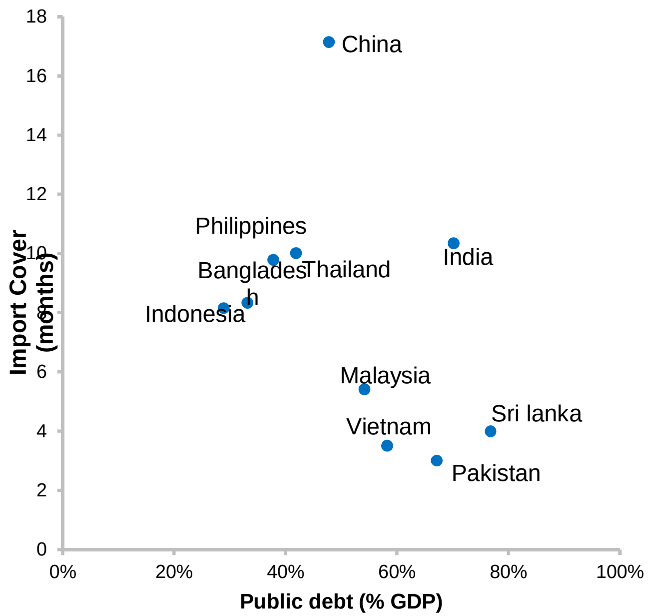
N.B. Fiscal balance refers to general government balance (IMF definition)
Sources: IMF, Allianz Research

Monetary policy rates (eop)

	17	18	19
Australia	1.50	1.75	2.00
China	4.35	4.35	4.60
India	6.00	6.50	6.75
Indonesia	4.25	5.00	5.00
Japan	-0.10	-0.10	0.10
South Korea	1.50	1.75	2.00
Malaysia	3.00	3.25	3.50
Philippines	3.00	3.50	3.75
Taiwan	1.375	1.375	1.500
Thailand	1.500	1.500	1.750

Sources: IHS, Allianz Research

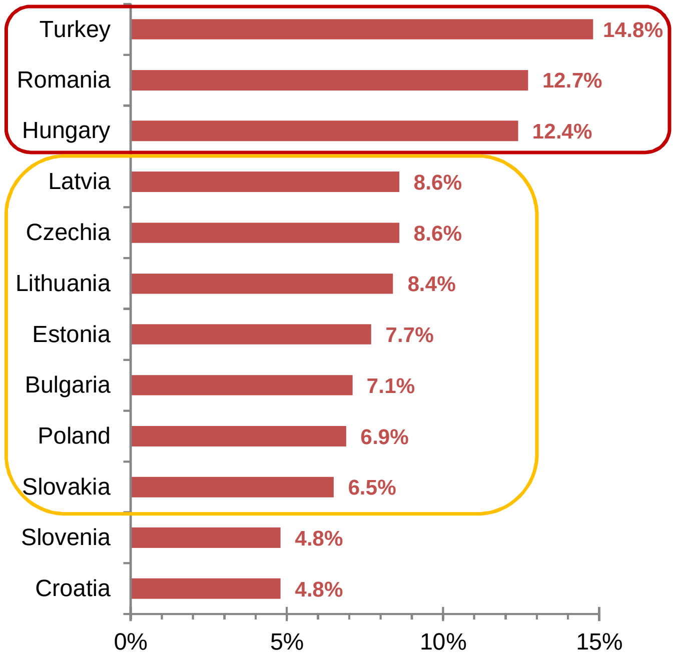
Public debt vs import cover (goods)



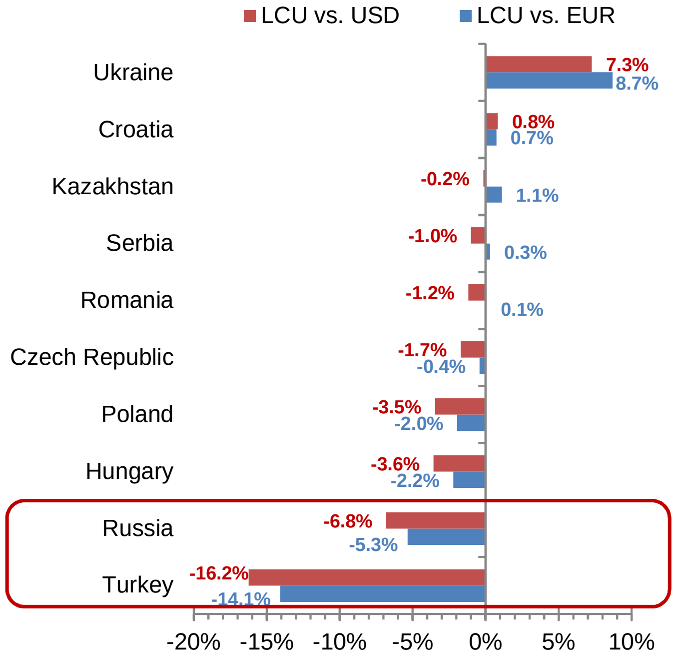
Sources: IHS, Allianz Research

Expect some turbulences on the currencies of twin deficits markets. Yet, pre-emptive tightening should ease tensions going forward. Moreover, if push were to shove, the region has enough buffer to keep growth in-check

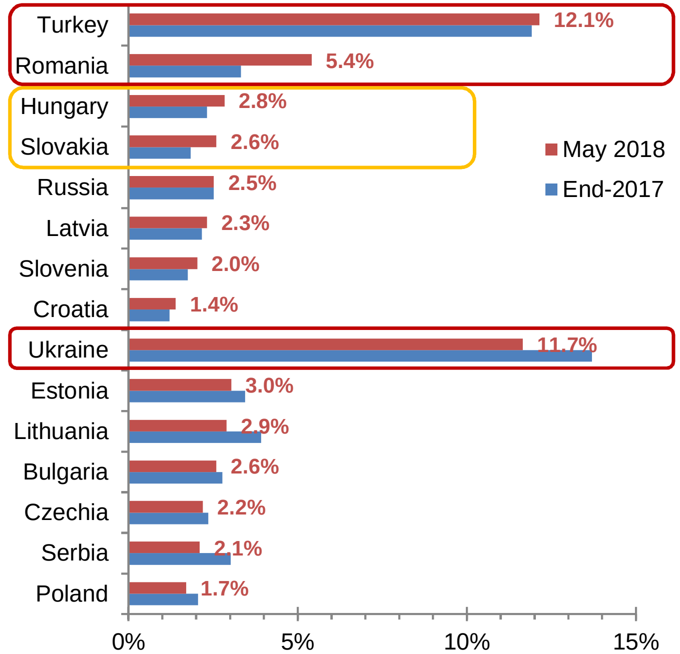
EMERGING EUROPE: WHO IS THE MOST VULNERABLE (1)



