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Economic Outlook

No time for complacency

Editorial

With its title, ‘A hint of spring is in the air’, our last Economic Outlook suggested we were cautiously observing signs of a firming recovery in the global economy. As growth started to improve though, we saw a wave of economic policy uncertainty after the US elections and ahead of elections in a number of European countries. Such uncertainty, if prolonged, would make firms and households more careful in spending, weakening the global recovery.

Six months on, it is clear that the signs of firming were not false flags. Firstly, economic growth has kept solidifying across the regions, forcing a series of upward forecast revisions (including those of ourselves), especially for the eurozone. Secondly, and most notably, economic policy uncertainty has fallen off a cliff in 2017. Despite stepped-up US self-assertion in trade matters, fears for large-scale US protectionism have faded. In Europe, voters have kept populist parties out of the mainstream, triggering at least a whiff of optimism regarding further European integration. We are definitely in calmer waters, finally.

Such an upbeat introduction could strike the regular Outlook reader as somewhat surprising. But complacency is precisely what we do not need at this stage. The reasons are not so much the consumption-driven character of the acceleration or the still-muted level of growth. Rather, what deserves full attention now is awareness that in calmer waters we will certainly not remain. The current upswing, being largely cyclical, will undoubtedly be succeeded by a downturn.

It is therefore crucial that when the next downturn sets in, economic policy tools – especially those of monetary policy – need to be available to keep the global economy above water. One can question: will they be? For the moment, we think that the answer is in the affirmative. Monetary tightening that has currently set in by the Federal Reserve, and to be followed suit by the European Central Bank, will provide for that: interest rates are being hiked and money taken out of the market. Still, as it stands now this looks like a very, very gradual process. At some point in time acceleration will become inevitable. That will be a balancing act. Tightening should create necessary utensils to address the next downturn. At the same time, accelerating the next downturn by that very tightening should be avoided.

The waters we are in are calm, and we should enjoy them. But they are also uncharted. This is no time for complacency.

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Executive summary

Global economic momentum, which began picking up in H2 of 2016, has solidified through the year. While six months ago we were cautiously optimistic, this edition of the Economic Outlook paints a positive picture of the world economy over the forecast period. However, now is not a time for complacency. Particularly the normalisation of US monetary policy, badly needed to address a future downturn, is a balancing act.

Key points

- Global GDP growth is forecast to expand 2.9%, a marked acceleration from the lacklustre 2.4% growth last year. The 2018 outlook is stable, with 3.1% growth expected.
- Eurozone growth has been stronger than expected thus far in 2017 and is expected to lead other advanced markets with 2.3% growth forecast. The US is forecast to see a 2.2% expansion while the UK economy is expected to slow to 1.5% this year and next.
- Emerging markets are also enjoying strong growth, largely driven by high external demand, better policymaking, and recovering commodity prices. Latin America is forecast to expand 1.1% and further to 2.5% in 2018. Eastern Europe is surprising to the upside with growth expected to pick up to 3.1% this year before moderating to 2.3% in 2018. Emerging Asia continues to lead growth with a steady 6% forecast this year and 5.9% next year.
- The cyclical upturn in the global economy is driving a more positive insolvency outlook in both advanced and emerging markets.

The cyclical upturn in the global economy has continued to take root, accelerating world GDP growth to 2.9% after the slowest expansion since the global financial crisis. Momentum has been broad-based and spans both developed and emerging economies and is expected to carry through 2018. This increasingly robust outlook is outlined in *Chapter 1*. We also highlight again the uncharted territory that we find ourselves in, in advanced economies, where inflation is staying stubbornly low but central banks look to move forward with monetary tightening. While the outlook for 2017-2018 is strong, it is now that monetary policy tools must be sharpened to counter the next economic downturn.

There remain a number of risks that could push the global economy out of the calm waters it is now in. The key risks to our global outlook are: (1) misguided Fed policy, (2) a hard landing in China, (3) US protectionism, (4) oil price volatility, (5) geopolitical risk, and (6) financial market correction.

Chapter 2 presents the outlook for developed markets. The eurozone has been the star performer thus far in 2017, with loose monetary policy and tightening labour markets finally pushing consumption growth higher. While political uncertainty was the primary concern to the outlook in May, developments have largely rejected populism and strengthened the positive view. Policy uncertainty remains a concern in the US, but our baseline scenario is policy continuity. Economic growth is accelerating there, supported by consumption, higher investment, and possibly some fiscal stimulus. The UK economy is resilient but slowing slightly due to lower consumption and investment. Advanced Asia is benefitting strongly from the global upturn in international trade.

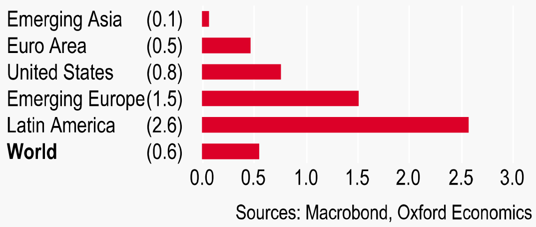
Stronger global trade flows are also a driver of the positive outlook for emerging markets, presented in *Chapter 3*. The modest recovery in commodity prices further aids commodity-exporting markets. The stronger economic outlook offers confidence for most regions that well-communicated, gradual Fed tightening should not be de-stabilising. Moderately slower economic growth in China is expected to strain growth slightly in many emerging markets in 2018 though.

Our global insolvency outlook is updated in *Chapter 4*. On top of a new forecast model, we expand our forecasting into advanced Asia and some key emerging markets, depending upon data availability. Besides a few exceptions, the insolvency outlook is moderately positive for 2017 and 2018, supported by the cyclical upturn in the worldwide economy.

1. The global macroeconomic environment

1.1 GDP growth accelerating across regions

% point difference in GDP growth from 2016 to 2017



GDP growth solidifies around the world

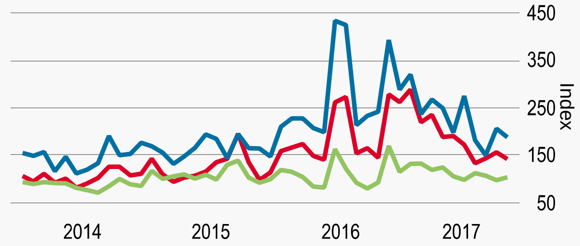
The cautiously optimistic outlook presented in May has been confirmed by stronger-than-expected economic performances through 2017. We expect global GDP growth to accelerate 0.5 percentage points in 2017, compared to 2016, with almost all regions enjoying the pick-up. The only exception is Emerging Asia – which was simply not affected by the 2016 mini GDP growth slump.

Economic growth in Emerging Asia is stable in 2017. Mild accelerations in China and Indonesia offset the temporary slowdown in India. In Latin America, Argentina and Brazil are creeping out of recession, due to better domestic policies as well as improved energy and commodity prices. In Eastern Europe a similar story holds as Russia also turned the corner, bringing GDP growth figures back into black, riding a mild energy price rebound. US growth is simply recovering from an unusually dismal 2016 towards its more habitual level of around 2%. Last but not least, economic growth in the eurozone remains unexpectedly robust and is even accelerating, helped by tailwinds such as ultra-loose monetary policy and improving employment that underpin consumption growth.

Growth developments are supported by the reduction in economic policy uncertainty. Concerns about a surge in US-initiated protectionism are receding now that the US presidency finds out that governing differs from campaigning. Moreover, concerns in Europe about the rise of populists and eurozone unity, and even European unity post Brexit, have abated. At this point, even further

European integration is being discussed, as we elaborate in Chapter 2. As economic policy uncertainty drops, a significant downside risk to the global economic outlook reduces as well.

1.2 Policy uncertainty has eased
Economic policy uncertainty index, news-based



Sources: Macrobond; Baker, Bloom & Davis

Low policy uncertainty is expected to continue in 2018. On the back of some expected mild tax reduction, US growth is forecast to accelerate to 2.6%. The eurozone will face some headwinds from trade growth that is expected to slide from its 2017 catch-up level, but GDP growth will remain at 2%. Emerging Asia GDP growth will be under some pressure as China continues to slow, towards an expected 6.4% GDP growth rate in 2018 as the government steps up its effort to rein in credit growth. Indian growth acceleration towards 7.5% can only partly compensate for that. In Latin America the Brazilian GDP growth acceleration in 2018 will set the country, and the region, back on a higher growth track. Eastern European growth will slow due to a slowdown in the Russian (new US sanctions) as well Turkish economies (fiscal stimulus dries up).

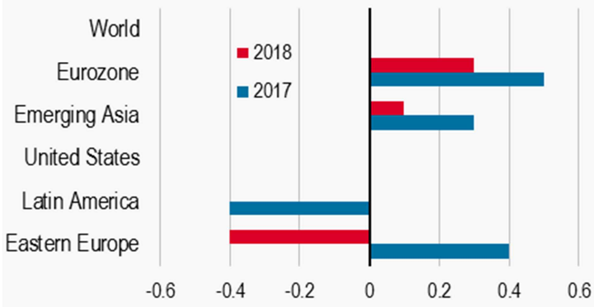
Table 1.1 Real GDP growth (%) - global regions

	2016	2017 f	2018 f
Eurozone	1.8	2.3	2.0
United States	1.5	2.2	2.6
Emerging Asia	6.0	6.0	5.9
Latin America	-1.5	1.1	2.5
Eastern Europe	1.3	3.1	2.7
World	2.4	2.9	3.1

Sources: Macrobond, Oxford Economics

Meanwhile, the trend of more stable forecasts signalled in previous Outlooks has also continued.[1] Most forecasts were upwardly revised over the past six months, especially for the Eurozone and Asia in 2017. Latin American GDP shrank more in 2016 than anticipated in May, leading to the current downward growth revisions. Still, we consider the overall picture as being more stable.

1.3 GDP revisions leaning to the upside
Change in 2017 and 2018 growth forecasts from May to November 2017



Sources: Oxford Economics

Trade growth rebounds strongly

The recovery of trade growth underway since late 2016 has continued through 2017. Global trade has experienced a stronger- and broader-than-expected expansion, growing 3.6% in the 12 months leading to August 2017, following a dismal 1.4% increase in 2016. US trade grew 3.3% (compared to 0.2% in 2016), Emerging Asia 6.3% (1.6%), Emerging Europe 8.2% (4.1%) and even Latin America grew 3.7% (0.7%), all significantly accelerating trade growth figures for the period up to and including July.[2] Even the eurozone, which had been a rare bright spot in 2016, reported a slight uptick to 2.6% (2.2%).

Forward-looking indicators offer confidence that these higher trade growth levels will persist for some time. The Baltic Dry Index (1985=100) which accurately helped predict the current trade growth revival as we reported in the May Economic Outlook has gone even higher to above 1500 in October from a previous peak of 1300 in March. Global export orders, another early warning indicator, have held firm since the rapid increase that started in July 2016. It now indicates higher export growth, albeit at a slower pace.[3]

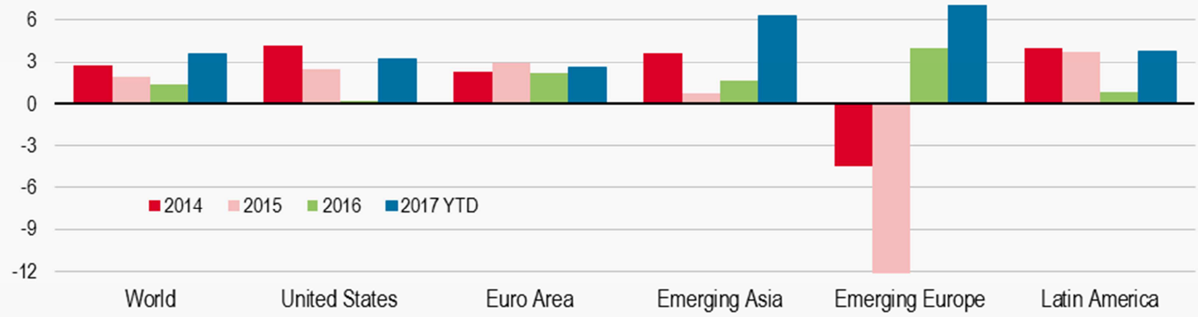
Then the positive forecasts revision since our May Economic Outlook comes as no surprise either. Our current forecast stands at 5% year-on-year for 2017, higher than the May figure. For 2018 the picture is strong as well, although slightly less buoyant. 2017 contained a catch-up element, especially for Asia and the US, which is expected to fade in 2018. We expect a deceleration towards a relatively strong level of 3.5%.

[1] We note that current forecasts are based on the Oxford Economics baseline scenario model, whereas previous ones used in the Outlook originated from Consensus Economics. At this level of aggregation we do not observe major differences between Oxford Economics and Consensus Economics forecasts.

[2] We use annual trade volume figures (monthly rolling) which are compared to the previous period as assembled by the CPB Netherlands Bureau for Economic Policy Analysis. Therefore, July 2017 trade volume figures cover the period starting July 2016, and these figures are compared to the July volume 2016 figures to calculate trade growth. Indeed, for the 2016 figures calendar year volumes are compared to 2015 calendar year figures.

[3] See Https://www.markiteconomics.com/Survey/PressRelease.mvc.

1.5 Trade growth picking up, highest level since 2011
Volume of goods trade, 12-month rolling average, % change y-o-y



Sources: CPB Netherlands Bureau for Economic Policy Analysis

This picture raises a few questions. Firstly, what explains this stronger-than-expected trade growth result in 2017? Secondly, are we now back on a higher trade growth track or is it just a temporary revival?

Addressing the first question, we should point at four driving factors: (1) economic policy uncertainty, (2) the US, (3) China, and (4) idiosyncratic developments in major emerging economies such as Brazil and Russia.

As to economic policy uncertainty, we already have seen that the index has come down dramatically over the course of the spring. This holds for the US and the eurozone, but also globally: the global index fell from 300 early this year to 130 in late September. With World Bank research having shown a 75% difference in trade growth between 2016 and 2015 falling on economic policy uncertainty,[4] there is a strong suggestion that this uncertainty reduction has contributed.

The EPU index fell significantly in the US as the conviction grew that the Trump administration was barking at but not sincerely biting into trade matters.[5] This has undoubtedly supported confidence, and therefore firms and household spending. Especially US firms, particularly those in the energy sector, have accelerated investments in the first half of 2017. The impact on trade growth was exacerbated by the very low levels of US investment in 2016.[6] On the export side, the stronger US dollar has been a contributing factor to lower US exports in 2016. These effects have faded through the first half of 2017.

Furthermore in China, demand for imports was strong, due to growth in industrial production (up 6.4% in the first half of 2017) and services (up 7.7%). As we have asserted in earlier Economic Outlooks the impact of China on global trade growth should not be underestimated. Simulations by Oxford Economics indicate that at least 30% of the recent global trade growth acceleration can be directly attributed to Chinese demand.[7] Via indirect channels such as intra-regional supply chains, this figure could rise to as much as 70%. [8] Another is commodity trade. Due to the sheer size of the Chinese market, demand there pushes up commodity trade as well as commodity prices. The latter trigger higher investment levels in commodity exporting countries.

Finally, as to idiosyncratic developments in various emerging economies it is important to point out that Brazil is creeping out of recession, which has a positive impact on regional trade, an effect strengthened by the recovery in Argentina. For Eastern Europe a similar story can be written. The Russian recovery is underway, although muted, helped by the higher oil price.

Addressing the second question, we see the drivers of the 2017 trade growth acceleration partly losing steam in 2018. The upward effect on trade of the decline in policy uncertainty will wane in 2018. Another plummet in economic policy uncertainty is not expected. Moreover, the pace of Chinese growth is expected to moderate in 2018 and beyond. That implies that two strong drivers of trade growth acceleration will be removed. On the other hand, the US trade growth is not expected to fall back to 2016 levels, now that there is even a slight uptick in GDP expected. Moreover, eurozone trade growth levels can be expected to hold up as well given the relatively favourable GDP forecast. And 2018 GDP forecasts for countries like Brazil, Argentina, Russia and Turkey are boding well. All this supports a somewhat lower trade growth level for 2018 that is embedded in the forecast of approximately 3.5%.

This is a reasonable level, but nowhere near the pre-financial crisis levels of around 5.5% per annum. For the time being, a return to those levels cannot be expected. Firstly, a boost from trade liberalisation is far off, with

[4] Trade Developments in 2016: Policy Uncertainty Weighs on World Trade, World Bank February 2017.

[5] There has been a US withdrawal from the Trans-Pacific Partnership, a deal for which ratification by Congress was unlikely. The renegotiation of the North American Free Trade Agreement was long overdue. There is an investigation into steel imports using national security arguments, and tariffs on solar panels, Bombardier Airliners and washing machines have been imposed. But this is not the wave of protectionism feared. Most importantly, however, a Trump campaign promise to impose an across the board 30% tax on imports disappeared to the backburner earlier in the year.

[6] The import component of investments is higher than other components of GDP.

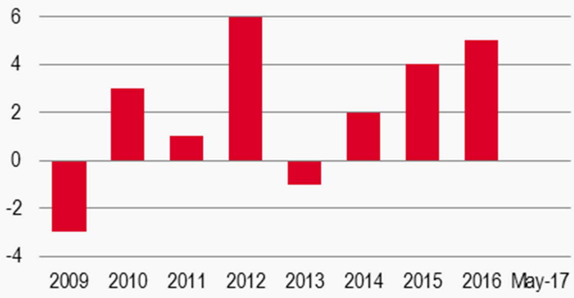
[7] China-commodity nexus at the heart of global upturn. Research Briefing Oxford Economics, June 12 2017.

[8] Investment levels in countries with close ties to China such as Korea, Hong Kong, Taiwan and Japan have indeed surprised in 2017.

initiatives such as TPP and TTIP having been stalled. Moreover, despite the positive tone from the WTO, no progress was made with net trade facilitation (meaning trade facilitations minus trade restrictions) in 2017. This is a departure from a positive trend since 2014. On the positive side though, the number of new trade restrictions is the lowest since the 2008 crisis. Secondly, little tangible progress is to be reported on the trade finance gap of which the most recent available figure is USD 1.6 trillion (or 10-15% of the total value of export finance markets).[9] There have been a number of measures proposed to address the issue,[10] but the impact hereof is yet to be seen.

1.5 Net trade facilitation grinds to a halt

Difference between trade-facilitating and trade-restricting measures; positive = more facilittative



Source: WTO

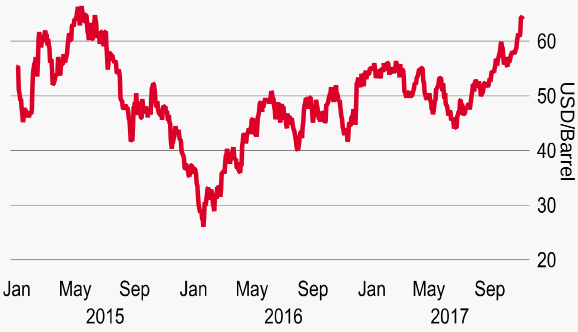
Oil price volatility is back

In our May Outlook we hinted at a relatively dull period for the oil market with prices on average staying in a USD 50-60 range per barrel Brent in 2017 and 2018. The lower boundary of this range, or floor, is provided by an agreement between OPEC countries and non-OPEC suppliers such as Russia to cut production. In May, this agreement was extended to March 2018. The upper boundary, or cap, is set by US shale producers that are quick to ramp up production in response to higher price pressures.

Since May this has not shown to be an absolute truth, as prices have moved through the USD 50 floor to reach USD 45 in July. This was attributed to lack of confidence in compliance with the output cuts agreed by OPEC and other suppliers. Moreover, uncertainty reigned with respect to the situation in the US where inventories ran high as production rose to unexpected levels. These uncertainties, precipitating in a negative market sentiment, have now been reduced; US inventories declined sharply over the summer. Incoming oil demand data provided support for a view on the oil market rebalancing earlier than expected. In other words, the currently high stock levels may be called on as oil supply no longer meets demand. This has driven the oil price up, above the USD 60 ceiling. The oil price, therefore, remains on the expected trajectory, but has been less dull.

1.6 Oil price returns to USD 50-60 range

Daily spot price, USD per barrel Brent



Source: Macrobond

Over the forecast horizon, we maintain our earlier view of a price gradually moving up into the higher parts of the USD 50-60 for Brent.

Global demand for oil is expected to grow at 1.4-1.5 million barrels per day (mb/d) in 2017 towards 97 mb/d, and onwards in 2018. A large part of this demand comes from China. Whilst economic growth in China will decelerate and rebalance higher income levels are expected to push up oil demand significantly, near 6% for 2017. Moreover, as a number of Chinese oil firms struggle at the current oil price levels, the country has decided to build strategic oil reserves. The latter means and import demand rise, pushing it up by 1 mb/d to 8 mb/d. Meanwhile, Asian demand more generally has continued to grow in 2017, a process that is unlikely to stop in 2018 (and beyond) given the GDP growth forecasts.

On the supply side US shale production has proven more resilient as production costs came down to lower levels than expected. Higher US production is then expected to partially offset the OPEC agreement, as has been the case in 2017 so far. The OPEC agreement as such is under some pressure with compliance levels falling to below 80% in June. Moreover, OPEC members Libya and Nigeria, exempt from the agreement, are ramping up production. This is also the case for Iran. It will put pressure on other OPEC members to reduce production. Despite these instability issues in OPEC, we do not think OPEC will return to its failed market share gain strategy that it briefly implemented in 2014 - 2016. OPEC countries can simply not afford oil price lows such as $30 that we observed during that period.

The upshot of supply and demand developments is that there will be pressure on reversing the balance in the oil market. Balance has been in favour of supply, pouring oil into storage. This picture is now changing, with the IEA already reporting a supply shortfall in the second quarter.

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[9] 2015 figure from the Asian Development Bank.
[10] Report to the TPRB from the director-general on trade-related developments, WTO, July 12 2017, p. 71.

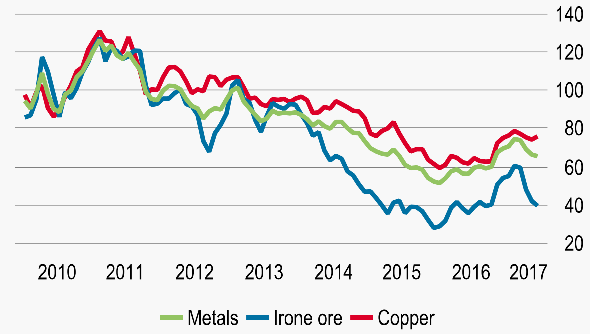
This clearly puts upward pressure on prices over the forecast period.

As to the medium term, we maintain our view that the oil price will further climb. This is predominantly driven by fairly stable demand developments in the emerging economies. The gradual price increase forecast over the medium term is strongly built on the assumption that investment levels will rebound to meet demand. If not, the oil price can become very volatile in the medium term as well.

Rising commodity prices clouded by uncertainty

Commodity prices have declined since the start of the year, while medium-term upward pressure remains. The metal price index has peaked in the early part of the year, and then fell back significantly, after which it recovered again. This now leaves us with a price level above the level observed in the trough of mid-2015.

1.7 Commodity price rebound reverses
Price index, 2010 = 100



Sources: Macrobond, IMF

The picture for the various individual metals is divergent. Iron ore prices have shown a more pronounced fall than metals. The index is back at its mid-2016 level, although a post summer 2017 recovery has set in. The indices of other significant components, copper and aluminium have fared better. Indeed prices, especially for aluminium, have hardly lost ground since early 2017 and have been on the rise since the summer as well. The 2017 year-to-date commodity prices picture is higher, but also more volatile.

Despite the decline in prices since the start of this year, commodity prices remain higher than their mid-2015 troughs. Broad based economic recovery definitely helps. Even more important is the mild Chinese stimulus for the construction (including infrastructure) and property sectors – 51% of global commodity demand comes from China. Automotive and construction are still on the up globally, providing another impetus. Moreover, the weakening US dollar contributed as commodity prices are denominated in US dollars.

With the demand side fairly robust, supply developments must account for the recent price volatility. In particular, the Chinese announcement that capacity will be reduced is relevant. Ambitious cuts they are: steel production capacity is to be reduced by 20% compared to its 2016 output, aluminium 30% in big production centres. Although official Chinese data show capacity reductions convincingly well ahead of schedule, anecdotal evidence suggest that at least part of the capacity cuts are complemented by new and modern facilities.[11] Moreover, output data do not back up the capacity cuts, with aluminium production up 17% in the first eight months of 2017.[12] This causes uncertainty. And as long as this is not convincingly addressed, Chinese data will continue to be scrutinized and price volatility will remain high.

Meanwhile the underlying trend in prices is upwards. This is because markets are moving into a negative balance in 2018, meaning that supply will start outweighing demand. For aluminium, the 2017 supply surplus is bound to reverse over the course off 2018 as the announced Chinese capacity cuts become manifest. That will provide further support for prices. Whereas in the copper market no significant supply cuts are envisaged and mining output is expected to tighten.[13] That results in a negative balance as well. For iron ore the picture is somewhat more muted as cooling of the Chinese economy and stricter environmental policies in China will put pressure on steel production. This as such will reduce the demand for iron ore and raises uncertainty about a negative balance for iron ore. To the extent such negative balance manifests the built in expectation of higher prices will be reinforced. Until then, uncertainty will reign.

An inflation puzzle - to some extent

We have already mentioned above that we will emphasize the stance of monetary policy in this Economic Outlook, and more particularly the phase-out of the extraordinarily lax monetary policy in the US and the eurozone since the Great Financial Crisis in 2008. The current calm in global economic developments is a good moment to assess monetary policy tools, which will be needed by policymakers to smooth the next downturn,[14] or crisis.

First, one must consider inflation. This is currently the focal objective of the Fed and ECB.[15] Then we move on to sketch the current stance of monetary policies, the outlook as well as the implications for financial flows to emerging economies. Our view is that there is no reason

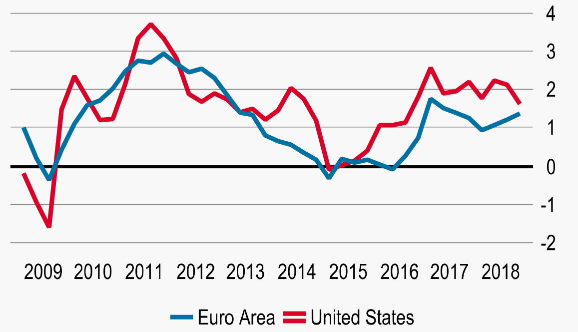
[11] See The Economist, Great Leap Backward, September 2017.
[12] Rising metal prices need more than eco talk. Financial Times, September 23 2017
[13] ABNAMRO. Weather dominates commodity markets, Monthly Commodity Update September 2017.
[14] Fiscal policy tools would be needed then as well. We will focus on in another economic outlook.
[15] The Fed objective also contains a full employment target, which is arguably met now in the US so that the current focus of the Fed is also on the inflation rate.

to postpone monetary tightening in the US, whereas in the eurozone matters are a little more complicated, warranting a cautious approach.

We have reported in our May Outlook that inflation in the US and eurozone was approaching the 2% target, whilst questioning how robust the incoming data were. Now, as we will elaborate in Chapter 2, it has become clear that they are not. Indeed, inflation readings have again come down in both the US and eurozone during 2017. On the face of it this is somewhat puzzling, because both regions are in a cyclical upturn, although the eurozone is clearly lagging as the recovery started much later.

1.8 Inflation expected to stay below target

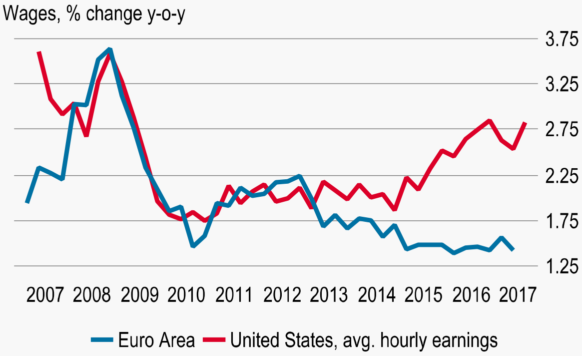
Headline inflation indices, y-o-y % growth



Sources: Macrobond, Oxford Economics

1.9 Wage pressures stronger in the US

Wages, % change y-o-y



Source: Macrobond

The US labour market has almost reached full employment at a current unemployment rate of 4.1%. That would normally push up wage demands and wages, and in turn lead to higher prices. Firms simply want to keep up their profits. Now, the first step of the process is already being taken in the US, with wage growth rates on a clear upward path and currently hovering just below 3%. But here it stops: higher wages have so far not translated into higher prices.[16] Apparently there are other factors at play that prevent firms from raising prices of products and services.

Such is not the lack of pricing power by US firms. Indeed, research[17] found increased pricing power over the past 20 years, consistent with rising profit margins and industry concentration. Firms are then able to push up prices, but they simply do not make use of that ability. Why? To answer this, we may consider whether it is really necessary to further drive up prices from a profit point of view. If there are other costs which are lower, and thus help keep profits up, the answer is perhaps no.

Such (lower) costs are not too difficult to detect. Firstly, the lower oil price and US dollar appreciation play a role as Institute of International Finance (IIF) research points out.[18] It finds that current US inflation is in line with the unemployment rate, the lower oil price and the USD appreciation. These latter factors have helped rebalance profits of firms that are faced with higher wages. Secondly, in several sectors prices are lower because of the so-called Amazon effect. Firms move online to sell products and services, implying lower costs. Improved transparency on the internet then helps push down prices as well. IIF research[19] that takes a sectoral approach concludes it is only a handful of sectors that determine the low inflation, including prescription drugs, cell phone services and women's clothes. This is where the impact of online shopping is highest.

The eurozone labour market has clearly not yet reached levels of full employment or even close to that. Although the unemployment rate has decreased almost 2.5 percentage points since early 2015, the current 9% level is still considerably high and there are also a significant number of workers who are willing to work more hours. Significant pressure on wages is therefore not to be expected, although in countries such as the Netherlands and Germany labour market tightening suggests higher local wages. But for now, such a mechanism is not visible in eurozone-wide wage growth figures, which remain muted in the range of 1.5%. Therefore, from the labour market the inflationary pressure is limited. Still, even taking this into account and the low oil price as well as the euro depreciation, the current eurozone inflation is too low according to IIF research.[20] Product market reforms, leading to opening up and increased competition in sectors such as legal and healthcare in countries such as Spain, Portugal and Greece, may play a role here. But convincing research is lacking.

Then, upon closer inspection, the picture is arguably less puzzling. US inflation seems broadly in line with what can be expected given the labour market stance, oil price, US

[16] Whether higher wages are in line with the current stance of unemployment is, currently, an often discussed matter. There are clear factors at work, in the US and elsewhere, that depress wage growth, such as globalisation. This leads to migrating labour flows, especially into countries where wages are higher, depressing wage growth. Migrating labour flows will also depress the already depressed negotiating power of trade unions with a similar effect. And so has, on the demand side, movements of business activities towards low wage countries.

[17] For a reference see e.g. http://equitablegrowth.org/report/u-s-merger-policy-amid-the-new-merger-wave/.

[18] The Low Inflation Puzzle, IIF Global Macro Views, June 7, 2017.

[19] A Bottom-up explanation of US low inflation, IIF Global Macro Views, July 13, 2017.

[20] IIF as in note 19.

dollar swings and the Amazon effect. With the latter unlikely to last forever and the price of oil likely to climb, higher wages can be expected to impose themselves and push up inflation; this effect can be exacerbated or mitigated by US dollar swings. More robust US inflation figures in the range of 2% are therefore probable in the near term. Such is not the case for the Eurozone, where lower and more volatile inflation can be expected. Continued high unemployment depresses wage growth - that is the dominating factor. The climbing oil price will lend support to inflation. But as part of the low inflation is yet to be identified, a significant uncertainty remains on top of these exchange rate swings. Therefore, inflation is most likely to stay below 2% for the forecast period.

Further moves into tightening mode

The suggestion from this inflation analysis is that the Fed has room to tighten its monetary policy, whereas the ECB will have to tread carefully. This raises the questions where we currently are and where we are headed with monetary policy. It appears tightening is a balancing act.

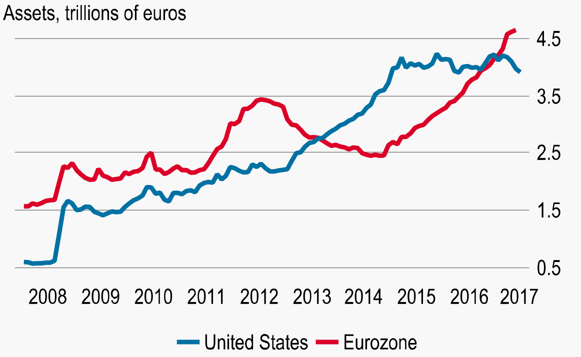
The Great Financial Crisis demanded swift policy action to keep the economy afloat. The Fed delivered that. It was quick in reducing the policy rate from over 5% to around 0%. Moreover, the Fed started to purchase government bonds and mortgage-backed securities. Its balance sheet consequently swelled by USD 3 trillion to USD 4.5 trillion as a result of this. It was dubbed 'quantitative easing' (QE), referring to the volume (rather than price and thus interest rate) element of monetary policy.

Essentially, ample money became available at low or even no cost, triggering spending. It worked. The economy stabilised and in June 2013 the Fed announced it would commence tapering QE, and by the end of 2014 the purchase programme indeed stopped. As from that moment the Fed would only replace assets that had been repaid. For the balance sheet that meant: no longer growing. In late September 2017 the Fed took another step by announcing it would start gradually unwinding QE (and therefore reducing its balance sheet) to the tune of an amount gradually rising to around USD 50 billion per month.[21] At that pace, fully unwinding QE will take quite some time, perhaps more than 20 years.[22]

Meanwhile, the policy rate has gone up in three steps to 1%. The Fed now plans to further hike rates, gradually as well, towards levels that will be in the range of 4% to 5% if one takes the 2008 level as a benchmark.[23] Rate hikes will be done complementary to the Fed balance sheet reduction, with the latter 'running quietly in the background' as stated by the Fed chair. The picture that emerges then is one of a very, very gradual tightening. As a consequence, at some point, acceleration of Fed tightening seems inevitable. As we will further discuss in the next subsection, that will be a balancing act.

As the Fed reacted swiftly and decisively to the crisis, the ECB took a more cautious approach and initially relied on policy rate cuts towards 1%. A European QE only developed as the banking crisis evolved after the crisis of 2008. The first step, in 2010, was to purchase government bonds and swap lines in an attempt to keep liquidity in the financial system up. In late 2011, as matters in the eurozone banking sector really got worse, the ECB launched its LTRO program. That provided long-term financing to the banking system at very low rates.[24] Meanwhile government bond purchases continued, pushing the ECB balance sheet to approximately EUR 3.5 trillion. All of these measures helped the banking system, but proved insufficient to pull the eurozone economy out of the doldrums. With inflation approaching danger zones of zero or even negative level, the ECB then came up with its own variant of QE in 2014. EUR 80 billion per month asset purchases blew up the balance sheet to EUR 4.5 trillion, a level that is still rising. The policy rate for bank lending was pushed to zero in parallel.[25]

1.10 ECB and Federal Reserve balance sheets
Assets, trillions of euros



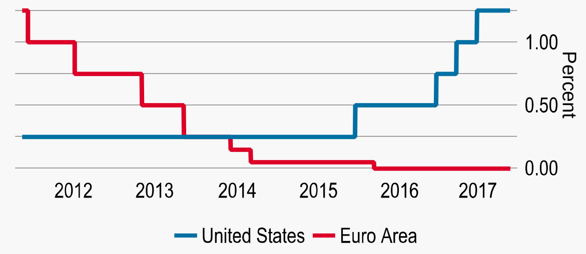
Source: Macrobond

Now, as the Fed is already in cautious tightening mode, the ECB is still far from that. In view of the current stance of euro area inflation this is justified. If the economic (and inflation) data become more robust, the ECB first needs to stop QE. This is expected to happen somewhere in late 2018: the ECB has recently announced 'tapering' QE to EUR 30 billion per month until at least September 2018. ECB rate hikes are not expected before early 2019. In the Eurozone, therefore, the money tap remains open during our forecast period.