Sources: National statistics, IHS Markit, Allianz Research



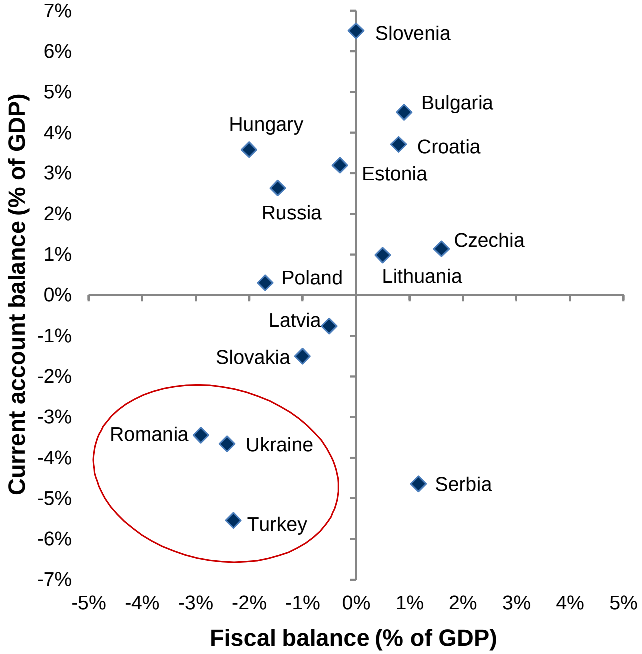
Sources: National statistics, IHS Markit, Allianz Research



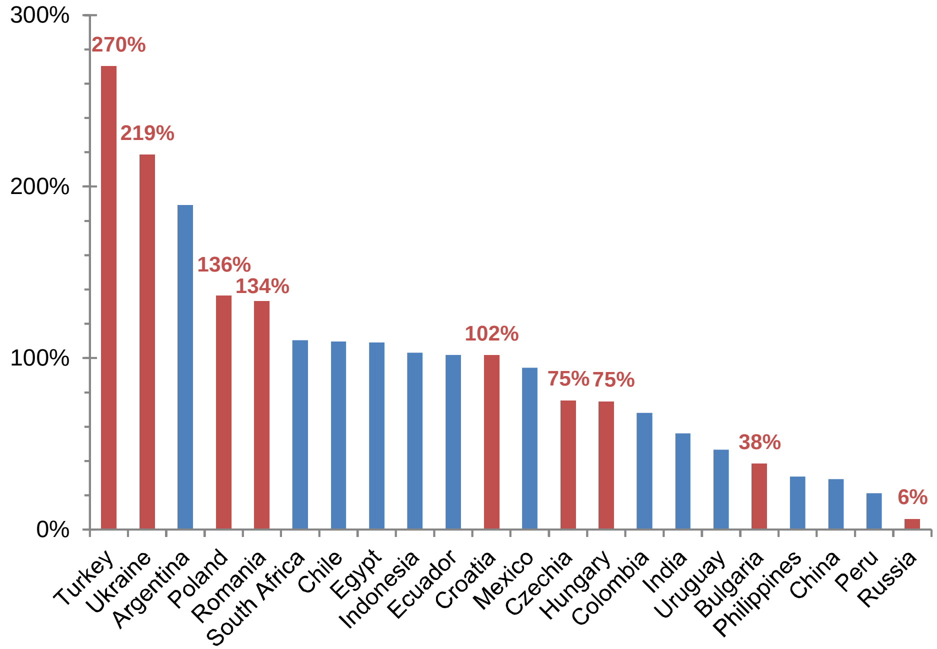
Sources: National statistics, IHS Markit, Allianz Research

- Nominal wage growth has been well above productivity growth in most Emerging European countries
- So far, wage growth has not yet stoked inflation as firms have absorbed higher wage costs by accepting smaller profit margins, rather than raising their prices.
- The exceptions are **Turkey** and **Romania** where inflation is now well above targets. In **Turkey**, sharp currency depreciation has contributed as well. **Hungary** needs to be watched
- **Ukraine** has been in crisis for many year and will remain so.

EMERGING EUROPE: WHO IS THE MOST VULNERABLE (2)



Sources: National statistics, IHS Markit, Allianz Research



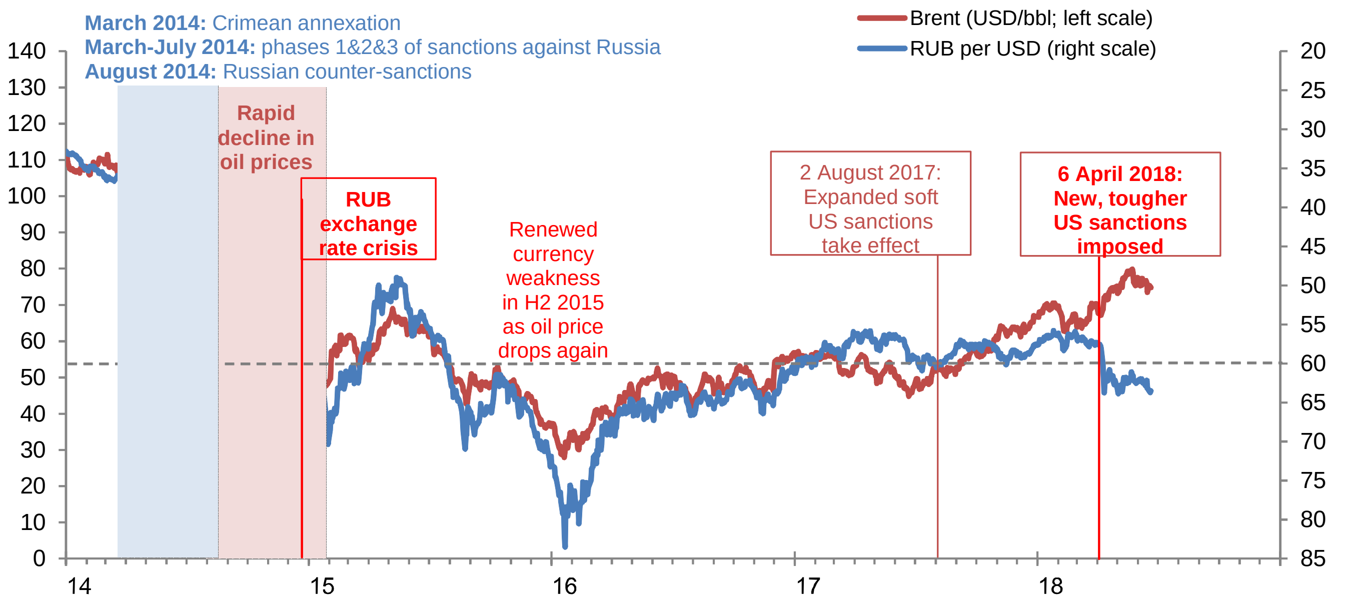
* Defined as sum of current account deficit and external debt maturing within the next 12 months.