[21] There will be a limit to the amount for which the balance sheet is reduced by not reinvesting. These amounts will gradually rise towards USD 30bn for treasury bonds and USD 20billion for asset backed securities.
[22] After 20 years around USD 2.5trillion will be unwound.
[23] The level of such benchmark may be questioned as the underlying real interest rate is arguably lower due to higher global savings levels. We have discussed this so-called secular stagnation view in our May 2016 Economic Outlook.

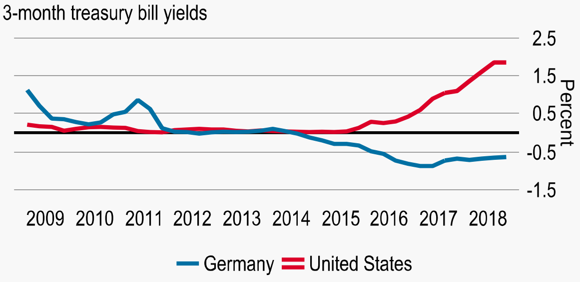
[24] An amount of approximately Euro 800 billion was lent to European banks for maturities up to 3 years at the rate of 1% in late 2011 and early 2012.
[25] Depositing rates for banks at the ECB are even negative at 0.5%, implying it costs banks money to deposit money at the ECB.

1.11 ECB vs Fed policy rates
Percent per annum



Source: Macrobond

1.13 Short-term rates diverge significantly
3-month treasury bill yields

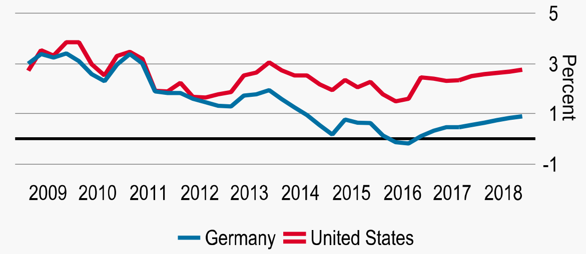


Sources: Macrobond, Oxford Economics

The right Fed chair for tightening please

With the current stance on monetary policy in mind, it is time to take a closer look at the path of monetary tightening by the Fed, or perhaps: expected monetary tightening. QE as well as other Fed measures have pushed 10-year Treasury yields down by approximately one percentage point. One may then simply conclude that, with Fed tightening, yields will move back up. But that is a big question mark since the Fed has so far carefully provided the so-called ‘forward guidance’ as to what can be expected of its gradual tightening path. Then, barring Fed (or data) surprises, 10-year yields can only be expected to move up very slowly. Such is not the case for short-term yields, which follow the official rate hikes more closely in the expected upward path. The emerging picture is then one of higher short-term yields as long-term yields remain more or less the same. It leaves us with a flattening yield curve as the Fed tightens.

1.12 Long-term yields expected to rise gradually
10-year government bond yields

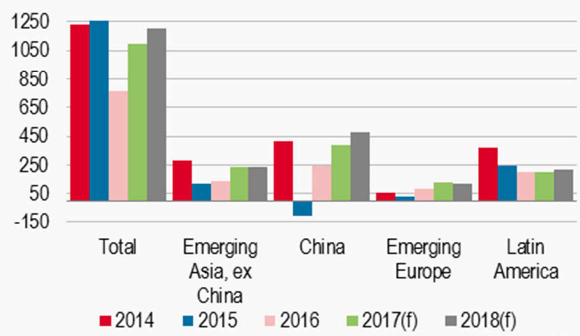


Sources: Macrobond, Oxford Economics

Refer back to the ‘taper tantrum’ in June 2013 that followed the Fed announcement that QE would be phased-out. Although common sense should already have suggested that QE would not last indefinitely, the announcement still came as a surprise and spurred a mini-crisis in the financial markets. Financial flows reversed from emerging economies, accompanied by depreciation of EME currencies, and pushing up 10-year yields in the US. The Fed then moved quickly to assure the market that rate rise considerations would include global financial market impact and calm was restored.

This time is different. The Fed has carefully crafted its tightening policy communication strategy, so that markets have already priced in future moves. Therefore, barring surprises, financial flows to emerging economies could hold up or even mildly accelerate, as is now forecast. This allows the investment by firms, as well as governments, to continue at relatively low rates.

1.14 Capital flows into EMEs are recovering
USD billion



Source: IIF

If the Fed is able to follow this careful path, this acceleration can be expected to run relatively smooth. Note the word if, implying the conditionality: it is not certain that such a careful course will be followed. In comes President Trump with the opportunity to reshape the Fed policy as three slots on the Fed Board are or will soon open. Amongst these was the Chair, Janet Yellen, who has presided over the current, thus far successful, policy. Her successor, Jerome Powell has been a Fed governor for some time and is reported to be a choice for continuation of the current cautious Fed policy. That may remove the higher likelihood of an unbalanced hawkish approach towards tightening. Still Mr Powell, being trained as a lawyer, lacks the heavyweight status amongst economists that Yellen and her predecessor Bernanke held and still hold. With tightening essentially moving into unchartered territory this may be a more risky choice than continuing with Ms Yellen. The ‘taper tantrum’ of 2013 has demonstrated that the Fed is walking on a very tight rope. That requires a safe pair of hands, which Mr Powell still needs to prove he is. That is the uncertainty surrounding Fed policy.

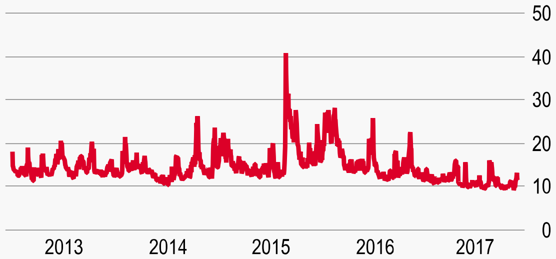
In short, it is clear the degree of freedom for monetary tightening is limited. Whereas tightening is important to create the necessary tools to address the future downturn,[26] the process as such should be carefully handled. Otherwise the occurrence of the downturn will be accelerated by the very process of monetary tightening. The monetary tightening process will then abruptly come to an end, with the tools ending up insufficiently sharpened. In this environment, the nomination of the Fed chair is a clear risk for the global economy.

Buoyant financial markets not fully confident

In our previous Economic Outlook we signalled that financial markets, especially in the US, were exuberant. There was also a suggestion that this may not be sustainable and that a correction was likely. Simply because firms' profits and macroeconomic data did not back it up. Financial markets seemed enthusiastic, perhaps overenthusiastic, about the new US government plans for infrastructure spending and lower taxes.[27]

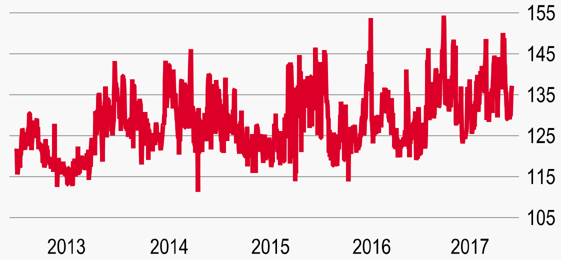
Having moved on another six months we see the picture of buoyancy in financial markets, particularly equity markets, confirmed. Share price indices for the US, the eurozone and emerging economies have continued upward. The VIX index, which measures the implied volatility of US equity markets, is now even lower than in May. Such low implied volatility signals that financial markets assessment of an equity price correction is relatively low. Higher price and lower volatility have also now received backing from macroeconomic data as well as in confidence indicators, across the advanced as well as emerging economies. Financial markets are still confident, and that confidence now seems more robust.

1.16 Volatility continues downward trajectory
S&P 500 volatility index (VIX)



Source: Macrobond

1.17 SKEW index shows higher potential risk
S&P 500 SKEW index



Source: Macrobond

But are markets really more confident? This question can be raised because the CBOE Skew Index, which measures the tail risk in the S&P 500, has continued to increase since May and is now historically high.[28] It tells us that the financial markets prices in the risk of a large price correction. Such is a signal that could be expected given the large and relatively high paced equity price increases in the US (and elsewhere). In May we already hinted at it but were not able to detect it. Now we observe that the risk signalled by the Skew Index, at least for the US, was already significant in May and is even more so at this stage.[29]

Thus, higher equity prices and lower volatility come with a higher probability of a large correction. This is arguably a more complete picture of the current stance of the financial market. It is also one that nuances the suggested exuberance. Still, even this nuance does not prevent the conclusion that financial market conditions are favourable, supported by the low interest rate environment. That reflects and supports the economic environment sketched above.

Risks to the Outlook

While the outlook has strengthened, the risks have changed. As we have argued in this chapter, there is potential for misguided Fed policy, topping our list. What we have so far observed from US policymaking is relatively careful manoeuvring, despite rhetoric and difficult NAFTA negotiations. This confirms our view, already hinted at in the May Outlook, that the implementation of a very strict US protectionist policy is a lower, though not absent, risk. The full set of risks, now also includes oil price volatility and geopolitical risk, while we have moved the financial market correction to the bottom of the table. That is because we use a stricter interpretation of the event as we discuss below. Finally, the eurozone continues to demonstrate solid, and even improving, economic performance, for which reason we have removed the risk of a drop in eurozone growth.

[26] This view does not have to remain necessarily unchallenged. The impact of the 2008 financial crisis is still felt and predominantly monetary policy tools have been used to address it. It may then be questioned whether addressing the next business cycle should be done using monetary policy. Given that we think this is the case, our underlying assumption is indeed that the impact of the 2008 crisis is no longer (significantly) hampering the economy, at least not in the US.
[27] There were talks about the 'Trump' bump.

[28] See BIS Quarterly Review, September 2017, p. 11.
[29] The VIX Index indicates the risk of a correction as such, not the size of it.

Fed policy. Our baseline scenario is a well-guided and well-targeted tightening policy by the Fed essentially following the current approach. The risk is that a leadership change will produce less-balanced guidance about policy. Moreover, interest rate hikes and QE reduction could be followed with less careful economic analysis. Still, even a careful, data-driven approach has a risk if the US administration uses fiscal policy tools to stimulate the economy towards 3% or higher growth targets. Higher US rates could trigger capital flows away from the emerging economies, hampering finance access and growth opportunities. In such a scenario, businesses, households and governments across the globe will face higher finance costs. With the Fed leadership change and the uncertainty it creates, we now consider the risk to our baseline scenario moderate.

China hard landing. The Chinese authorities have proven consistently able and willing to uphold the GDP growth targets that were set for the economy. They have used fiscal and monetary space to this end. Therefore, from this one can be confident that a sudden drop in economic growth or a hard landing (which has never been our main scenario) has moved further away. Reigning in credit growth, to be accelerated after the National Congress of the Communist Party, provides further support for this view. As we discuss in Chapter 3, the vulnerabilities in the economy, and more specifically those related to the financial sector, have continued to grow in 2017. With these risk now elevated, the probability of a hard landing has gone up, though it is still considered low to moderate now.

US protectionism. Under such a downside scenario, the US turns significantly more inward. Particularly concepts such as the cross border adjustment tax could be taken off the backburner. Counter-actions of trading partners, specifically China, will follow suit suggesting the picture of a trade war. The dollar moreover, would likely surge under this scenario, undoing a large part of the protectionist impact of the tax. Still, with such a sweeping scenario not likely the US administration is very clearly on a more protectionist path. This is shown by the difficult NAFTA renegotiations (which we elaborate on in Chapter 3) as well as a range of smaller protectionist measures such as the investigation into steel tariffs based on national security grounds. Other measures may follow, restraining trade and growth.

Oil price volatility. Our baseline scenario is a gradually increasing oil price over the forecast period. This is based on an investment level that enables accommodation of oil demand over the medium term and does not enable shocks in demand development. If such investment levels turn out insufficient, the oil price can go up swiftly and become very volatile in the short term. This is just because the market is no longer confident about a gradual development. Then, the global economy will face higher and more volatile oil prices, hampering growth in oil importers such as the eurozone. The volatility will also hamper investments in the industry and limit the ability to reset macroeconomic policy in the oil exporting countries. Global growth will be negatively affected.

Geopolitical risks. These risks have gone up recently, especially in the Middle East and on the Korean peninsula. In the Middle East, Saudi Arabia is leading a boycott of Qatar for alleged links with Iran. This has pushed up the risk of a military conflict between the two rivals in the region. Such an event will impact the global economy via the oil production in the Middle East. Oil price volatility will be the result which will affect global confidence and via that channel hamper global growth (lower investment and household spending). The impact of a (limited and thus nonnuclear) conflict on the Korean peninsula will have predominantly regional impacts, although US-Chinese tensions will also mount. Confidence effects, running via the financial market, will put some pressure on global growth. Emerging economies risk premiums will go up, hampering financing opportunities for firms.

Financial market correction. The surge in equity prices that we have seen in the aftermath of the Trump election has persisted and is now better underpinned by stronger economic data. That allows for more confidence in the current asset prices and, as Fed tightening takes off, a gradual correction. Still, there is a sense that in a world still awash with money, equity prices, and more broadly asset prices, have gone up to far. In the VIX index there is no hint of an upcoming correction, but in the SKEW index there is. It suggests that, if a correction occurs, it could be large and, if so, damaging and reinforced if Fed policy is misguided or poorly targeted. The damage will be done because firms as well as households may react by restraining spending. With overall demand just recovering, such a scenario is unwanted.

Table 1.2 Risks to the global economic outlook

	Risk	Symptoms	Effects	Probability	Impact
1	Misguided Fed policy	Financial market turbulence, flows to emerging economies plummet	Tighter credit for firms in emerging economies; debt service issues	moderate	high
2	China hard landing	Unstable banking sector, credit constraints, acceleration capital outflows, pressure on currency	Financial market volatility, spill-over into dependent (REM) economies	low/moderate	high
3	US protectionism	Trade barriers such as tariffs or targeted restrictions introduced	Severe constraints on trade with US	low	high
4	Oil price volatility	Lagging oil industry investments with strong demand. Pressure on oil price stocks.	Uncertainty affects confidence, especially firms. Unexpected swings in inflation. Lower investment.	low	moderate
5	Geopolitical risk	Exploding tensions in Middle East, especially between Saudi Arabia and Iran, and/or Korean peninsula	Middle East: Lower oil production and GDP, oil price volatility, fall in confidence. Korean peninsula:confidence declines, predominantly regionally	low	moderate
6	Financial market correction	Strong, rapid and sustained correction on overvalued equity markets, not triggered by risk 1-5	Fall in confidence affecting spending. Negative wealth effects households affecting consumption	low	moderate

Source: Economic Research

2. Advanced economies – prospects and risks

Table 2.1 Real GDP growth (%) - major markets

	2016	2017 f	2018 f
Eurozone	1.8	2.3	2.0
United States	1.5	2.2	2.6
United Kingdom	1.8	1.5	1.5
Japan	1.0	1.7	1.7

Sources: Macrobond, Oxford Economics

Economic strength exceeding expectations

Economic momentum has been picking up through 2017 in advanced economies, driven by domestic as well as higher-than-expected external demand. Upward revisions have been significant in the eurozone and Japan as broad-based growth in these markets has surprised to the upside. The US and UK outlooks are broadly in line with the May Outlook.

Challenges remain: most advanced economies are plagued by persistently low inflation, with the exception of the UK where pound sterling depreciation has increased consumer prices. However, all are in unchartered territory following nearly a decade of non-conventional monetary policy. Tightening at a pace that does not jeopardise the current economic recoveries will be a balancing act. But as the global financial crisis is nearly a decade behind us, the policy instruments of central banks to address the next downturn remain constrained. The US is beginning to sharpen its tools as the eurozone follows suit. The UK and Japan are lagging behind.

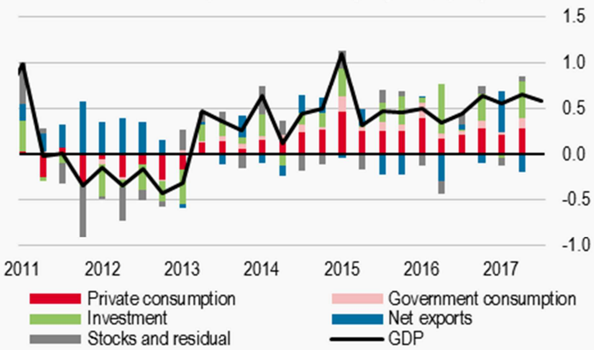
Eurozone recovery is gaining momentum

Eurozone economic growth remains supported by low inflation, employment growth and favourable financial conditions. GDP is expected to strengthen to 2.3% in 2017, which is a marked improvement compared to expectations in the May Economic Outlook. Owing to lower export and consumption growth, economic growth will cool slightly in 2018 to 2.0%. Risks remain skewed to the downside in the medium term, as political risk has not abated and the probability of a hard Brexit seems to have risen. On the upside, the ambitious French president Emmanuel Macron is pushing for more eurozone integration which, if properly executed, could strengthen economic and political credibility within the union in due course.

The Economic Sentiment Indicator (ESI) rose to a level of 114 in October, the highest since the early 2000s. The eurozone composite PMI rose to 56.7 in September, up from an already high level of 55.7 in August. This is signalling robust output growth going forward, flagging the eurozone as a region that is clearly in a cyclical upswing.

Eurozone GDP was up 0.6% in Q3 2017 compared to the previous quarter, according to the flash estimate. Q2 2017 GDP for the eurozone was revised upwards from 0.6% to 0.7% on a quarterly basis. The eurozone breakdown of Q2 2017 GDP shows that the Netherlands (1.5% q-o-q), Ireland (1.4%), Spain (0.9%) and Germany (0.6%) were among the fastest growing countries. Trailing behind were Italy (0.4%) and Portugal (0.3%).

2.1 Eurozone growth maintains momentum
Eurozone GDP and components, seasonally adjusted, q-o-q %



Sources: Macrobond, Eurostat

The factors that supported growth in 2016 are likely to continue this year. Compared to May's Economic Outlook, all eurozone countries see economic conditions improving as domestic demand is accelerating, sentiment is upbeat and the world economy is going through a cyclical recovery. On the other hand, the appreciation of the euro is slowly turning into a headwind for growth. In 2017, Ireland (4.1%), Spain (3.1%) and the Netherlands (3.1%) are expected to be the fastest growing of the main eurozone economies. Growth in these member states is strongly underpinned by domestic demand, housing market recoveries and improving financial conditions. Domestic conditions are also improving in Italy and Greece, although their GDP growth rates (1.6% and 1.1% respectively) are lagging those of other eurozone countries.

Table 2.2 Real GDP growth (%) - eurozone

	2016	2017 f	2018 f
Austria	1.5	2.9	2.2
Belgium	1.5	1.7	1.5
France	1.1	1.8	1.8
Germany	1.9	2.2	2.1
Greece	0.0	1.1	2.4
Ireland	5.1	4.1	2.5
Italy	1.1	1.6	1.4
Netherlands	2.1	3.1	2.1
Portugal	1.5	2.7	2.2
Spain	3.3	3.1	2.6
Euro Area	1.8	2.3	2.0

Sources: Macrobond, Oxford Economics

External environment is improving

World output growth is expected to increase in 2017 compared to last year and will support this growth rate into 2018 as explained in the previous chapter. Eurozone export growth is benefitting from the cyclical recovery in global trade, although restrained by the real effective exchange rate. This weighted exchange rate has appreciated 5.1% since April and is not expected to give back much of its recent gains – the euro is projected to remain around the USD 1.20 level.

Despite the euro appreciation, export growth is expected to expand by 4.5% this year compared to 3.2% last year. However, with global trade slowing in H2 2017 and 2018 and with lagged effects of the euro appreciation kicking in, export growth is forecast to ease to 3.5% in 2018.

Risks to the forecast are more balanced in the near term, but remain skewed to the downside in the medium term. Particularly, political uncertainty remains a downside risk for the eurozone. The risk of a wave of populist election victories has receded after the Dutch and French elections. The Italian elections scheduled for early 2018 remain a political risk given that the Eurosceptic Five Star Movement (M5S) is polling around a 30% share of the vote and could, at least in theory, form a majority coalition with other Eurosceptic parties. Meanwhile, political uncertainty has increased in Spain surrounding the referendum on Catalonian independence, but our baseline scenario is stable with limited impact to GDP growth.

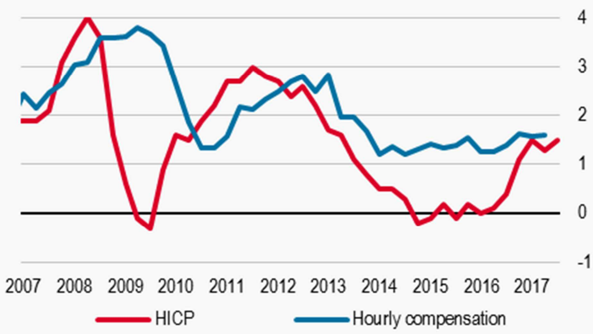
In the medium term, a hard Brexit could throw sand in the wheels of eurozone recovery, although its impact should not be exaggerated, as discussed in our November 2016 Economic Outlook. Negotiations between the EU and UK have so far been disappointing and appear to have reached a stalemate[30], with disagreements remaining over critical issues such as the divorce bill and the rights of EU citizens living in the UK.

Domestic demand accelerating

Domestic demand remains the pillar of growth in 2017. Q2 growth figures show a strengthening of household spending and investments. Private consumption growth is underpinned by rising employment, moderate inflation and strong sentiment indicators. Employment growth accelerated in the first half of 2017 compared to H2 2016. The inflation rate will be higher in 2017 than last year, owing to higher energy prices. This higher inflation rate dampens growth of real personal disposable income. Consumption growth is therefore expected to moderate somewhat over the remainder of 2017. This slowdown continues into 2018, when more moderate employment gains make conditions for consumption growth less favourable.

While inflation fluctuated between 1.3% and 1.9% over the past four months, core inflation has remained relatively stable at around 1.2%. Increasing inflationary pressures caused by higher energy prices, slightly improved wage growth in Q2 and record-levels of sentiment indicators, however, will not be sufficient to push the inflation rate anywhere near the 2% target. We forecast an inflation rate of 1.4% this year and 1.2% in 2018.

2.2 Eurozone inflation and wage growth
HICP inflation and compensation per employee, y-o-y %



Sources: Macrobond, Eurostat, ECB

Wage growth is still subdued and is unlikely to generate strong inflationary pressure in the short-term. There are several reasons for this. Despite the significant decline in eurozone unemployment, there remains a significant amount of labour market slack. The still-high unemployment rate, underutilised labour force and the potential additional labour force reduces pressures for wage bargaining.[31] The link between unemployment and inflation also seems to be much weaker than in the past[32]. There are several possible explanations for this, such as weak productivity growth, increased incentives for the unemployed to find work and the removal of automatic wage indexation mechanisms in some countries.

As mentioned in chapter 1, the ECB announced in its October meeting that it will reduce the monthly pace of asset purchases from the current EUR 60 billion, to EUR 30 billion from January 2018 onwards. Asset purchases will continue until the end of September 2018, or longer, if necessary for inflation to adjust to the 2% target. The decision to keep the asset-purchasing programme (APP) in place, but to reduce its pace, represents a gentler move than was expected. The ECB still seems worried about subdued inflation levels and the negative impact of the recent euro appreciation on inflation. However, the ECB is also under pressure to taper due to a scarcity of public-sector debt eligible for purchase under the APP. In particular, there is a lack of eligible German sovereign debt.[33] Rate hikes are thus not expected before 2019.

Investment growth picked up significantly in 2016, growing 4.3% year-on-year. Q2 2017figures showed improving momentum for investment growth, which should continue throughout this year given rising corporate profitability, strong business sentiment and favourable financing conditions. The rate of capacity utilisation is showing steady improvement, reaching 83.2% in 2017 Q3. Bank lending to non-financial corporations and households also improved over the first half of 2017. Total fixed investment growth is expected to reach 2.6% this year and to accelerate further to 3.1% in 2018. However, a number of structural issues (low productivity growth, deleveraging) will stand in the way of a stronger pick-up in investment growth.

Structural weaknesses are also found in the banking sector. Eurozone banks continue to suffer from excess capacity, high NPLs and poorly adapted business models. Despite its return to growth, Italy is still worrisome because of its high rate of non-performing loans, which stem from a prolonged domestic property slump. Weak bank balance sheets imply the monetary transmission channel is working sub-optimally, as banks' weak capital positions inhibit further lending even in a low-interest rate environment. This is also why bank lending, while picking up, is still growing at a much slower rate than before the financial crisis.

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[30] Brexit Talks Hit Deadlock as Both Sides Prepare for Cliff Edge, https://www.bloomberg.com/news/articles/2017-10-12/barnier-chides-talks-deadlock-as-cliff-edge-brexit-inches-closer (12 October 2017)

[31] ECB and Eurostat define a measure of "broad unemployment" that takes into account the underemployed (part-time employees willing to work more hours) and the potential additional labour force (persons seeking work but not available and persons available to work but not seeking).

[32] This relationship is known as the Phillips Curve, named after New Zealand economist William Phillips, describes the short-term relationship between unemployment and inflation. The relationship is inverse: pushing up inflation using e.g. monetary policy would result in lower unemployment.

[33] "The ECB's 2018 Scarcity Constraint", Global Macro Views, Institute of International Finance, June 15, 2017

Box 1: A more integrated eurozone

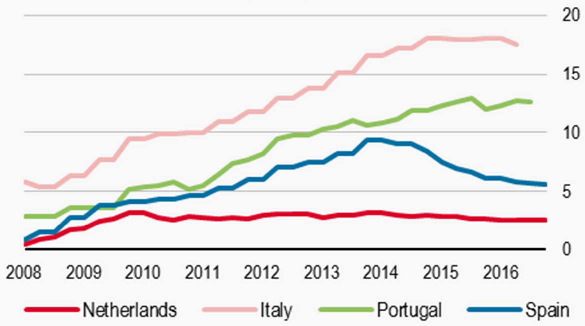
Against the background of a cyclical eurozone recovery, and using the momentum of the first months of his presidency, Emmanuel Macron is seeking to reignite the debate on further eurozone integration. In a recent speech at the Sorbonne in Paris he proposed for the EU to clamp down on tax avoidance by multinationals, and to penalise member states that set corporate tax rates too low. All this would be accompanied by an institutional overhaul, such as a much smaller European Commission and pan-European lists of candidates for 2019 parliamentary elections. His proposals echo some of the ideas expressed by Jean-Claude Juncker during his State of the Union speech, in which he also called for a deepening of the EU's budgetary powers, institutions and remit in areas such as tax and foreign policy.

Macron also wants a Europe "of different speeds", with deeper integration of countries that are in the eurozone bloc. In the long-term, he seems to be looking for a deal with Germany in which France restores its lost credibility in German eyes by curbing the budget deficit and reforming the economy and, in return, Germany supporting closer integration of the eurozone, with more fiscal convergence and joint investment, some form of common budget, a finance minister and a parliament.

Further eurozone integration could also involve completing the banking union, which still lacks a European fiscal backstop to rescue troubled banks and a common deposit insurance scheme. Europe also needs to transform its fiscal rescue fund, the European Stability Mechanism (ESM) in a proper European Monetary Fund with an expanded ability to borrow and increase capital subscriptions. The EMF could then take the place of the ECB and the European Commission in negotiating the terms of financing programmes with governments.

Whether such visions of a tightly integrated and confident eurozone will ever become reality is very uncertain. Right-wing Eurosceptic parties have generally strengthened their position in national parliaments in the countries which held elections this year, limiting the domestic room to manoeuvre by the establishment. In Germany, the Alternative für Deutschland (AfD) gained 13% of the vote share, giving it a place in national parliament for the first time. Furthermore, the position of Angela Merkel's CDU/CSU bloc has weakened and she is destined to govern with the Greens and the Free Democrats (FDP), the latter being mildly Eurosceptic and opposed to fiscal transfers and a big common eurozone budget. In Austria and the Netherlands, right-wing parties FPÖ and PVV managed to increase their shares of the vote compared to previous elections, which will make it more difficult for centrist parties to pursue more eurozone integration.

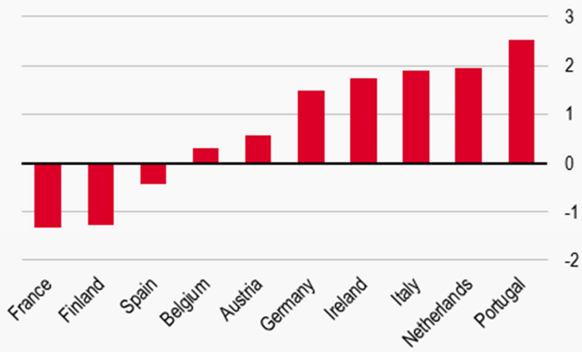
2.3 Non-performing loans
Bank NPLs to total loans, %, quarterly



Sources: Macrobond, IMF FSI

In the presence of structural weaknesses and constrained monetary policy, fiscal support can be a good instrument to promote growth. The primary government balance is one way to measure a country's fiscal stance. It measures the budget balance before interest payments. After predominantly negative primary balances in the years following the financial crisis, fiscal stances have generally improved. In 2017-2018, governments of most large eurozone countries run primary budget surpluses. In the case of Belgium, Austria, Ireland, Italy and Portugal, interest payments are higher than the primary surplus. However, the Netherlands and Germany run surpluses both before and after interest payments and therefore can do more to support eurozone growth, for instance by stepping up productive investments in infrastructure, education and R&D. Countries with considerable economic slack, such as Spain and Italy, could benefit from the positive spill-overs effects that these investments have.

2.4 Fiscal stance in eurozone countries
Primary government balance (% of GDP), average 2017-2018

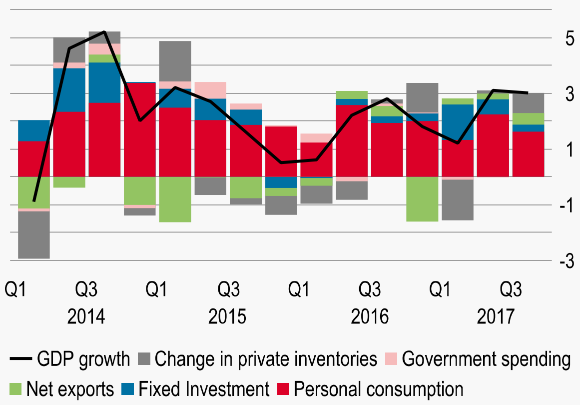


Sources: Macrobond, OECD

US economy is on track

The US economy is experiencing its eighth year of recovery and momentum is continuing to pick up. Inflation on the other hand remains subdued, which has been holding back the Federal Reserve from increasing interest rates more quickly to be better prepared for the downturn of this business cycle. In the first half of 2017, GDP grew 2.1% and it is forecast to close the year at 2.2%. After a lacklustre 1.5% expansion in 2016, the US is benefitting from increasingly broad-based growth, most notably a recovery in exports and investments.

2.5 Investment boosting US growth in 2017
Quarterly contributions to GDP growth (% change y-o-y)



Sources: Macrobond, US BEA

Investment picked up significantly in Q1 and has continued to contribute to growth through 2017 so far. A third of this though is a rebound in investment in the oil and gas industry. In response to higher oil prices, US energy firms have been opening and re-opening rigs. About one-third of refining is done in the hurricane-impacted regions of Texas and Louisiana, suggesting that clean-up and recovery should boost this component in the coming quarters. There is also some recovery in investment in the non-oil sector, however the moderation in investment growth in Q2 and Q3 suggest that the heightened business confidence is not enough to motivate any sort of 'boom' in business investment at this point.

Net exports have also surprised to the upside in 2017. The boost is coming primarily from stronger demand for US exports and lower import growth, as opposed to the weaker US dollar. By historical standards, the dollar remains strong, but has weakened through 2017 due to political uncertainty and the stronger euro, on the back of stronger GDP growth there. We expect the dollar to put downward pressure on net exports in 2018 as the Fed tightens monetary policy.

Consumer spending, which comprises more than two-thirds of the US economy, continues to be the primary driver of growth. Despite slowing real income growth, the tightening labour market is continuing to support spending and boost confidence. The outlook for private consumption remains robust, supported by moderate real wage growth, falling unemployment, and access to cheap credit.

Policy uncertainty remains a downside, and upside, risk

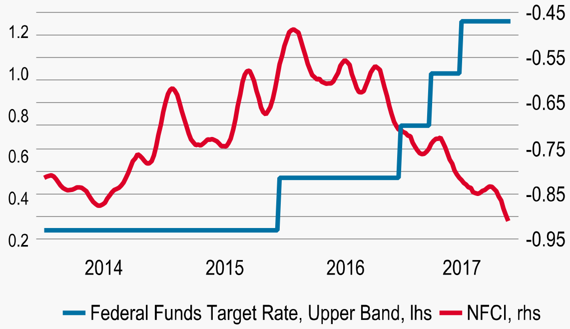
2.2% growth in 2017 is well below the ambitious 3% target which was to be largely boosted by fiscal stimulus. Thus far, the Trump administration has been unable to pass legislation for healthcare or tax reform. However, in September, President Trump unveiled the largest tax overhaul in three decades that would lower corporate tax rates and simplify the tax code. The current proposal would cost an estimated USD 1.5 trillion over the coming decade but does not provide details on how it will be financed. This makes it likely that a greatly scaled-back version of the proposal will make it through Congress. But the higher chances of some tax reform is an upside risk for our 2.6% GDP growth forecast next year.

Trade policy, on the other hand, remains a serious downside risk to the US outlook, ant the global outlook, as discussed in Chapter 1. Thus far, policymaking has not been too radical – stepping out of the planned TPP and scrapping TTIP negotiations were largely expected and do not change current trade regimes. In our last Outlook, we concluded that dependence of some large segments of the economy on North American supply chains would ensure a pragmatic approach to NAFTA re-negotiations. But that has taken a turn for the worse with strict US "America first" demands providing significant obstacles to negotiations in October. As many (but not all) Republicans in Congress are opposed to withdrawal, this would lead to a further deterioration in the relationship between the president and his lawmakers. This would also come at a time when Congress and the President desperately need a domestic policy 'win', ahead of mid-term elections in November. Such a win could come in the form of tax cuts. Lawmakers have already indicated that they won't support such cuts in case Mr Trump pulls out of NAFTA. This would reduce chances of a NAFTA collapse. However, given Mr Trump's unpredictability, the outcome could also be otherwise.

Monetary normalisation smooth thus far

The Federal Reserve continues to move very cautiously in its monetary normalisation process. The tightening process thus far has been gradual and well-communicated, not posing a significant drag on GDP growth. This can be seen in the Chicago Fed's national financial conditions index which has an average of zero and standard deviation of one – with positive values pointing to tighter-than-average conditions and negative values looser. National financial conditions have been loosening in general since the Fed began tapering in December 2015. This trend will help offer the Fed confidence in moving forward with its normalisation path in the face of still-subdued inflation figures.