Sources: National statistics, IMF, IHS Markit, Allianz Research

- **Turkey**, **Ukraine** and **Romania** have relatively large twin deficits and very high external financing requirements in relation to their FX reserves
- **Hungary** has a current account surplus and acceptable fiscal deficit. Its external financing needs are also adequate
- **Poland** has external financing requirements in relation to its FX reserves but otherwise relatively solid macro fundamentals (e.g. twin surplus, low inflation)

RUSSIA – HIGHER OIL PRICES MORE THAN OFFSET ANY IMPACT FROM NEW US SANCTIONS

Exchange rate and Brent oil price



Source: IHS Markit, Allianz Research

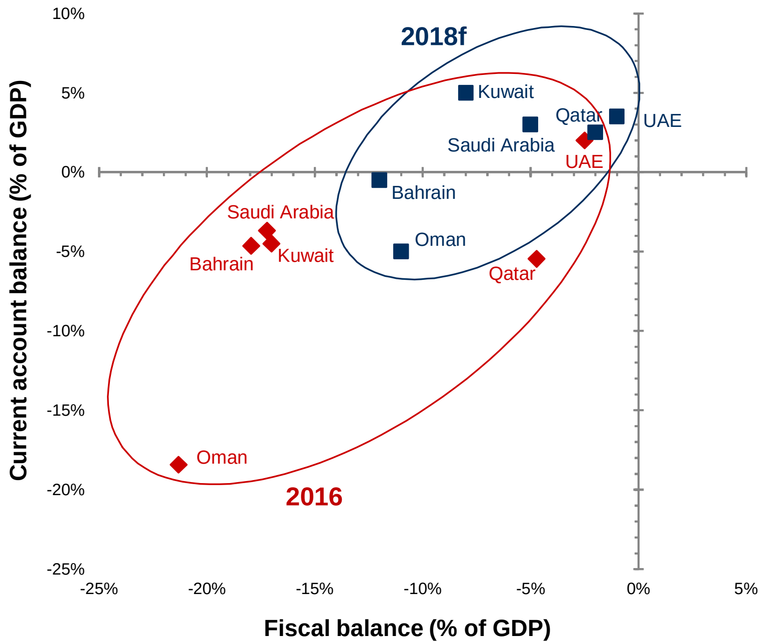
Industrial production and real retail sales growth (y/y; quarterly averages)

Source: National statistics, IHS, Allianz Research

- The latest sanctions (imposed by US on 6 April) seem to be the first ones that have an impact on the USDRUB rate.
- But markets have calmed as President Trump drew back from further new sanctions (which many had expected) in mid-April.
- RUB has stabilized around 62-63 vs. USD which is adequate and supportive for exports.
- The imposed sanctions will certainly affect the targeted companies, but Russian authorities have pledged to help if needed.
- And the higher oil price is positive news for the Russian economy. Activity indicators point to strengthening momentum in Q2.
- Overall, we forecast GDP growth of +1.8% in both 2018 and 2019 (after +1.5% in 2017).

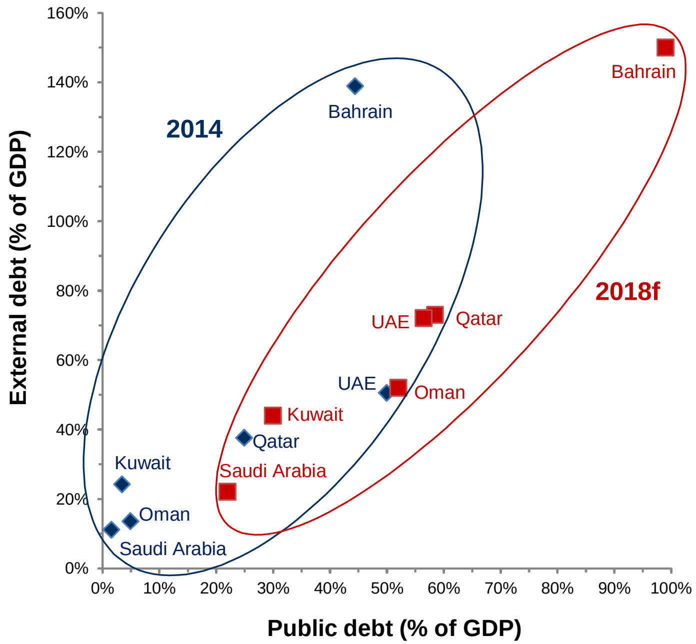
GCC: GRADUAL FISCAL AND EXTERNAL REBALANCING IS UNDERWAY, BUT MIND THE WEAKER SPOTS

Fiscal and External Balance in the GCC



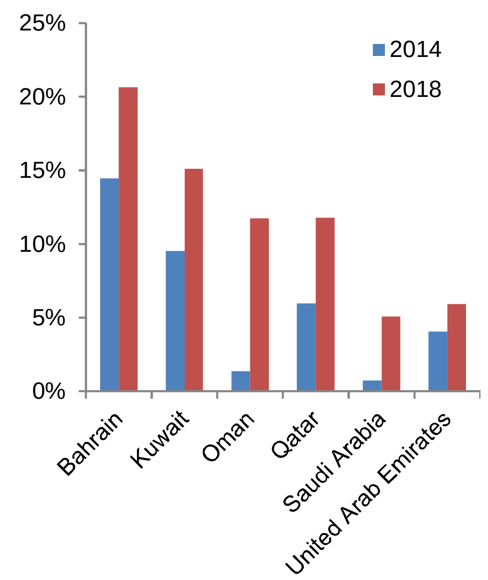
Sources: IMF, IHS, Allianz Research

Public and External Debt in the GCC



Sources: IMF, IHS, Allianz Research forecasts

External debt service
(% of exports earnings)



Sources: IHS Markit, Allianz Research

- After sharply deteriorating in the wake of low oil prices in 2014-2017, fiscal and external accounts are rebalancing in 2018 as oil prices are rising
- **Bahrain** and **Oman** are weaker and laggin

- Likewise, public and external debt levels have risen markedly since 2014 across the GCC.
- Debt risks in **UAE** and **Qatar** are offset by large SWFs which make them net external creditors
- Again, **Bahrain** and **Oman** are the weak spots as their smaller SWFs provide less cushio

- Principal and interest payments have risen over the past years but are still adequate on average (12% of export earnings)
- **Bahrain** with an external debt service ratio of 21% is borderline