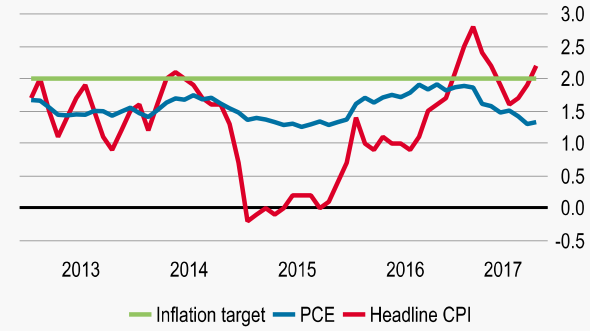
2.6 US financial conditions continue to ease
National financial conditions index (NFCI) vs. Fed policy rate



Source: Macrobond

The Fed has a dual mandate: unemployment and inflation-targeting. While labour market data is strong, inflation continues to disappoint. Headline inflation, as measured by annual growth in the consumer price index including food and energy prices, has breached the Fed's 2% target again in September. The jump to 2.2% inflation though is driven by a 6.1% month-on-month jump in energy prices related to hurricanes Harvey and Irma.

2.7 Headline index is only part of inflation picture
Headline inflation vs. Fed's preferred inflation measure



Source: Macrobond

Personal consumption expenditures, the index that the Fed prefers to assess, on the other hand, remains subdued, even weakening. Thus underlying price pressures remain weak. This can be explained in part by one-off factors in prescription drug and cell-phone plan prices. Other depressive effects like a strong dollar and low oil prices are also fading out. Thus, as the Fed would argue, the transitory nature of the current low inflation should continue to fade away, pushing inflation toward its target in the coming months in large part due to rising price pressures from the tightening labour market.

However, as noted in Chapter 1, the tightening labour market is not translating to higher prices as economic theory would suggest. Prospects are improving here though. Unemployment is low at 4.1% but in October, wage growth slipped to 2.4%, down from 2.8% in September. However the U-6 unemployment rate, which includes discouraged workers who are no longer seeking work and part-time workers looking for full-time work, improved to 7.9%, from 8.3% the month before. This is a strong indicator for increasing wage pressures. The weak upward pressure on wages though through this recovery shows that there are still some pockets of slack in the labour market. The labour force participation rate, for instance, remains relatively low at 62.7% - after breaching 63% for the first time since March 2014 in September. Discouraged workers who have the desire to work but are no longer seeking employment are also a sign of remaining slack. This should continue to dampen inflation keeping the PCE inflation rate around 1.6% to 1.7% in 2017 and 2018.

Another strong year in 2018 should be taken advantage of

The upside of the moderate but subdued inflation outlook is that the risk of overheating has subsided since our last outlook. Combined with dimmer prospects for fiscal stimulus, the chance that the Fed will have to hike rates more rapidly in order to keep inflation from exceeding its target has decreased. We are not yet at full employment so there is still room to improve through 2017 and 2018. With strong GDP growth of 2.4% next year, the labour market should continue to bring in marginal, disaffected workers. Thus we believe the downturn of this current business cycle that has had a nearly eight-year expansion phase, is being further postponed. While pinpointing the exact time the next recession will come to the US, we are confident that it will not occur in this Outlook's forecast period.

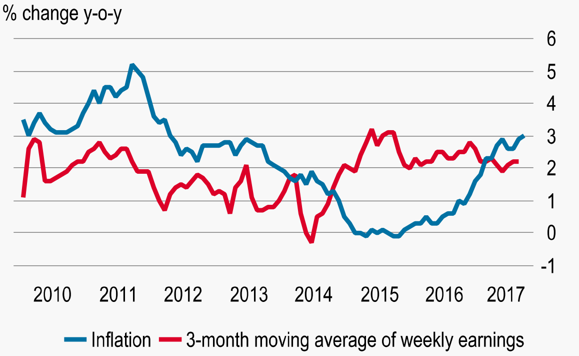
Financial conditions for US households and corporates remain loose though and confidence is very high. The outlook for 2018 is robust and it is evident that the Fed will not be held back by below-target inflation. Thus far, the Fed has hiked rates four times through this tightening cycle with lower-than-desired inflation and has begun shrinking its balance sheet in October. In December, the Fed is on track to hike rates a third time this year from 1.25% to 1.50%. We expect the Fed to continue to gradually increase interest rates – at least twice in 2018. It is critical that the Fed takes this time to increase interest rates so that the tools used to stabilise the American economy after the financial crisis are on hand and ready to be implemented in the next downturn.

UK: carrying on but weakly

The UK economy has performed better than expected in 2017, underlying the inherent strength of the domestic economy. GDP growth has been modest at 1.5% y-o-y in Q2 and Q3. Nearly all growth is coming from consumption as opposed to exports or business investment. The global economic upswing, especially in the eurozone, should be having a stimulatory effect on exports, further supported by significant pound sterling depreciation. However, the UK economy is very consumer-driven and lower business and household confidence in the face of uncertainty outweighs external benefits.

Despite political uncertainty, the UK labour market has continued strengthening, with unemployment at 4.3% as of June 2017, the lowest it has been since 1975. This has supported private consumption through this year despite rising inflation. Since February, prices have been increasing at a faster rate than wages. Monthly inflation has averaged 2.5% thus far in 2017 compared to 2.1% average monthly wage growth. While consumers were initially resilient, households have begun to cut back spending. It is thus unlikely that private consumption can continue to drive growth in the absence of an increased drawdown of savings and higher borrowing. Furthermore, the rapid expansion of consumer credit experienced in 2017 is unlikely to continue, especially considering the Bank of England's latest Bank Lending Survey which points to banks' expectations of tightening credit access to households in the coming quarter.

2.8 Real incomes contracting in the UK
% change y-o-y



Sources: Macrobond, UK ONS

As the eurozone begins tapering its QE programme and the US continues its normalisation path, the Bank of England (BoE) is also looking to tighten monetary policy. The monetary policy committee of the BoE increased interest rates for the first time in over a decade in its November meeting. However, unlike the US and eurozone, monetary tightening in the UK is not coming from a position of economic strength.

Pressure on the BoE to hike rates has been increasing due to fears of persistent high inflation. The current headline inflation is driven by the weak pound which will fade over the forecast period, but there are domestic pressures coming from lower potential growth which may cause persistent high inflation. Effects of Brexit on immigration, trade and investment, alongside very low productivity growth since the crisis, suggest that UK potential GDP growth is lower than in the past, according to BoE governor, Mark Carney. This means that it takes a lower growth rate to drive excessive inflation.

Productivity growth in the UK has been dismal at less than one percent over the past decade. This problem is exacerbated by Brexit-related uncertainty which is already driving lower net migration, alongside investment (including FDI), posing a downside risk to potential output. Risks of lower labour supply amid very low unemployment, despite weak signs of a pick-up in wage growth, support the November rate hike. However, making this move into the unknown without choking economic activity and employment will certainly be a balancing act.

This small increase in borrowing costs should not be de-stabilising but is likely to be a one and done. Growth in 2018 should be supported by external demand, but higher rates run the risk of further straining investment which is already under pressure due to uncertainty. Domestic drivers of inflation are expected to remain limited, averaging 1.8% over the forecast period.

Advanced Asia reaping benefits of trade pickup

The pace of expansion in Japan is increasing more than expected, thanks to strengthening external demand and supportive fiscal policy. It appears that some benefits of Abenomics are feeding into the economy as evidenced by tighter labour market conditions and increasing bank lending to non-financial firms, pushing up domestic demand.

Stronger domestic activity has put upward pressure on inflation, pushing it to 0.7% in August, its highest level in more than two years. This trend should continue in part due to higher oil prices and the weaker yen, but with low wage growth, inflation is expected to average only 0.4% this year and 0.6% next. With inflation much lower than its 2% target, the Bank of Japan (BoJ) is set to keep its monetary policy ultra-loose with negative rates.

GDP growth is expected to stay stable at 1.7% driven by domestic demand. Growth will also be restrained still by labour market shortages and a slowdown in import demand from China.

Table 2.3 Real GDP growth (%) - Advanced Asia

	2016	2017 f	2018 f
Japan	1.0	1.7	1.7
Hong Kong	2.0	3.6	2.5
Singapore	2.0	3.0	2.8
South Korea	2.8	3.3	3.0
Taiwan	1.5	2.7	2.7

Sources: Macrobond, Oxford Economics

The economic outlooks of other advanced countries in the Asia-Pacific region are also moderately strong. This year, the recovery in global trade and higher-than-expected import demand in China is driving a pickup in GDP growth in Korea, Hong Kong, Taiwan, and Singapore. This trend however will ease slightly in 2018 also due to lower Chinese import demand. But also local developments will have their impact on the growth prospects for next year. High private debt in South Korea will continue to limit consumption growth. In Hong Kong an expected decline of home prices due to rate hikes may dampen both private consumption and business investments. For Singapore, this year's strong momentum is likely to moderate as Chinese import demand cools and domestic demand is expected to be held back by weak residential construction activity. Taiwan could be the exception within this group, showing moderately higher growth next year. A turnaround in investments in the high-tech sector and relatively solid labour market, underpinning consumer confidence and spending, could give enough stimulus to compensate for weaker external demand.

3. Emerging economies – prospects and risks

Gaining strength but diverging

Table 3.1 Real GDP growth (%) - emerging markets

	2016	2017 f	2018 f
Sub-Saharan Africa	0.8	2.3	3.2
Emerging Asia	6.0	6.0	5.9
Eastern Europe	1.3	3.1	2.7
Latin America	-1.5	1.1	2.5
MENA	4.2	2.2	3.3
Emerging Markets	3.6	4.4	4.7

Sources: Macrobond, Oxford Economics

The economic recovery in emerging and developing economies is gaining strength, on the back of stronger global trade, a modest recovery in commodity prices, still benign external financing conditions and supportive domestic policies in some of the major markets.

This general picture however reflects diverging developments between regions. Growth is strengthening in Latin America, Eastern Europe and Sub-Saharan Africa as the major countries in these regions are exiting their recessions. Meanwhile, economic growth in global powerhouse Emerging Asia is stabilising, whereas the MENA region is experiencing a temporary slowdown. Going forward, this divergence is set to continue. But whereas the recoveries in Latin America and Sub Saharan Africa are expected to pick up pace and MENA growth will likely rebound in 2018, momentum will slow in Eastern Europe and Asia, where China switches into deleveraging mode.

The main challenges for the emerging economies are a faster pace of US monetary policy normalisation and a sharper slowdown of the Chinese economy than assumed in our baseline scenario. Many countries now are better able to deal with shocks than some years ago, given lower external vulnerabilities. Still, for countries with high external financing needs, low buffers and fixed exchange rates this is no time for complacency.

Emerging Asia: Fed policy less important than before

In a world that shows benign economic developments, Emerging Asia still is the best performing region. Economic growth rates are the highest and, if our baseline scenario is not false, that will remain so in the near future. But also here the downside risks cannot be neglected. Monetary tightening by the Fed - followed by the ECB in a later stage - is the most probable, but not the most severe threat to the in most cases not so vulnerable countries in the region. The major risk for the region, but not the most probable one, comes from inside: the fine line the Chinese must walk in deleveraging their economy.

Table 3.2 Real GDP growth (%) - Emerging Asia

	2016	2017 f	2018 f
Cambodia	7.0	7.1	7.1
China	6.7	6.8	6.4
India	7.9	6.5	7.5
Indonesia	5.0	5.1	5.3
Laos	7.0	6.7	6.6
Malaysia	4.2	5.6	4.8
Philippines	6.9	6.5	6.1
Thailand	3.2	3.9	3.2
Vietnam	6.2	6.8	6.4
Emerging Asia	6.0	6.0	5.9

Sources: Macrobond, Oxford Economics

Fed tightening more a headwind than a risk

Asia and the United States traditionally are strongly connected. Trade flows across the Pacific and capital flows through financial channels are huge. It is therefore that interest rate developments in the US, and thus monetary policy conducted by the Fed, are important for the economic prospects of emerging economies in Asia. There is no doubt that normalisation of the Fed's policy, raising interest rates and shortening its balance sheet, will have an impact on Asia. First, it has a dampening effect on economic growth because central banks in specific Asian countries will feel the need to raise their own official interest rates, making domestic borrowing more expensive. Especially countries with a currency peg or a stabilised currency regime, like Hong Kong and Laos, or a less heavily managed exchange rate, like Vietnam, Pakistan and Myanmar, will feel pain to a greater or lesser extent.

For the region as a whole, this impact will be minor because an increasing number of countries have a flexible exchange rate and may not follow the Fed in hiking their rates. These countries, however, will be confronted with a weaker currency and so higher debt service costs and less appetite from international investors to buy emerging market bonds and equities. The search for yield described in chapter 1 will not suddenly stop, whereas the Fed will raise interest rates only gradually. Next to that, we expect the Fed will communicate every step in the normalisation process loud and clear and - most importantly for financial markets - early. A spike in US and international bond yields therefore is unlikely. Still, the appeal of emerging markets to investors will decrease and countries with large external deficits and reliant on the inflow of foreign capital may feel the impact of the Fed. Sri Lanka is a good example of a country for which resumption of capital outflows in response to a significant further strengthening of the US dollar and higher interest rates is an important downside risk. Greater exchange rate flexibility in this case is the first line of defence. It will support the build-up of reserves and external competitiveness, and so be a shock absorber. Last year, the monetary authorities of Sri Lanka said they have chosen for a more flexible currency regime, but the proof of the pudding will be in the eating.

Growing risk of 'yield decompression'

Apart from Sri Lanka, more Asian countries need capital inflows from abroad to finance their external deficits. The vulnerability of many of them fortunately has decreased in the last decade. Lower current account deficits, higher reserves and better access to capital markets means that, in general, emerging economies in Asia can weather the impact of monetary tightening in the US and Europe. Still, the decline of emerging market bond yields and - more so - interest rate spreads are a risk factor. The IMF warns in its recent Global Financial Stability Report that near-term risks to financial stability continue to decline, but the medium-term vulnerabilities are rising. Yields on global fixed income instruments have fallen so much, that only riskier corporate and emerging market bonds offer yields of more than 4 percent. This clearly encouraged capital flows to and borrowing by emerging countries in Asia and elsewhere.

The very low market and credit risk premiums and high asset valuations make the world economy vulnerable to a 'decompression' of risk premiums, a problem which, according to us, is very relevant for emerging markets. Non-financial corporate debt denominated in US dollars in countries like India and Indonesia is high, posing a risk to the banking sector in both countries. Steps were set to strengthen the financial sector and most banks can bear higher non-performing loan ratios, so for most countries we cannot speak about a systemic risk. The businesses concerned, however, will be hit if in an adverse scenario financial markets sentiment switches from risk-on to risk-off, like it did in the Taper Tantrum period in 2013.

For China, the corporate debt problem has another face. Here, external developments like monetary tightening by the Fed and a possible change in risk appetite on financial markets are not crucial, because it mainly concerns domestically financed debt. There are, however, reasons to be worried about the rising debt burden of China.

China switches into the deleveraging mode

One of the reasons for the strong performance of the world economy is better than expected growth in China. In fact, the downtrend that started in 2010, was interrupted in the first half of 2017, when real GDP rose 6.9% year-on-year, after an average growth rate of 6.8% last year. The third quarter showed continued strength (real GDP up 6.8%), based primarily on domestic demand which was, like in the first half of the year, supported by policy easing and supply-side reforms. But external demand was also helping, due to the stronger world economy and the real effective exchange rate depreciation of the Chinese currency over the last two years. For the coming two year period a resumption of the growth decline in previous years is on the cards. Recent indicators already point downwards again, like weakening investment growth and lower purchasing managers' indices.

The expected growth slowdown fits in the economy's envisaged transition process, in which the authorities aim to shift growth from exports and investments to private consumption. More important, however, are increased efforts by the authorities to tighten credit policies to tackle the debt overhang created in recent years. As the IMF mentions in its recent Global Financial Stability Report, China's steady growth rate and financial policy tightening in recent quarters may have eased concerns about near-term problems, but the size, complexity and pace of growth in the financial system point to elevated financial stability risks. Banking sector assets now are at 310% of GDP, compared to 240% at the end of 2012. These are worrying figures. Earlier IMF studies have shown that in the past financial crises occurred when credit growth accelerated by more than 30 percentage points and outstanding credit is at a level of 100% or more of GDP.

As we explained in our May Outlook, especially the complexity of the debt problem is worrying. It concerns not so much central government debt, which is at a sustainable level of about 19% of GDP. Rather it is the quasi-fiscal spending channelled through Local Government Funding Vehicles (LGFVs). This has played a key role in infrastructure investment and growth promotion. But it does not appear on the balance sheet of local authorities. Moreover this growing use of short-term wholesale funding and shadow credit is often used to finance inefficient state-owned enterprises.

The Chinese authorities now have to walk a narrow cord in deleveraging the economy by tightening financial sector policies and avoiding a hard landing of the economy. The latter would aggravate problems on the borrowing side and increase bad loans.

No Minsky moment for China

The expected growth path for the next two years may be comforting. The Oxford Economic model we use predicts GDP growth of 6.4% in 2018, and a further slowdown to 6.0% in 2019. This implies the authorities proceed with the targeted tightening measures to deleverage the most risky parts of the financial system, without general tightening that would hurt the real economy more aggressively. The People's Bank of China (PBOC) is eager to reduce the risks from excessive debt and speculative investments. PBOC governor Zhou Xiaochuan recently warned that China could potentially face a 'Minsky Moment' because of high corporate debt and household lending. Zhou was referring to economist Minsky's theory that long periods of market stability actually spur instability by encouraging investors to take too much risk and authorities to be too complacent. Though Zhou's remarks show that the authorities may not be completely on the same page, we think that after the Party Congress the deleveraging process will speed up. That will reduce systemic risk and strengthen the financial sector. In our baseline scenario, a heightened sense of urgency on the side of the authorities will prevent Zhou's fear of a Minsky Moment from coming true.

India's reforms: short-term pain, long-term gain

Besides China, India has contributed to Asia's strong growth this year. Real GDP is expected to rise at an annual rate of 6.5%, with the highest growth rates for government expenditures (19%) and private consumption (7%) and moderate to slow growth of exports (5%) and business investments (1%). The growth performance this year is disappointing in the sense that it was both lower than expected and lower than in the previous three years. The reasons for the temporary growth slowdown, however, are economic reforms, which in fact will push the growth rate to a higher level in the coming years. For next year we expect GDP to rise to 7.5%, the highest growth number within the major economies in the world.

The first reform which had an initial negative impact on growth is the authorities' currency exchange initiative introduced late last year. Cash shortages and payment disruptions put a brake on consumption and business activity, but in the course of the year this faded. The long-term benefit on the other hand is that the formal economy could grow at the expense of the informal one and that tax income will increase. The second reform, the introduction of the country-wide Goods and Services Tax in July, was also initially disruptive for the economy because of some uncertainties around the design and pace of implementation. In the longer term the uniform tax system supports the medium-term prospects for the economy as it will create a single national market and enhance the efficiency of domestic trade.

In the short-term India's economy also will be helped by tailwinds from a favourable monsoon and relatively low oil prices. Bottom-up indicators already show that especially private consumption has turned a corner, with an impressive recovery in car sales in the third quarter. Growth in private investments is expected to lag other spending categories next year, but public infrastructure spending can rise again based on stronger public finances.

Still, also here economic risks are tilted to the downside. Despite its relatively closed economy, India will not escape the negative effects if in an adverse scenario US monetary policy normalisation causes an increase in financial markets volatility or if the growth slowdown in China is bigger than expected. On the domestic side, a potential further deterioration of corporate and public bank balance sheets is expected. Furthermore, setbacks in the reform process could weigh on private consumption and investments. Heightened levels of non-performing assets at public sector banks are weighing on banks' balance sheets. Recently announced steps to recapitalise India's state-controlled banks will be supportive for credit growth and stimulate investments. For the time being however, high corporate debt remains a risk for the Indian economy.

South East Asia benefits from the strong world economy

More exposed to external developments than China and India, and so benefitting from the strong world economy, are the ASEAN economies. We expect this group of countries, dominated by Indonesia, Malaysia, Philippines, Thailand and Vietnam, to show an aggregate GDP growth of 5.0% this year, a bit higher than the 4.6% in 2016. For next year a 4.9% growth rate is forecast.

The highest growth rates are foreseen for the smaller and less developed economies Cambodia (7.1% in 2017 and 7.1% in 2018), based on robust household spending, and Laos (6.7% and 6.6%), which is investing heavily in its infrastructure.

Still going strong is the Indonesian economy, by far the biggest of the group, driven by strong private consumption and business investments. Export growth will be more moderate, due to China's slowing economy, but GDP growth will remain in the 5-5.5% range. Healthy private consumption is the main driver for 6.5% growth rate this year in the Philippines. Investment growth is slowing though, as investor confidence in president Duterte's administration wanes. This will lead to slower growth in 2018.

As mentioned earlier, Vietnam belongs to the group of countries most exposed to monetary tightening in the US, though the central bank has taken steps towards a more market-oriented approach. The growth slowdown in China is a negative for the open Vietnamese economy, but Vietnam is also benefitting from China's relocation of export-oriented industries. Vietnam's relatively low production costs and policies to liberalise regulations and deepen global economic integration, together with strong private consumption growth, may result in 6.8% and 6.4% GDP growth in 2017 and 2018 respectively.

Malaysia's growth prospects for 2018 are a bit less positive than this year. Demand is falling for the country's largest export category, electronic and electrical goods, the bulk of which goes to China and the US. Because accommodative monetary and fiscal policies will support private consumption, still robust growth of 4.8% is possible in 2018, after a 5.6% growth rate this year.

The Thai economy probably will show moderate growth deceleration, from 3.9% this year to 3.2% in 2018. Growth will be supported by public investments in infrastructure and an export sector which is benefitting from high growth in the neighbouring countries. The military-controlled government has declared economic revival to be its top priority and pursues policies to boost consumption and investments.

Latin America: recovery gaining pace

Although growth in the region lags behind that of most other regions, the recovery from a two year recession is picking up pace. The rebound is widespread and underpinned by the increase in commodity prices, easier monetary policies, and improving labour market conditions. The recoveries in Argentina and Brazil are gaining pace and the outlook has brightened following reduced political uncertainty, although overall the political environment remains challenging. Growth in the Andean economies – Chile, Colombia, and Peru – is rebounding from idiosyncratic events earlier this year and is expected to accelerate over the forecast period. And Mexico's economy performed better than expected so far this year. Inflation has moderated further in most countries and with inflation and inflation expectations in many countries at or below target rates, monetary policy can still play a supportive role in most of the region. Argentina and Mexico remain the main exceptions. But also in the latter country, inflation has peaked, allowing the central bank to stay on hold over the forecast period.

Mexico's resilience will however be tested over the forecast period with the mood around the NAFTA negotiations having soured lately and political uncertainty rising ahead of next year's elections. But the country remains in a good position to deal with this uncertainty. The region is also well placed to deal with the impact of normalising US monetary policy. Current account deficits have narrowed in almost all of the major economies and are generally expected to remain moderate over the forecast period. Moreover, policy frameworks are generally sound, foreign currency debt ratios moderate, exchange rates flexible and usable as a shock absorber and buffers of international reserves are generally healthy. The main exception remains Argentina, given its high refinancing needs and relatively low buffers. Finally, with the political, economic and humanitarian crisis in Venezuela deepening further, the country is now also in technical default.

Table 3.3 Real GDP growth (%) - Latin America

	2016	2017 f	2018 f
Argentina	-2.2	3.0	3.9
Brazil	-3.6	0.8	2.4
Chile	1.5	1.7	3.5
Colombia	2.0	1.7	2.8
Mexico	2.0	2.3	2.3
Peru	4.0	2.5	3.8
Venezuela	-9.3	-7.7	-2.2
Latin America	-1.5	1.1	2.5

Sources: Macrobond, Oxford Economics

Argentina: fragile recovery

Argentina's economic environment remains fragile, despite a boost from sweeping victories in October's mid-term elections by candidates allied with President Mauricio Macri. This has strengthened his position in Congress, and gives the government a stronger mandate to press ahead with much needed fiscal adjustments and structural reforms to raise productivity. Although the opposition no longer holds the two-third majority needed to block presidential vetoes, the election results still leaves Macri's 'Cambiemos' or 'Let's Change' coalition with a minority in Congress. This means that progress with these reforms will remain slow, leaving room for disappointment.

The economy returned to growth in the second half of last year, growth has become more broad based and is expected to pick up steam over the forecast period. The economy will be driven by investments and increasingly by consumer demand as sentiment was boosted by rising expectations of a Macri win following the outcome of pre-elections in August. The improvements in institutional quality under the Macri government and progress with structural reforms should set the stage for faster growth.

However, downside risks remain significant. One of the reasons for the boom in investment and consumption was a loosening of fiscal policy ahead of October's elections, which needs to be unwound over the coming period. This is not only necessary to keep government finances in check, but also to make the economic recovery more robust, help the disinflation process, stimulate FDI and strengthen official reserves.

Inflation is on a downward trend but remains high at 24% YoY in September. It is not expected to reach single digit levels until 2019 and as such will stay significantly above the target band of 12-17% for this year respectively 8-12% for next year. As a result, the central bank needed to lift rates twice since last April to 27.75% and will only gradually ease them in the forecast period. This easing will depend significantly on fiscal consolidation efforts, which will most likely be gradual given their politically sensitive nature and the government still having a minority in Congress. Either way, government policies will not be as supportive for economic growth going forward.

Meanwhile, strong domestic demand has resulted in rising current account deficits, which are mainly financed by portfolio inflows. So far, such financing has not been a problem, and the government was even able to place a century bond last June, but this might change when sentiment shifts. Argentina remains vulnerable to shifts in market sentiment, given its still tight official reserves, which are insufficient to cover the external financing needs. Reflecting this vulnerability, the peso is among the weakest currencies this year, depreciating more than 10%.

Brazil: shallow recovery, politically challenging

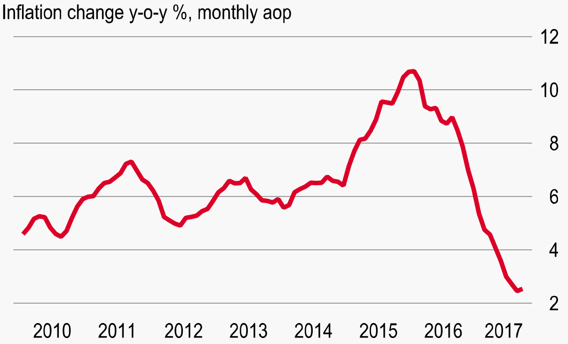
The economic environment is gradually improving, but remains crucially contingent on progress with fiscal reforms. President Michel Temer's chances of seeing out the end of his term (presidential elections in October 2018) have increased after he survived two votes in Congress, on whether to open a trial against him on charges of corruption and obstruction of justice. In spite of this, progress has been made with productivity-enhancing structural reforms. The cap on public spending approved last December has been complemented by labour market reforms. These votes have however delayed and diluted a crucial overhaul of the pension system. Meanwhile, institutional quality is improving and the country has started a programme to reduce the regulatory burden, simplify the tax system and enhance financial sector operations to improve the business environment and boost productivity.

These developments are underpinning sentiment and have helped the economy to emerge from its deep and lengthy 2015-2016 recession. Growth has firmed in Q2 2017, driven by exports and private consumption. The latter showed its strongest performance in three years and is profiting from stabilisation of the labour market, government policy allowing households to access dormant pension funds, rapid disinflation and lower interest rates.

Inflation has fallen to a multi-year low of 2.5% YoY in September, below the target range of 3-6% and enabling the central bank to cut rates from 14.25% in October last year to 7.5% last October, bringing borrowing costs to the lowest since 2013. The central bank is expected to remain accommodative and to cut rates further to an all-time low of 7% by December. These lower rates will continue to support the economy going forward and will also help to bolster investment, which so far has remained persistently weak. Business sentiment has further improved and reached its highest reading since 2013 last September. Positively, this improvement is expanding from manufacturing and mining to construction, the sector that has been particularly hit by 'operation car wash'.

3.1 Inflation in Brazil continues steep decline

Inflation change y-o-y %, monthly aop



Sources: Macrobond, EIU

The main risks to the mildly positive outlook are political. For sentiment to remain positive and for interest rates to stay low over the longer term, fiscal consolidation is essential. The sizable fiscal deficit, sticky at around 9% of GDP, remains the country's major macroeconomic weakness. Government debt has as a result jumped to 74% of GDP, from 70% in 2016. Congressional approval of the pension reforms is thus critical to put government finances back on a sustainable path. Our central scenario remains that the government will succeed in passing the reforms.

Fiscal consolidation will however negatively impact economic growth going forward and will mean that the recovery will be shallow. But failure to move ahead with fiscal consolidation could undermine sentiment and result in significant currency depreciation, which would prompt the central bank to raise interest rates and would weigh even more negatively on economic growth. Such a downward scenario would also raise the country's vulnerability to the normalisation of US monetary policy, which in our central scenario is mitigated by declining interest rates on domestic debt and by hedges of exchange rate risk. That said, Brazil's shock resistance remains strong overall and is underpinned by a flexible exchange rate, a solid external sector, large official reserves and a sound banking system.

Mexico: modest growth, strong resilience

Developments over the past months confirm that Mexico is most vulnerable to uncertainties about the future of NAFTA (see box), but that it remains in a good position to deal with such shocks. Its economy performed better than expected so far this year despite these uncertainties,

BOX 2: NAFTA talks hardening and will last longer

The mood around the NAFTA talks, that started last August, has soured. The fourth round of negotiations of a planned seven in total concluded on October 17 at an impasse, but with an agreement to keep talking. But all sides are further digging their heels and particularly the US's hard-line position in the latest round raises the risk of a breakdown in the negotiations. The US tabled several highly controversial proposals during the latest talks, including a demand to reform the current dispute-settlement provisions, a so-called sunset clause, and tighter rules-of-origin legislation for the auto sector. The current dispute settlement mechanism is seen as essential by both Canada and Mexico. The sunset clause would require all member states to restate their commitment to remain in NAFTA every five years in order for the trade agreement to remain in place. As this would raise uncertainty among investors, Canada and Mexico are deeply opposed. The stricter rules-of-origin for the car sector consist of boosting the share of component parts produced within NAFTA to 80% from 62.5% in three years' time for companies to sell finished vehicles tariff-free. Additionally, the US wants to introduce mandatory national content rules, requiring that at least 50% of component parts are sourced specifically from the US. These proposals are aimed at reducing the US bilateral trade deficit with Mexico and would severely disrupt existing supply chains, resulting in higher costs and lower profitability.

The fifth round of talks has been pushed back from early to late November, and all sides have agreed that negotiations will extend into the first quarter of 2018. This is more realistic, but longer than previously expected (ending of talks by year end), and may increase conflicts with the Mexican and US political calendars.

The general expectation still remains that the US will moderate its most radical proposals and that negotiations will conclude in 2018 with a revised NAFTA that contains some measures that benefit the US. But talks will remain contentious and there is still a chance that Mr Trump has no intention of signing a renegotiated deal but wants to pull out of NAFTA. Should NAFTA collapse, trade between the US, Canada and Mexico would revert to WTO rules. These rules set bands within which trade tariffs for different goods can be set. In the case of trade between Mexico and the US tariffs for Mexico's main export goods are relatively low – on cars it would be just 2.5%. The highest tariffs would apply to relatively less important exports, with the exception of vans and trucks. The economic repercussions on Mexico are generally expected to be manageable as the peso will continue to act as a shock absorber. Mexico is more concerned about the political repercussions of longer lasting negotiations and the hard-line position of the US. This– along with President Trump's plans to build a border wall - has fostered strong anti-US sentiment and has strengthened the position of leftist populist candidate for president, Andrés Manuel López Obrador of the Movimiento Regeneracion Nacional (Morena).

declining oil production and tight fiscal and monetary policies.

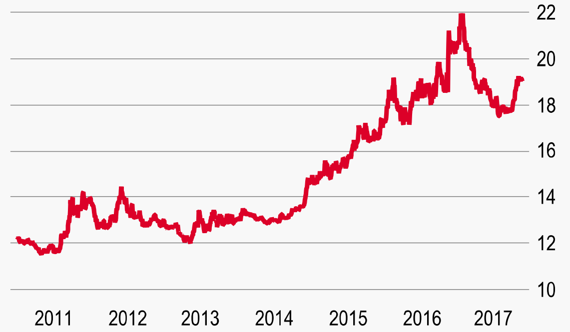
These policies were needed to adjust government finances to an environment of low oil prices and to allow the currency to act as a shock absorber. They are now paying off as they contribute to improving business and consumer confidence, with business confidence last September reaching its highest reading since end 2015, despite the devastating earthquakes that struck that month.

Moreover, both consumers and businesses seem immune to uncertainty related to the renegotiation of NAFTA thus far, although the latest developments are not yet visible. In the run-up to and following the October NAFTA talks, the peso has depreciated by some 7%, but is still 9% stronger YTD. Inflation has peaked and although at 6.4% YoY in September it remains relatively high, it is set to return within the target band of 2-4% in 2018. The central bank is expected to leave its policy rate on hold at 7% over the forecast period in the central scenario in which NAFTA negotiations will conclude in a revised agreement.

Going forward, growth in Mexico is expected to stabilize around this year's level as policies will remain relatively tight and as domestic confidence might start to be affected by uncertainty about NAFTA and the domestic political situation in the run-up to July's general elections.

Mexico remains in a good position to deal with policy normalization in the US. Authorities have pre-emptively covered external borrowing needs and are replacing existing bonds by new bonds on more favourable terms while private firms are substituting foreign currency debt with local currency debt to reduce exposure to currency fluctuations. External imbalances are moderate, official reserves are sizable and underpinned by an IMF Flexible Credit Line (FCL), and the country's medium to long-term prospects are still strong thanks to improving fundamentals and robust policymaking.

3.2 NAFTA uncertainty keeps peso volatile
MXN per USD, daily spot rate



Source: Macrobond

Other Pacific Alliance: set for faster growth

Economic growth in the other three Pacific Alliance countries **Chile**, **Colombia** and **Peru** is picking up after a meagre start of the year due to a spill-over of Brazil's Odebrecht corruption scandal to Colombia and Peru and a mining strike in Chile. Growth is profiting from a more supportive external environment and from the lagged effects of monetary policy stimulus. This has run its course and the regions central banks are expected to remain on hold over the forecast period. The exception is Colombia, where the central bank is expected to cut rates further over the forecast period.

In all three countries, falling unemployment and improving business and consumer confidence will continue to underpin economic growth going forward. In September, rising expectations that former president Sebastián Piñera from the centre-right Chile Vamos collation will win upcoming elections propelled sentiment in **Chile** to its highest level since early 2016. **Colombia** is also preparing for general elections in May 2018. Here sentiment is supported by the landmark peace accord with guerrilla group FARC which was recently supplemented by a ceasefire with the smaller Ejército de Liberación Nacional (ELN) guerrilla group. Independent of who wins elections in Chile and Colombia, orthodox macroeconomic policies will be continued. Of these countries, **Peru** is the only one were consumer confidence is falling, possibly on the back of rising political uncertainty. President Kuczynski, who is heading a minority government, is struggling to implement his ambitious infrastructure programme. But the government has room for other fiscal stimulus measures which will support the economy going forward.

All three countries are well placed to deal with the normalization of US monetary policy, due to sound policy frameworks, flexible exchange rates and healthy buffers, which for Colombia are underpinned by an IMF-FCL.

Central & Eastern Europe: catching up

Central & Eastern Europe (CEE) is forecast to enjoy solid 3.1% GDP growth in 2017. CEE is the region that has surprised analysts in 2017, with a full 0.5 percentage point upward revision in expected GDP growth in 2017. This has been motivated primarily by catch-up growth in Russia, which is emerging from recession and supported by energy prices; Turkey where looser fiscal policy is boosting activity; and Central Europe where investments are rebounding from a slow 2016. Economic growth is forecast to moderate slightly to 2.7% next year but the outlook is stable.