AFRICA: KEEP ON RUNNING, TRULY, MADLY, BLINDLY

Growth in Africa, per region

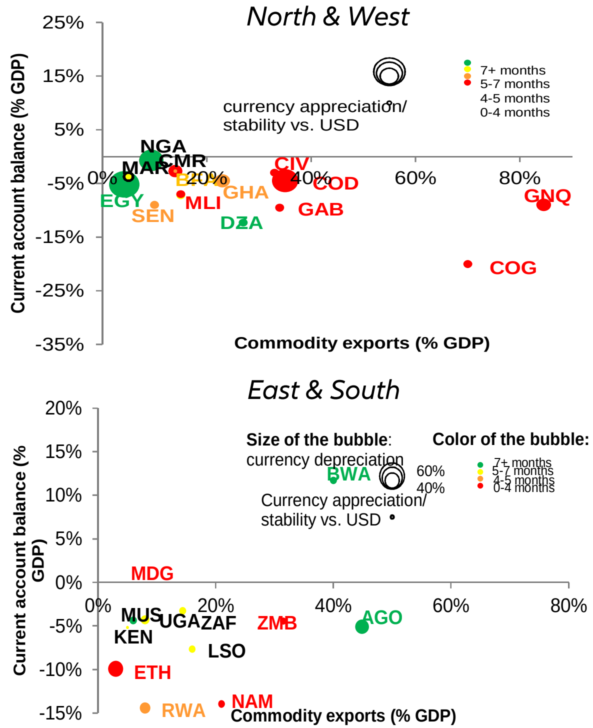
		2015	2016	2017	2018	2019
Africa*		**3.4**	**2.0**	**3.4**	**3.9**	**4.3**
North*		**3.9**	**3.2**	**3.4**	**3.6**	**3.7**
Algeria	C3	3.7	3.3	2.0	2.7	2.5
Morocco	B1	4.5	1.2	4.0	3.0	3.0
Egypt	C2	4.4	4.3	4.2	5.2	5.8
Tunisia	C4	1.1	1.0	1.9	2.5	2.5
West		**3.0**	**0.1**	**2.5**	**4.0**	**4.7**
Cote d'Ivoire	C2	8.9	8.4	7.8	8.2	8.5
Ghana	B1	3.8	3.5	8.4	9.0	7.5
Nigeria	D3	2.7	-1.6	0.8	2.5	3.5
Senegal	C2	6.5	6.7	7.2	7.2	7.5
East		**7.2**	**6.2**	**7.1**	**7.3**	**7.1**
Ethiopia	D3	10.4	8.0	10.9	9.0	9.5
Kenya	C2	5.7	5.9	4.8	6.5	5.7
Tanzania	C3	7.0	7.0	7.1	7.2	7.5
Uganda	C3	5.7	2.3	4.5	6.0	5.0
Central		**2.8**	**0.5**	**1.0**	**1.9**	**2.9**
Cameroon	C3	5.8	4.5	3.0	3.7	4.0
Congo, DR	D4	6.9	2.4	3.0	3.5	4.0
Southern		**3.1**	**1.0**	**2.1**	**2.5**	**3.8**
South Africa	B2	1.3	0.6	1.3	2.0	2.5
Angola	D3	3.0	-0.8	0.7	2.0	3.0
Zambia	C3	2.9	3.7	3.9	4.5	4.7

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

Sources: Allianz Research

Growth is accelerating in Africa, particularly in key Eastern and Western economies.

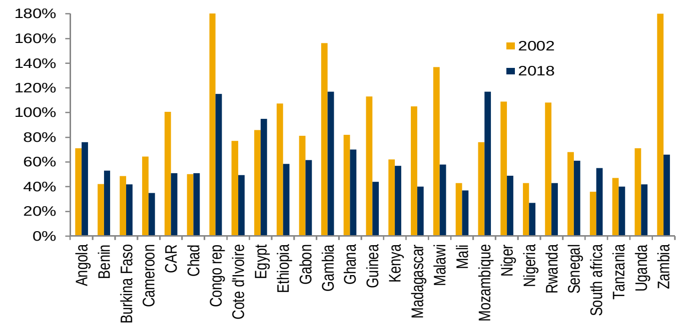
Exchange rate vulnerability



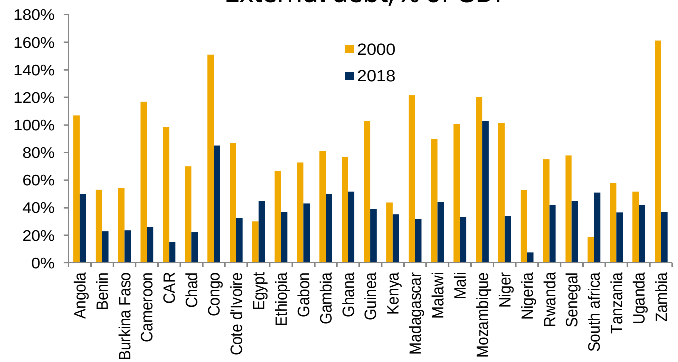
Sources: Euler Hermes

Countries with the poorest liquidity levels are vulnerable to capital flows reversals.

Public debt, % of GDP



External debt, % of GDP

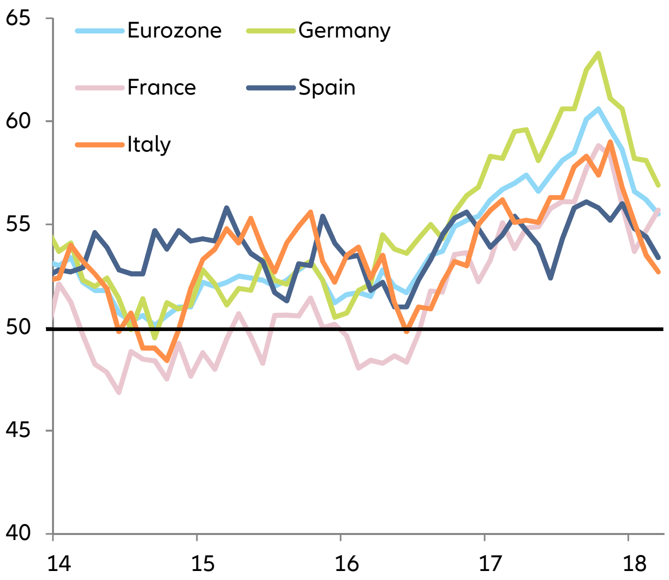


Sources: World Bank, Allianz Research

However, too much financing through debt may derail the growth momentum.