Table 3.4 Real GDP growth (%) - Eastern Europe

	2016	2017 f	2018 f
Bulgaria	3.9	3.6	2.2
Czech Republic	2.5	4.8	3.5
Hungary	1.9	3.7	3.3
Poland	2.6	4.3	3.4
Romania	4.8	6.0	3.8
Russia	-0.3	2.1	1.8
Turkey	3.3	5.0	3.5
Ukraine	2.3	1.7	3.0
CIS	0.3	2.3	2.2
Eastern Europe	1.3	3.1	2.7

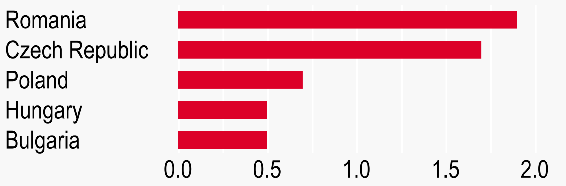
Sources: Macrobond, Oxford Economics

Central Europe: heightened political concerns not affecting growth

Nearly across the board, the major central European economies have seen significant upward revisions in their GDP growth forecasts. GDP growth across the region is broad-based, driven by external demand and domestic consumption (both private and government) and investment.

3.3 Central Europe surprising to the upside

6-month percentage point difference in GDP growth forecasts



Sources: Consensus Economics

Romania is leading the upward revisions and is now forecast to enjoy the highest growth rate, 6.0%, in the region. All assessed markets are now forecast to see at least 0.5 percentage point higher GDP growth than expected in May.

These economies are generally export-driven so the pickup in external demand has had a very positive effect on them. Nearly two-thirds of exports are directed to the EU, particularly Germany, and regional supply chains are deeply connected, also to Germany in particular.

Capital inflows are also higher, supported by strong growth outlooks and relative competitiveness in terms of wage costs and geographic location. EU structural funds are recovering after a marked fall in 2016 which is driving strong construction growth and fixed investment. Private consumption is growing strongly thanks to easy financing conditions and tightening labour markets.

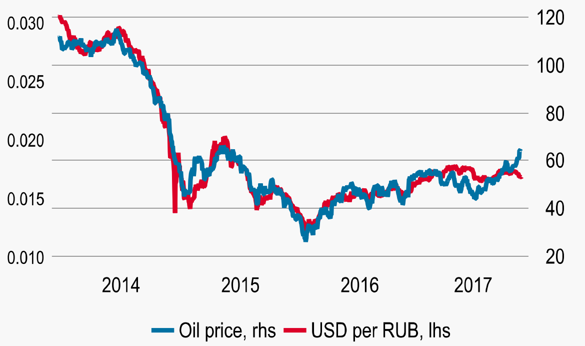
Politics in the region, while not swaying the attractiveness for investment and growth, are a downside risk though. Populist governments are in place in Hungary, Poland and now the Czech Republic. Thus far, this has not severely affected economic growth or investment inflows, but unorthodox policies largely targeting foreign-owned businesses and/or spates with the EU could change this. The risk of international investor sentiment souring toward these markets could also decrease as monetary tightening in the US makes those safe assets more attractive. Governments across the region, including Romania, are also rejecting fiscal austerity. Through tax cuts and targeted social spending, fiscal stimulus is also boosting private consumption and growth. However, these pro-cyclical fiscal policies may be kicking the can down the road of high and rising debt levels which could produce further risks beyond our forecast period.

Russia: picking up steam

The Russian economy has been picking up steam in H1 2017. Quarterly GDP figures were particularly strong in in Q3, with a 2.5% year-on-year rise in GDP. Q2 growth was almost entirely driven by private consumption and investment, including both fixed investment and growth in inventories. Based on the better-than-expected performance in Q2, GDP is forecast to expand by 1.8% in 2017. The balance of risks to the 2017-2018 outlook is tilted to the upside due to an increasing oil price. The Russian authorities have been showing fiscal discipline while the central bank has credibly adhered to the inflation target, while allowing for a flexible exchange rate.

Private consumption is expected to grow by 3% in 2017 and by 2.5% in 2018, up from a 4.5% contraction last year. The recovery in consumption is underpinned by a pick-up in household borrowing, appreciation of the rouble and easing inflation. The rouble has steadily appreciated against the USD since early 2016, driven by the recovery in oil prices as well as the US election result (Figure 3.4). While the USD/RUB exchange rate averaged 75 in January 2016, in September 2017 this had declined to 58 (reflecting a 23% rouble appreciation).

3.4 Ruble recovering alongside oil prices



Source: Macrobond

Consumer price inflation has been below the central bank target rate of 4% for three consecutive months, falling to a record low of 3% in September. This allowed the Russian central bank to cut its main policy rate by 50 basis points to 8.5% in September, after a three-month pause. However, in an accompanying note the central bank also made clear it would adopt a moderately tight monetary policy as it considers the medium-term risks that inflation rises above target greater than any sustained downward deviation from the target. This is signalling a more moderate easing cycle going forward.

Despite the pick-up in Q2, investment growth is likely to remain constrained due to international sanctions and broader political and business uncertainty. In 2017 investment is likely to grow 4.5%, before receding to 1.1% in 2018.

While private consumption and investment display cautious recovery, the fiscal position is likely to remain tight. The fiscal deficit is expected to narrow to 1.9% this year, from 3.7% in 2016. The government has adopted a budget rule based on a conservative oil price baseline of USD 40. It will continue to use above-budgeted oil revenues to intervene in the currency market to stem the rise of the rouble and to build foreign exchange reserves. This build-up of foreign reserves is allowing the government to pursue a more independent economic policy.

In the long-run, potential GDP growth remains constrained to 2-2.5% annually, unless Russia adopts structural reforms and reduces its reliance on commodity exports and attracts more investment. The Russian economy is struggling with US and EU sanctions. US have slapped additional sanctions on Russia in July, in reaction to the alleged Russian interference in the US presidential elections. The new US sanctions tighten restrictions on lending to certain state banks and energy companies, and prohibit investment in Russian advanced energy technology. The sanctions also target Russian individuals involved in human rights violations, weapons delivery to the Syrian regime or in cyber-attacks.

The Russian banking sector remains under strain from sanctions, low economic growth and the lower oil price compared to 2011-2014. The central bank is pursuing a consolidation strategy in the banking sector, which resulted in 110 credit institutions closing their doors in 2015 and another 101 closing in 2016. The government bailout of Otkritie in August 2017, the seventh-largest bank in the country, and the bail-out of the smaller B&N Bank in September. This shows the sustained weakness in the banking sector. The strong state interference in the banking sector and willingness of the government to bail-out troubled banks mitigates banking sector risk, however.

Turkey's economy flourishes on the surface, but rumbles beneath

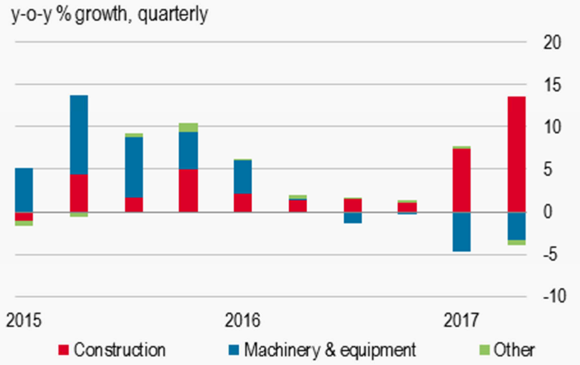
The V-shaped recovery from the economic dip following the failed coup attempt in July 2016 continued in the first half of 2017. Strong GDP growth of 5.1% y-o-y was registered in Q2. Consequently, growth projections for 2017 have been revised upwards to 5.0% growth from 4.0% previously. As an alternative to monetary loosening, Turkey resorted to tax and credit support measures and applied moral suasion to encourage banks to lend more to the private sector despite higher interest rates. On a macro level this is visible by the strong credit impulse, calculated as the change in the commercial credit flow normalized by GDP, and the surge in domestic fixed investment of +9.5% y-o-y in Q2. Real GDP growth rates are also inflated by a major overhaul of Turkey's national accounts system at the end of 2016. Construction investment, which is currently Turkey's main growth engine, obtained a much larger share in the revised GDP approach.

Meanwhile, the effective policy interest rate has hovered around an historic high of 12% since May. Turkey requires a tight monetary policy stance to curb inflation, which was well above the 5% target at 11.9% in October. The sharp depreciation of the currency has caused inflation to increase as imported goods become more expensive in local currency. Inflation has become more entrenched though as long-term inflation expectations have shifted up substantially. High interest rates are also necessary to maintain a certain differential with US rates to prevent the lira from depreciating too much. The US monetary policy normalization process is a major risk to the volatile capital inflows on which Turkey overly relies for its high external financing needs. Portfolio investment inflow actually lost some momentum in July, a month after the latest US rate hike. So Turkish monetary policy is to a large extent constrained by what happens in the US and hence no real stimulus tool is needed. The broader cooling of market sentiment towards Turkey, amid rising geopolitical tensions, is also worrying in this respect. The lira plunged again in September, allegedly triggered by the arrest of a US embassy employee in Istanbul that led to mutual suspension of visa services between Turkey and the US.

This latest diplomatic incident is only one of many that underline Turkey's growing international isolation after President Erdogan won the presidential reform referendum in April. Political purges continue as he seems to be clearing the way for winning the elections in 2019. He faces a dilemma though. On the one hand he needs to secure domestic electoral support, which also explains the raft of temporary economic stimulus measures, while on the other hand his room to maneuver is limited as he cannot afford to scare away international investors. However, his hardline approach is increasingly backfiring. In response to the arrest of a German human rights activist in July, Germany – Turkey's largest trading partner – announced a policy reorientation towards Turkey, and warned its companies and citizens about doing business with and traveling to the country. Not long after, Germany also limited its cover for export credit insurance to Turkey. Turkey's EU accession bid also hangs in the balance with several EU leaders hinting at ending accession talks. Reduction of pre-accession aid has already been discussed. Elsewhere, Turkey picked sides in the diplomatic rift between Qatar and some of its Gulf neighbors by openly supporting Qatar and sending troops to its military base there. Another worry for Turkey is that the vote for independence by Kurds in Iraq could have spillover effects to its own Kurdish population and further escalate its conflict with the PKK.

In any case, current momentum will not be sustained and a slowdown to 3.5% economic growth is in the cards for 2018. Various tax benefits will expire in 2017 and private consumption growth is increasingly held back by concerns about high unemployment and inflation. This is also reflected in consumer confidence being less buoyant than business confidence and even receding over the past few months. Commercial loan growth is now easing as the upper credit limit of the guarantee fund is in sight and the government does not intend to raise it. This is understandable as it adds to rising contingent liabilities of the government. The relatively high corporate debt burden of almost 70% of GDP is the Achilles heel of the Turkish economy, especially as a significant part of debt is held in foreign currency. Moreover, banks are no longer able to keep lending rates artificially low, because of rising funding costs. The spread between the mortgage and deposit rates has turned positive again and is widening. Regardless of the availability of cheap credit, high political uncertainty in combination with a lack in structural reforms is still casting a shadow over Turkey's investment climate. While investment in construction projects has been booming, more productivity enhancing investments in machinery and equipment continued to fall in Q2 for the fourth quarter in a row (see figure). This is also mirrored in a drop in FDI inflows from already low levels.

3.5 Turkey's investment rebound is unbalanced
y-o-y % growth, quarterly

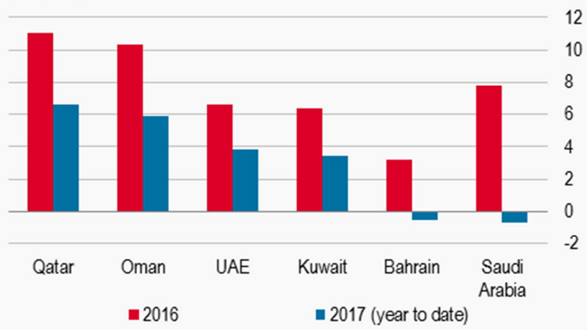


Source: Macrobond

MENA: an inconvenient time for monetary tightening

Despite the improved global outlook, economic growth in the MENA-region will slow more significantly than previously foreseen to 2.2% in 2017. Saudi Arabia and also Kuwait (are expected to have) entered a recession. This is due to an extension of the OPEC-initiated oil production cut to March 2018. Furthermore, fiscal adjustment to lower oil prices is weighing on non-oil growth as most countries in the region are on track to register lower fiscal deficits in 2017 than in 2016. Monetary policy room is constrained by long-standing US dollar pegs. Most of the Gulf Cooperation Council (GCC) countries closely mimicked the US tightening cycle including the latest rate hike in June, while Kuwait and Oman have been lagging behind with raising their policy rates in order to support economic growth. Monetary tightening comes at an inconvenient time as the business cycles - coping with low growth and low inflation - are out of sync with that of the US. Moreover, it coincides with the aftermath of the oil-crash-related liquidity squeeze and adds to higher financing costs. Consequently, private credit growth rates have moderated further and are even negative in Saudi Arabia and Bahrain (see figure). To alleviate the tight liquidity situation and prevent crowding out private investment, governments are increasingly tapping the international capital markets to finance their deficits.

3.6 MENA private sector credit growth moderates
y-o-y % growth



Source: Macrobond

Real GDP growth in MENA will rebound to 3.3% in 2018. Supported by higher oil prices various oil exporting countries, particularly the ones that still have ample financial buffers such as Saudi Arabia, Kuwait, UAE and Qatar, seem to be shifting to a more gradual pace of fiscal reforms to limit the short-term negative impact on growth and social tensions. Saudi Arabia's reversal of cuts in public sector remuneration in mid-2017 is evidence of this. While there are also indications that the country's authorities are planning to water down its prestigious

National Transformation Program, that includes ambitious targets on economic diversification, they recently announced the plan to build a US$ 500bn new city and economic zone (to be called NEOM). Going forward, fiscal consolidation will focus on raising non-oil revenues, including the 5% VAT introduction across the GCC in 2018, and rely less on cuts in capital expenditure. Particularly the UAE and Qatar will continue to invest heavily in infrastructure in the run-up to organizing the World Expo 2020 and the FIFA World Cup 2022 respectively.

The outlook for oil-importers is also improving, as the regional security situation (e.g. conflicts in Syria and Iraq) is de-escalating and structural reforms are progressing in countries like Egypt, which is good for tourism, trade and investment. Egypt continued with an aggressive tightening streak since its exchange rate was floated in November 2016, and raised rates in July by another 200 bps to 19.25%. This helped to reverse capital outflow and enabled the relaxation of capital restrictions. Despite high inflation stuck around 30% since early 2017, economic rebalancing in Egypt is on its way.

On the other hand, political stability in the Middle East is becoming an increasing concern, centring on rising tensions between Iran and Saudi Arabia, with the US also playing a role. This could affect the attractiveness of the region to foreign investors in the medium term. While the rivalry used to be mainly vented in proxy wars (e.g. in Yemen and Syria), political and economic pressure is increasingly applied on other countries such like Qatar to pick a side. Saudi Arabia's foreign policy has become more assertive since the young and ambitious Mohammed bin Salman has been rising to power and was recently appointed to Crown Prince. This culminated in a Saudi-led regional boycott of Qatar in June – after a controversial visit of US President Trump to the region – based on accusations against Qatar of supporting terrorism and developing cordial relations with Iran. It is unlikely that the political impasse will be solved quickly, as Qatar is unwilling to bow to the steep demands of the block that besides Saudi Arabia includes UAE, Bahrain and Egypt. Instead, Qatar's economy is quickly adjusting to the severance of transport links and is digging into its deep pockets to fend off pressure on the currency peg and on banking sector liquidity. The initially massive withdrawal of foreign deposits – allegedly mainly by residents in the boycotting counties – already slowed to a trickle. The boycott may achieve the opposite of what was intended, by driving Qatar and possibly other countries into the arms of Islamist regimes of Turkey and Iran.

In Iran the reform oriented President Rouhani was re-elected in May and is pressing to reintegrate his country in the world economy after nuclear sanctions have been lifted. The economy has been booming with an upwardly revised 13.4% growth rate in 2016. Meanwhile, its ballistic missile program continues, and in October US President Trump has finally decided to decertify Iranian compliance with the nuclear deal, hoping to renegotiate for tougher conditions. Although a snap-back of nuclear sanctions by the US would have limited effectiveness without cooperation of the other signatories (EU3, Russia and China) that have reaffirmed their commitment to the deal, the future of this important multilateral agreement has become uncertain. Economic growth in Iran will normalize to around 3 - 4% in 2017/2018, as the oil production catch up is complete, while sanction related uncertainty and Iran's banking sector weakness persist.

Sub-Saharan Africa: indebted countries vulnerable to US monetary tightening

The increase in commodity prices, although still at a relatively low level, is supporting the recovery in most countries in the Sub Saharan region. Economic growth will increase to 2.3% this year, a marked acceleration compared to the meagre 0.8% in 2016 when the lowest growth figure in years was recorded. Next year economic growth will further speed up to 3.2%. Almost all countries in the region show higher economic growth figures this year. However, economic growth is still weak in many countries which suffered from the sharp decline in commodity prices, especially oil, and are adjusting to the lower revenues. The largest economies in the region will move out of recession, commodity exporting countries like Zambia and Angola will recover from low economic growth and the more diversified economies like Senegal and Ethiopia will continue growing at a fast pace. As the worst seems over for the commodity dependent economies and their currencies are recovering from the low levels seen last year some have started loosening their monetary policy. In contrast to the developed economies African countries needed to sharply increase the interest rate to support their currencies and combat high inflation. Ghana, Nigeria and also South Africa have all started to cut the interest rate as their currencies more or less stabilized, inflation declined and their economies need a stimulus. A (faster) tightening of the US monetary policy will definitely have an impact on the African region. In past years countries in the Sub Saharan region have borrowed intensively to finance their ambitious (but much needed) investment programs and large budget deficits as government finances were hit by the drop in commodity prices. Many have turned to the international capital markets (Zambia) or found nonresident appetite for domestic bonds (Ghana). Investors in developed countries turned to exotic paper in the search for yield.