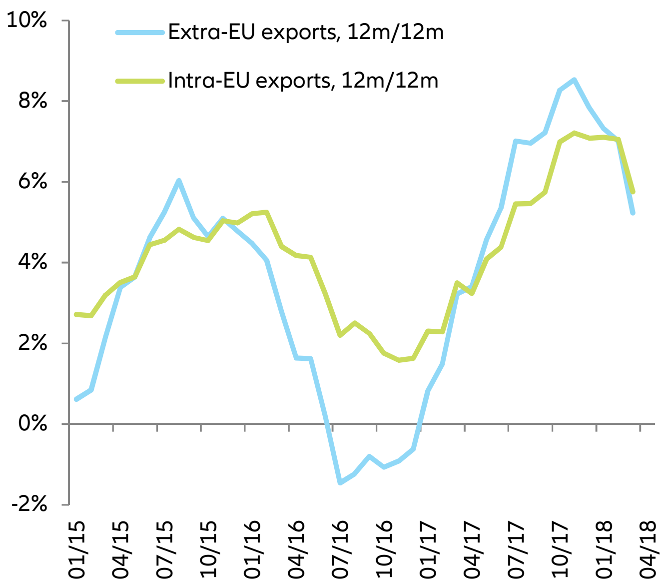
EUROPE: SLOWER GROWTH BUT STILL ABOVE POTENTIAL

Manufacturing PMI Index



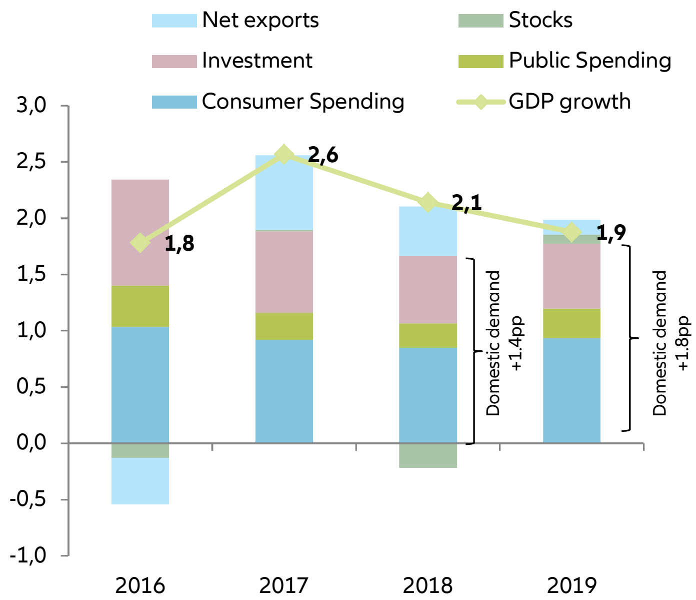
Source: IHS, Euler Hermes Allianz Research

Extra and intra-EU exports



Source: IHS, Euler Hermes Allianz Research

GDP growth and components



Source: IHS, Euler Hermes Allianz Research

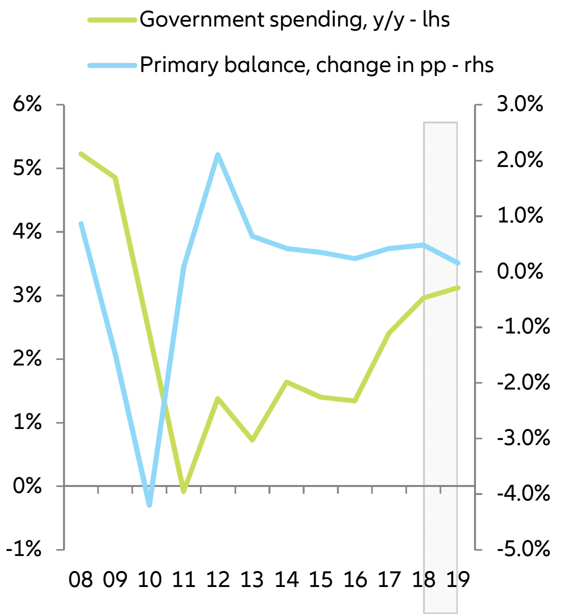
The **soft-patch** is not as severe as it may seem: Manufacturing PMIs remain in expansionary territory and suggest moderate growth in activity

Intra-EU trade shows more resilience and offsets part of the external trade shock, partly linked to **protectionism**

Boosting the domestic engines: public spending in Germany is expected to accelerate in 2019 while the European reform agenda is back in the forefront

EUROPE: STILL ENOUGH BUFFERS

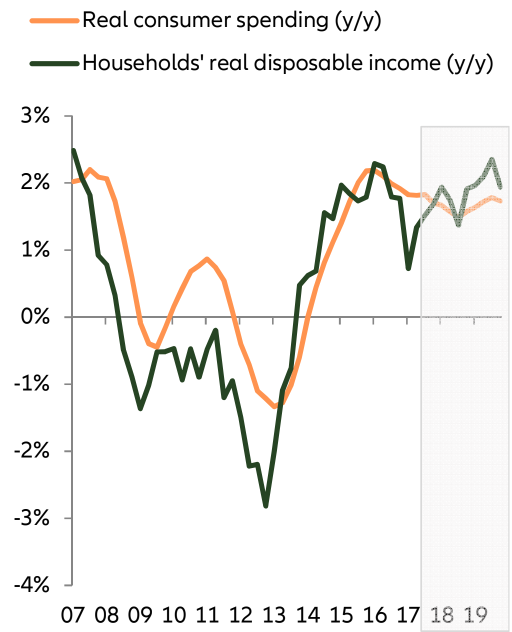
Eurozone: government spending vs primary balance



Source: IHS, Euler Hermes Allianz Research

Europe becomes more fiscally expansionary, notably in 2019. This is the case for **Germany**.

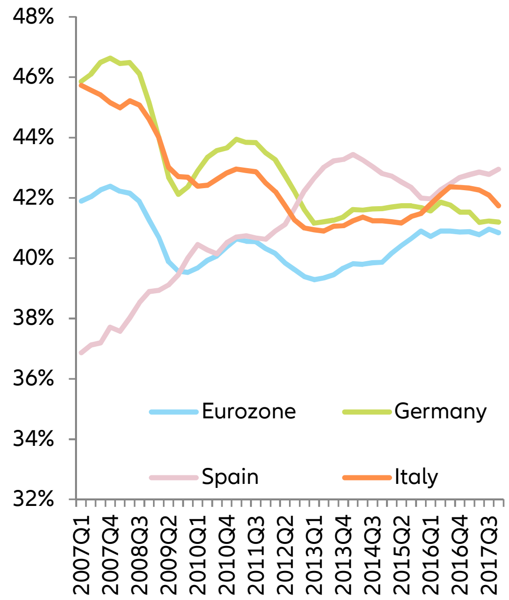
Eurozone: consumer spending and disposable income



Source: IHS, Euler Hermes Allianz Research

Europe is at the start of the WS/PS loop which will allow households to benefit from higher real purchasing power starting in H2 2018. This is the case for **France**.

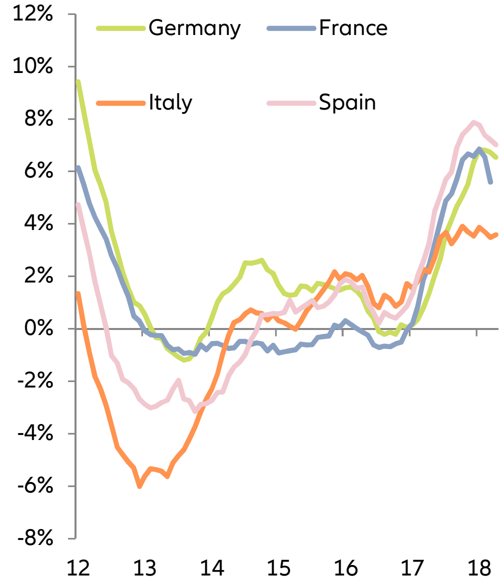
Non-financial corporations margins, % of value added



Source: IHS, Euler Hermes Allianz Research

Margins remain at a relatively high level, but they are expected to have peaked at end-2017, notably in **Spain** and **Italy**.

Manufacturing turnover growth, 12m/12m

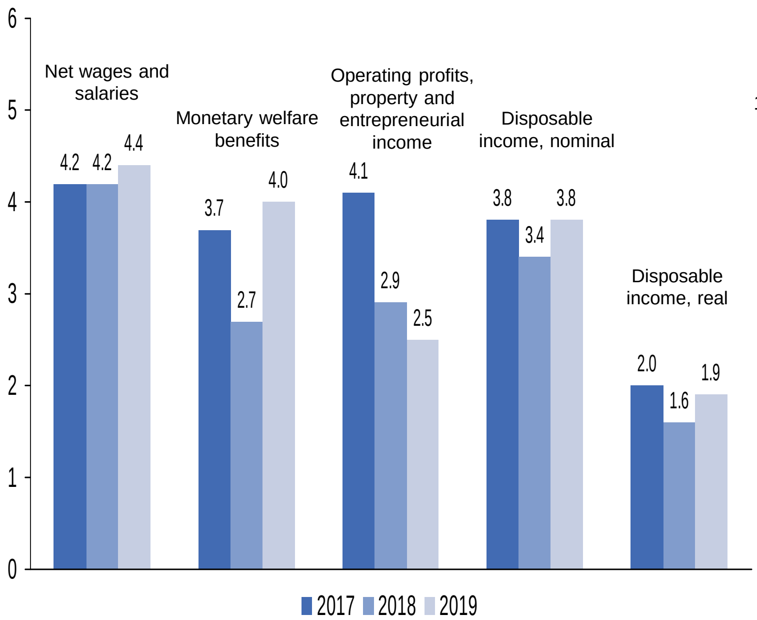


Sources: IHS, Euler Hermes Allianz Research

Turnover growth has cooled down but remains above pre-crisis average. **Spain** enjoys high growth.

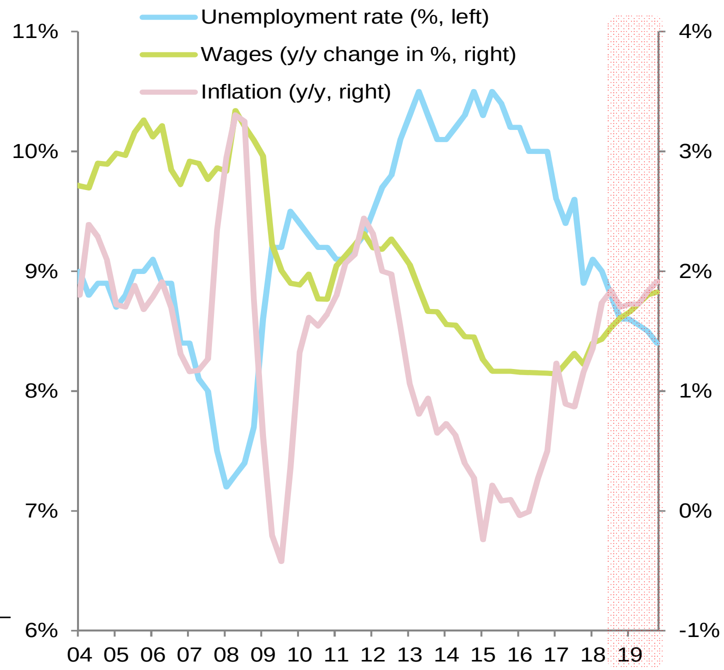
GERMANY, FRANCE AND SPAIN: GROWTH ENGINES

Germany: Nominal income and selected components (percentage change y/y)



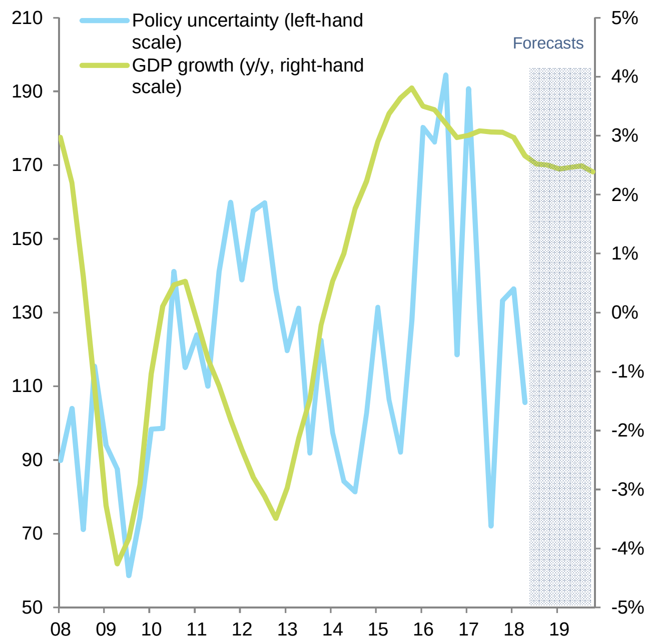
Sources: IHS Global Insight. Allianz Research

France : Unemployment, wages and inflation



Sources: IHS Global Insight. Allianz Research

Spain: Policy uncertainty index and GDP growth (y/y)



Sources: IHS Global Insight. Allianz Research

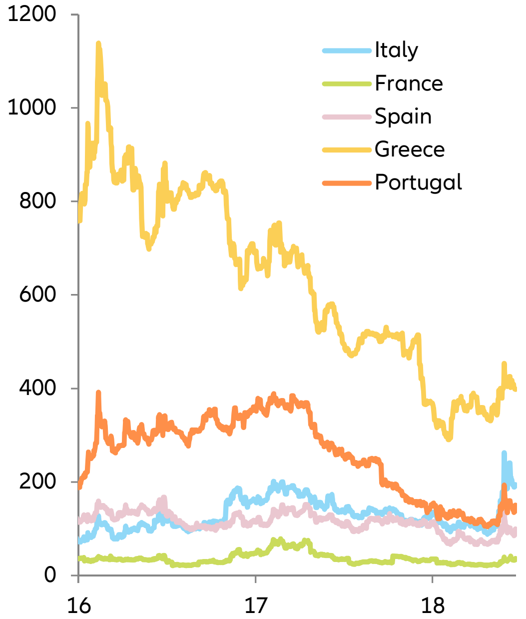
Germany: Economic soft-patch temporary. Employment growth, tax relief and additional monetary social benefits key drivers of strong rise in disposable income and thus of private consumption

France: Household consumption was hit hard by inflation. Wage growth acceleration should close the purchasing power gap from H2 and drive GDP growth to +1.8% in 2018 and +2% in 2019.

Spain: Political uncertainty has a negligible impact on activity. +3.1% in 2017, expect +2.7% in 2018 and +2.4% in 2019. Moderate deceleration of private consumption in sight. Fiscal policy a bit more expansionary in the next 2 years

EUROPE: AREAS OF TENSION

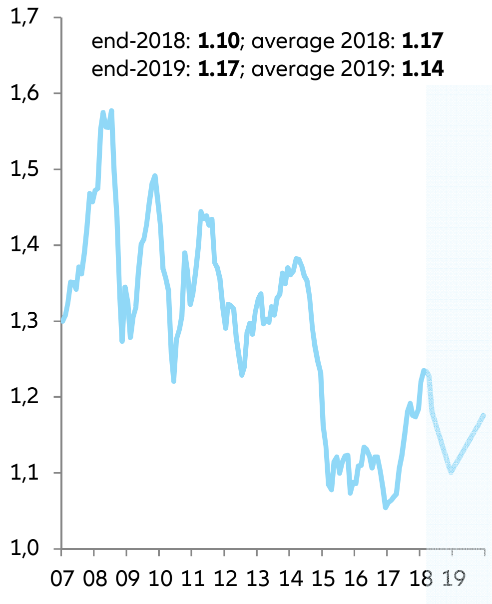
10-year spreads vs Bund



Sources : Euler Hermes, Allianz Research

Bond spreads are contained (except in Italy as they reflect the political stress). Downside risk could come from a generalized spread widening

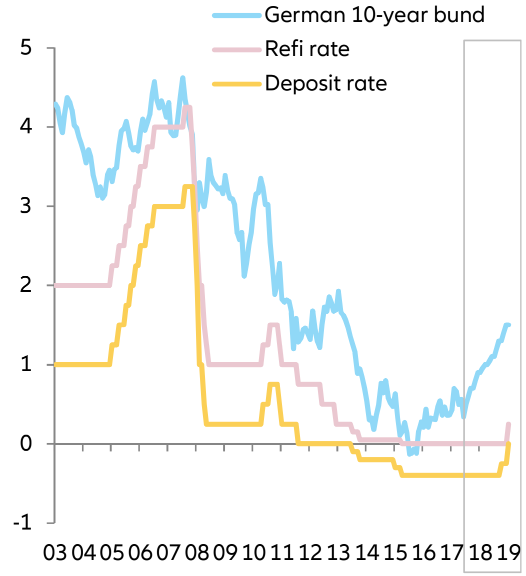
EUR/USD



Sources : Euler Hermes, Allianz Research

Diverging growth prospects and monetary policy should drag the EUR/USD to 1.10 at end-2018

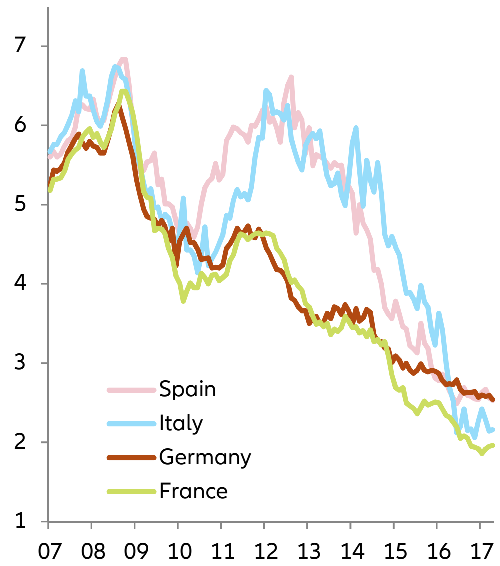
German 10-year vs ECB key rates



Sources : Euler Hermes, Allianz Research

Contained inflation (+1.7% in 2018-19) and softer growth justify a progressive normalization by the ECB

Bank interest rates for SMEs (1 to 5 year maturity)



Sources : Euler Hermes, Allianz Research

The private sector should still enjoy very low interest rates until H2 2019

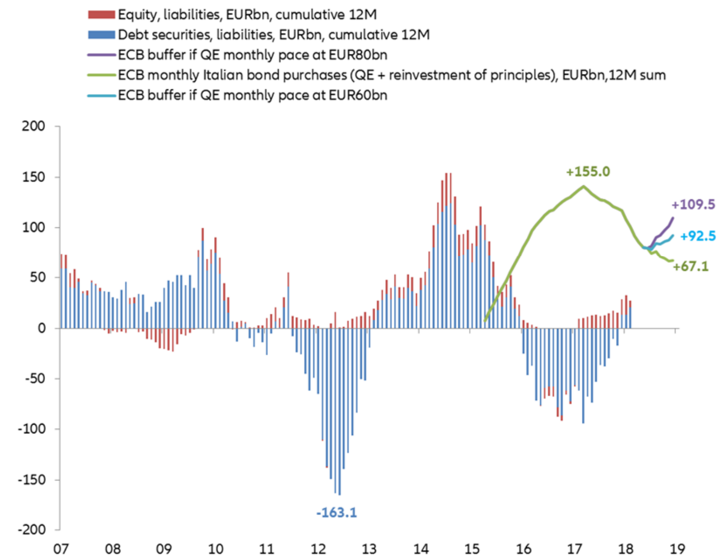
ITALY: FINANCIAL STRESS IS HERE TO STAY

Economic and financial scenarios

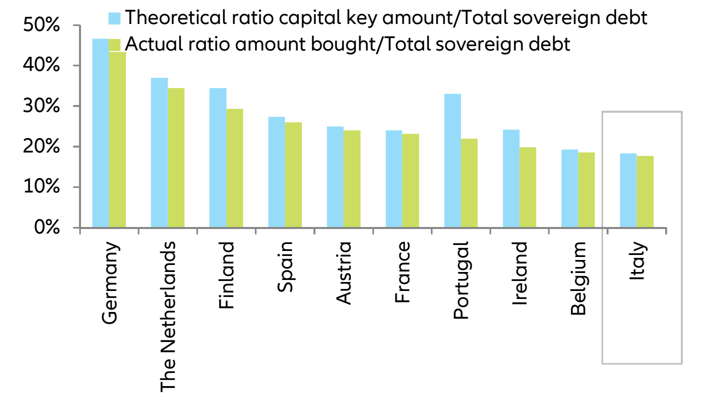
	Upside	Baseline	Downside	Tailrisk
Scenario	Mild Fiscal Expansion & Conciliatory EU Stance	U-Turn After Significant Fiscal Expansion & Moderately Confrontational Stance with EU	Marked Fiscal Expansion & Confrontational EU Stance	Marked Fiscal Expansion & Extreme Confrontational EU Stance leading to Italexit
Probability	30%	50%	15%	<5%
Policies	20% of fiscal plans implemented in 2019 budget. Constructive stance towards Europe.	30% of fiscal plans implemented in 2019 budget. Relatively constructive EU stance	60% of fiscal plans as soon as 2019. Confrontational EU Stance	More than 60% of fiscal plans as soon as 2019. Extreme confrontational EU Stance
Financial markets	Markets are reassured but the regime switch will maintain spreads above pre-election level (>180bp)	Spreads remain high (180-250bps) given the announced fiscal spending plans in Fall and a one-notch credit rating downgrade	Downgrade to non-IG by end-2019, spreads climb above +400bp and banks' lose access to ECB liquidity which forces an ESM program	Downgrade to non-IG in H1 2019, spreads climb above +700bp and banks' lose access to ECB liquidity but Italian government refuses an ESM program
Economic consequences	Mild fiscal expansion helps prop up economic activity in the short-run: GDP growth expected at 1% in 2019	GDP growth expected at 0.8% in 2019	Economy in multi-year recession (GDP contraction greater than -2% in 2020)	Deep recession (-3% fall in GDP in 2019)
ECB	Negligible impact. The ECB stays on course: End of QE in December 2018 and first rate hike in September 2019.		Marked contagion to the periphery. Eurozone in mild recession (0-0.5%). No ECB rate hike in 2019/2020, new TLTROs & OMT for Italy after signed ESM program .	Significant contagion to the periphery. Eurozone in deep recession (-2% in 2019). ECB implements significant non-standard measures.

Source: Allianz Research

Portfolio net inflows vs ECB QE Italian bond purchases



Sources: Bank of Italy, Allianz Research



EUROPEAN REFORM ROADMAP: A FIRST COMPROMISE - THE MESEBERG DECLARATION BY MACRON AND MERKEL

June 22: The Eurogroup agreed on further debt relief for Greece and the right to use the EUR24.1bn cash buffer

EU Summit: 28-29 June

- **ESM goes EMF** which will allow faster financial interventions
- Agreement on an **Eurozone budget** as part of the EU multi-annual budget to be implemented by 2021
- Agreement to establish a **European unemployment stabilization fund**
- **Security:** Agreement on giving more resources to the EU border police, **Frontex** — and to create a common **European asylum system**
- Agreement to work on a **common corporation tax regime**
- Agreement on **majority voting instead of unanimity** when making foreign policy decisions so as to increase the effectiveness of EU policymaking

EU Summit: 18-19 October

- Agreement on the **size of the Eurozone budget**
- Agreement on the **Single Bank Resolution being part of the EMF**
- Progress on **Capital Market Union**
- European **Defense Fund**

EU Summit: 13-14 December

- Agreement on a time schedule for implementing the **Common Deposit Guarantee** Scheme once the EBA stress tests prove the reduction of banking risk across all Eurozone banks
- Agreement on the **financing sources of the Eurozone budget** (regular transfers made by individual countries or a tax on financial transactions or a levy on digital companies)
- Agreement on the **Brexit deal**

UNITED KINGDOM: SOFTER BREXIT LIKELY

Economic forecasts

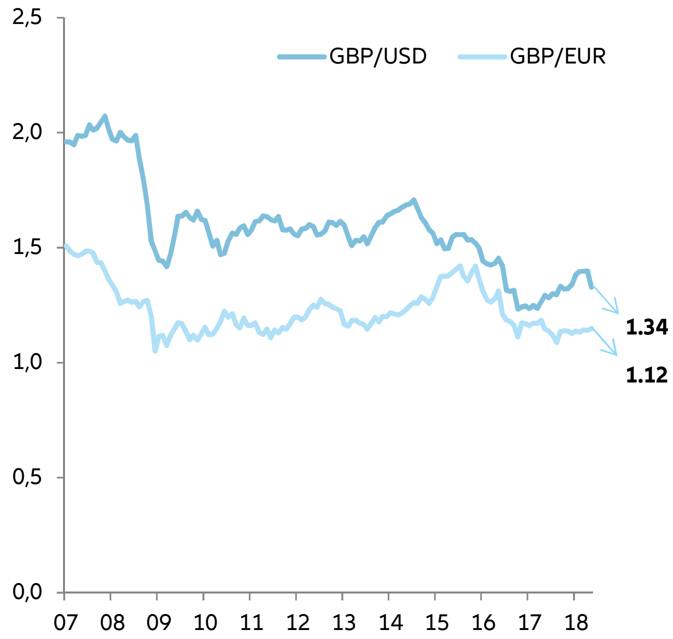
	Weight	2016	2017	2018	2019
GDP	100%	**1.9**	**1.8**	**1.4**	**1.3**
Consumer Spending	66%	**2.9**	**1.7**	**1.0**	**1.0**
Public Spending	19%	**0.8**	**0.1**	**1.6**	**1.4**
Investment	21%	**1.0**	**4.5**	**2.9**	**1.0**
Construction	9%	2.5	6.8	2.8	1.4
Business investment	9%	-0.5	2.4	1.1	1.4
Stocks *	-4%	*0.4*	*-0.9*	*-0.1*	*0.1*
Exports	28%	**2.3**	**5.7**	**1.3**	**1.9**
Imports	30%	**4.8**	**3.2**	**1.6**	**1.7**
Net exports *	-2%	**-0.8**	**0.6**	**-0.1**	**0.0**
Current account **		**-114**	**-83**	**-81**	**-69**
Current account (% of GDP)		**-5.8**	**-4.1**	**-3.9**	**-3.2**
Unemployment rate		**4.9**	**4.5**	**4.2**	**4.0**
Wages		**2.4**	**2.2**	**2.9**	**2.7**
Inflation		**0.9**	**2.7**	**2.4**	**2.3**
General government balance (% of		**-3.0**	**-1.9**	**-2.2**	**-2.4**
Public debt (% of GDP)		**88.2**	**87.7**	**87.4**	**87.3**
Nominal GDP **		1963.3	2037.6	2096.3	2158.8

Change over the period, unless otherwise indicated: * contribution to GDP growth

** mds de £

Slowest GDP growth since 2009 with below potential consumer spending

GBP/EUR and GBP/USD



Sources: Bloomberg, Allianz Research

The BoE relatively hawkish stance to limit the downward move on the currency: -4% depreciation of the GBP vs. the USD and -1% vs. the EUR at end-2018

Higher probability of a soft Brexit

- Brexiters showed they are capable to compromise and avoid a political deadlock as they showed during the last two ‘meaningful votes’ in the Parliament
- The Parliament will have a say on the deal before it goes to the European Parliament.
- The ultimate deadline for a deal fixed to end-2018 to allow enough time for ratification
- An EU Association Agreement (Ukraine-style) is likely. It will sets the framework but gets the details later. This would concern topics like trade, internal security, thematic

Extensive FTA ?

- The UK needs to publish the White Paper explaining their preferred position. Staying in the Custom Union would be an easier fix to the Northern Ireland issue
- EU takes a pragmatic stance and looks capable for compromise

THANK YOU!

Economic Research Department

26.06.2018