High public debt, external as well as domestic, resulting in high debt service costs, cause vulnerability to an increase in interest rates and an appreciating dollar in these countries.

South Africa: out of technical recession, but uncertainties remain

In the second quarter of 2017 economic growth reached 2.5%, after two quarters of contraction. The economy will recover only moderately growing 0.7% this year from 0.3% in 2016. After a severe drought last year the agriculture production has rebounded this year and is the main contributor to economic growth. The moderate recovery in commodity prices is also providing some support. However, economic growth is being constrained by policy uncertainty, having a negative impact on consumer and business confidence. Corruption scandals, the cabinet reshuffle in March this year followed by the downgrades of external rating agencies Fitch & S&P and the soft economy has weakened the position of President Zuma and have also hit the popularity of the ANC. In December this year the new leader of the ANC, and next president, will be appointed. It is highly uncertain who will succeed Zuma. A more business-oriented candidate will be the best solution as it would support international investor confidence in the country. In previous years concerns have increased about governance, policymaking and fiscal prudence. Structural reforms are necessary to bend this trend.

Inflation is still high, but has fallen within the target of the central bank (3-6%) due to the decline in food prices and a modest strengthening of the rand against the US dollar. With the decline in inflation the South African central bank took the opportunity to lower the interest rate 25 basis points to 6.75% to support the economy. The weak economy could benefit from more interest rate cuts, but it has limited room to do so with US tightening on the agenda. South Africa is one of the countries highly vulnerable to changes in market sentiment due to its dependency on portfolio inflows. Therefore, it is important for South Africa to have a (relatively large) positive interest differential with the US to keep attracting investors and thereby supporting the rand. This holds especially in current times of policy uncertainty and populist rhetoric. Policy uncertainty will continue next year and therefore contribute to the sluggish growth projection next year of 1.4%.

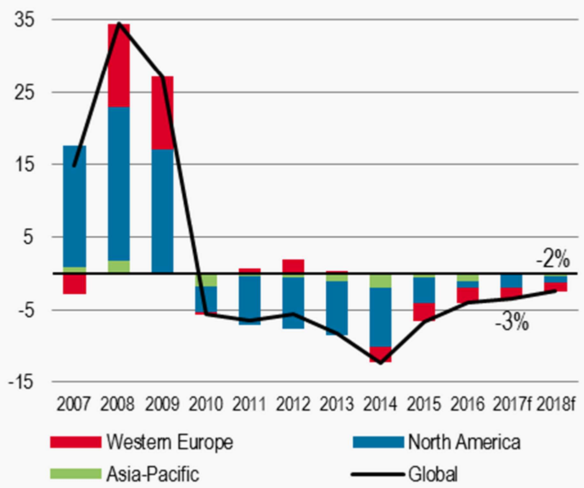
Nigeria: adjusting to lower oil prices

After posting its first recession in years in 2016 (-1.6%) the economy is slightly improving. This year economic growth of 1.1% is expected due to the increase in oil production and higher oil prices. However, economic activity is still being hampered by high inflation and high interest rates which are constraining domestic demand. Although the situation has improved in the forex market and dollar supply has increased, some dollar shortages remain. The central bank is still intervening in the exchange market, multiple exchange rates exist and some restrictions are still intact. Therefore, transparency issues and a highly complicated situation as to doing business in this country continue. Support for the economy will come from a strengthening agriculture sector and investments in infrastructure, resulting in a further improvement in economic growth to 2.3% next year. However, for Nigeria policy uncertainty will keep economic growth moderate and pose downside risks. More particularly, it has a negative impact on confidence and restrains investments.

4. Implications for the insolvency environment

4.1 Global insolvency developments

Global insolvency growth, regional contributions



Insolvency environment improving

Economic momentum has continued to build around the world, contributing to a stronger insolvency outlook than presented in May. As discussed in the preceding chapters, we now see a broad-based, cyclical recovery in global economic activity. This is reflected in a slightly more optimistic global insolvency forecast of -3% in 2017, a claim already supported by the insolvency figures this year so far, compared to -1.0% previously predicted. Considering we expect the momentum to persist next year, a further 2% decline is forecast in 2018.

Risks to our baseline insolvency outlook remain tilted to the downside. Disorderly monetary tightening, the number one risk to our global economic outlook, would also have the most negative implications for our insolvency forecast. Should the Fed, or other advanced economy central banks, tighten rates too fast, it runs the risk of choking economic activity, in part by tightening access to financing. This is a downside risk for heavily indebted corporates in advanced markets, but also for emerging economies. As already mentioned in chapter 3, poorly-communicated or misguided Fed tightening threatens firms in EMEs who could see capital outflows and higher financing costs. Further risks lie in a possible equity market correction, and a pronounced slowdown in China decreasing global import demand. Political uncertainty is also a persistent risk, with Brexit negotiations taking place as well as renegotiations of trade deals in the US.

Box 3 New insolvency forecasting model

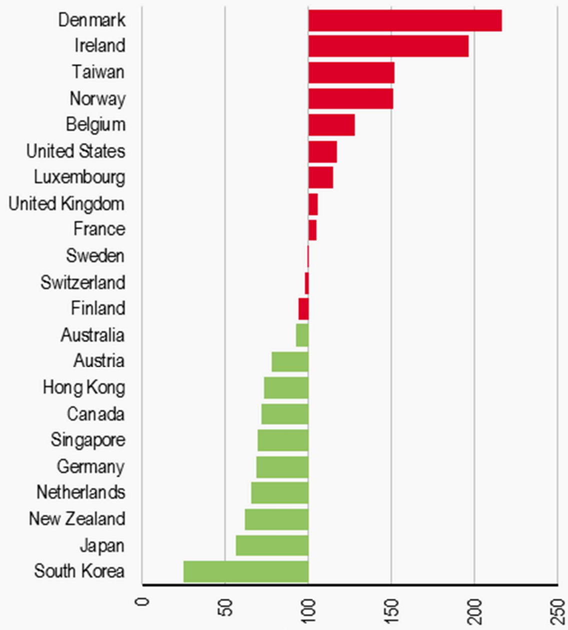
The Economic Research team has developed a new econometric model to better predict corporate insolvencies in advanced markets. The foundation of the model is still the same: general business cycle indicators, such as GDP growth, are inversely related to insolvency growth. The predictive power is now much improved by incorporating additional significant macroeconomic variables.

- The unemployment rate (or changes therein) is an input for the current health of the labour market
- Industrial production growth is a significant indicator for business activity and economic performance

As before, the approach to insolvency forecasting at Atradius follows a two-step approach. On top of the quantitative model outcomes, expert judgment is applied. Deviations from the model outcome may be recommended by country experts based on other macroeconomic or financial developments, credit conditions, and historical insolvency trends.

4.2 Insolvency levels 2017 relative to pre-crisis

Percentage insolvency level relative to 2007, 2007=100



Source: Macrobond, National bureaus

Europe driving the brighter outlook

Economic momentum in the Eurozone has been gathering pace since late 2016 and a broad-based recovery is finally underway. Domestic demand is picking up, supported by still-low inflation and ultra-loose monetary policy, which is expected to last through 2018 as discussed in chapter 1. Credit standards continue to ease across all loan categories and bank lending growth to enterprises continues to increase, according to the ECB's Q3 Bank Lending Survey. Exports are boosting GDP growth, supported by a stronger global economy. Eurozone-wide, insolvencies are expected to decrease 7.8% this year, followed by -6.1% next year.

However, in a number of countries the number of insolvencies[34] are still considerably higher than pre-crisis levels; mainly in the southern periphery of the eurozone.

The decline in insolvencies will again be led by the **Netherlands** (-23.0%). Despite the volume of bankruptcies already being historically low in the Netherlands, the total number of insolvencies until September was 22% lower than in the same period of 2016. A continuation of this trend is expected, in line with robust, broad-based economic growth and post-crisis highs in consumer and producer confidence. We predict an easing in the pace of decline in 2018 (-4%) as the annual volume of insolvencies is now only at 60% of its 2007 level.

Germany's 2017-2018 outlook is also characteristically strong supported by exports, increasing domestic demand and government spending. Sentiment indicators have reached all-time highs, led by the manufacturing and construction sectors. This is expected to support a 7.0% decrease in 2017 and a 4.0% decline in 2018.

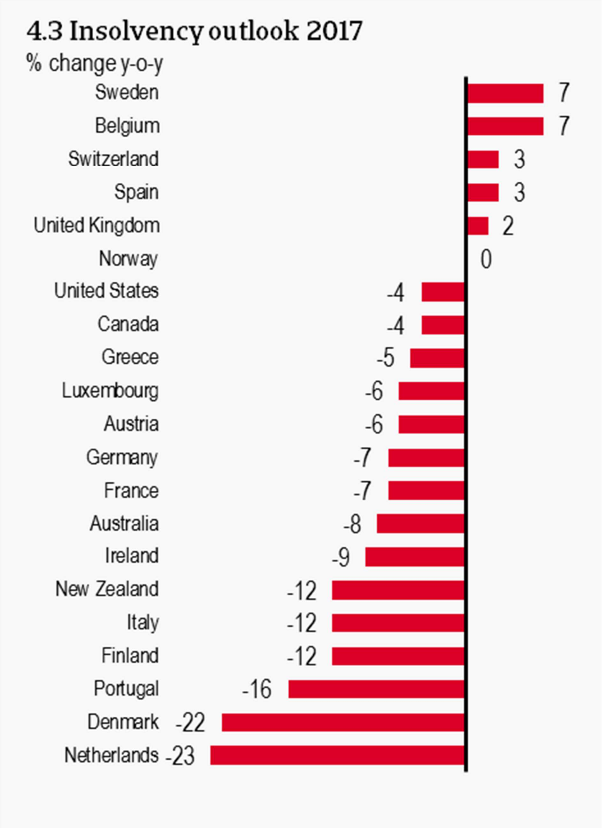
Finland (-12%) is predicted to see the third-largest decline in insolvencies in 2017 before easing to a more stable 2% decline in 2018. Growth is picking up in Finland, driven by private consumption from pent-up demand this year, declining unemployment, still low inflation, and very low interest rates.

France, boosted by pro-growth policies under its new president, is forecast to see GDP expand 1.5% this year and 1.6% in 2018. After a strong 7.6% decline in insolvencies in 2016, we have revised the French 2017 outlook to a 7.0% decline. A further 7.0% decline in the total number of insolvencies in 2018 will bring the country's annual count close to pre-crisis levels.

Domestic demand in **Italy** is driving a modest economic recovery that should persist in spite of political instability. The performance of insolvencies through H2 2017 has been strong, -15%, for 2017 we expect a decrease of 12%.

Spain is enjoying the highest rate of GDP growth in the eurozone thus far this year, marking its fourth year of

[34] As of July this year, we use data from data supplier Macrobond.



expansion and steady job creation. From 2014 to 2016, Spain saw double digit declines in the annual number of bankruptcies. In this light, we previously forecast another 8.0% decline in Spain. However, data from the first half of 2017 has not come in as expected, showing a 4.0% increase compared to H1 of 2016. This could be driven by an increasing number of active companies (+5.2% in Q2 of 2017 compared to the year before) and/or on-going deleveraging in the private sector. There is little evidence though that this trend will continue. The economic expansion is broad-based and the outlook is positive. The labour market is also tightening with unemployment at an eight-year low of (however still high) 17.2% of the active population. Thus we forecast the full-year change in insolvencies to be a more stable 3.0% increase before a 4.0% decline in 2018. Spain's annual number of insolvencies is still four times its 2007 levels, the highest in the surveyed countries.

The level of insolvencies in **Portugal** is still around three times higher than in 2007, but is seeing the second-largest decrease in the Eurozone of 16.0% this year and 11.0% next year clearly brings it down. But it remains at about 235% of pre-crisis levels. GDP growth in Portugal is the fastest it has seen in a decade.

Outside the eurozone, the 2017 forecast for **Denmark** stands out. Denmark's insolvency statistics are difficult to predict, however, because of a structural change in insolvency statistics last year, including the resolution of a major backlog. Therefore, insolvencies increased substantially last year despite economic acceleration. We expect this to translate to a statistical adjustment in 2017 (-22%, from a high starting point in 2016). For 2018, we expect a further decrease of -6%. Businesses will be further supported by very low interest rates.

Despite economic resilience over 2016 and high business confidence, insolvencies in the **UK** are on an upward trend. For the first time since 2011, total corporate failures increased last year, albeit by only 1.0%. This trend is expected to continue through this year and next as GDP growth eases. Higher inflation is increasingly feeding into lower real earnings, weighing on private consumption, the main driver of UK economic activity. This is likely to be exacerbated by expected tightening in consumer credit by banks as the BoE has already started monetary tightening

We expect GDP growth to ease to 1.6% in 2017 and annual insolvencies to increase 2.0%. With Brexit negotiations with the EU underway, uncertainty is rising and is projected to weigh on business investment, bringing GDP growth to only 1.0% in 2018. We predict corporate failures to increase by a further 4.0% next year.

US continues strong performance but policy uncertainty remains downside risk

Across the Atlantic, the **US** economic outlook is also robust, which is reflected in high business confidence. US GDP is expected to expand a solid 2.0% in 2017 and 2018. The positive outlook is supported by strong job growth, very low and still declining unemployment, and even firming wage pressure. In this environment, the number of bankruptcy filings is at historical lows. In Q3 of 2016, the number of bankruptcies in the US reached its lowest quarterly level since Q4 of 2006. We forecast a 4.0% decline in the overall number of insolvencies this year and a mild 2.0% decline in 2018. The US outlook is subject to risks, on the upside (tax reform) as well as downside (trade, NAFTA).

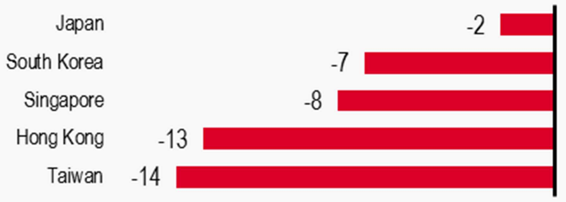
Pick up GDP growth developed Asia improves insolvency statistics

As discussed in chapter 3, we see a pickup in GDP growth in developed Asia, resulting from a recovery in global trade and higher-than-expected import demand in China. Consequently, we expect insolvencies to decrease sharply this year. Next year, we also expect insolvencies to decrease further, albeit at a slightly slower pace due to the easing of the GDP pickup in 2018.

Risk to the insolvency forecast will be the scenario of a Chinese hard landing, which would lead to a strong decrease in import demand from China and a heavy negative impact on the mentioned insolvency forecasts for developed Asia.

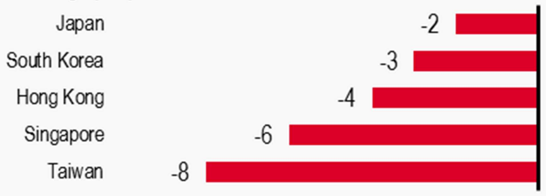
4.5 Insolvency outlook Asia 2017

% change y-o-y



4.6 Insolvency outlook Asia 2018

% change y-o-y



Insolvencies expected to decrease in BRICS markets, except for China

Economic conditions in many emerging markets slowed last year. Commodity exporters suffered from lower natural resource prices, while the slowdown in China negatively impacted trade and finances in many markets.

Whilst economic conditions are already improving, the impact of this slowdown is still be felt in 2017 in the BRIC countries. India is the exception. This year, the economy of **India** is growing less than expected, however it still maintains a high level of economic growth. Therefore, the number of insolvencies is still expected to decline this year. With **China**'s economy slowing down and rebalancing last year, and despite the better than expected growth this year, insolvencies are expected to increase in 2017. Companies face a change in funding conditions for the worse. Moreover the structure of the economy changes as it rebalances towards more services and consumption. This will inevitably lead to shrinking business opportunities in sectors such as steel as we discussed in chapter 1, and an increase in insolvencies. The opening up of other sectors provides opportunities, but those are not taken into account for insolvencies.

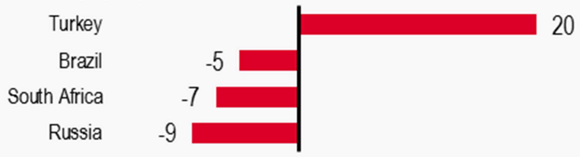
Turkey is expected to see an increase in insolvencies this year of 20% and 7% next year due to high inflation, lira volatility and expected slowdown of domestic demand in 2018. Moreover, rising political risks are weighing negatively on the growth outlook. In **Russia**, the elevated oil price is helping its economic recovery. Despite GDP growth being weak, a decrease in insolvencies is expected in 2017 (-9%) and 2018 (-2%).

Also, in **Brazil** we expect a decrease in insolvencies this year (-5%) and a substantial decrease next year (-10%). as Brazil is recovering from a deep recession in 2015-2016. Brazil is forecast to grow 0.6% in 2017. Inflation is easing and the central bank is cutting the Selic rate (now 7.5%) to below 7% over the forecast period. Its credit risk environment is improving. Furthermore, the Q2 Bank Lending Conditions Survey of the Institute of International Finance expects that lending conditions in Latin America will improve in Q3.

Finally, **South Africa** has been emerging from a technical recession since Q2 with growth underpinned by agriculture. But the recovery remains very fragile. Policy uncertainty is weighing on investment and business sentiment, while unemployment is very high. The decrease in insolvencies of 10% up until September is surprising in this environment. We expect insolvencies to decrease this year (-7%) and next year (-2%).

4.7 Insolvency outlook - major EMEs 2017*

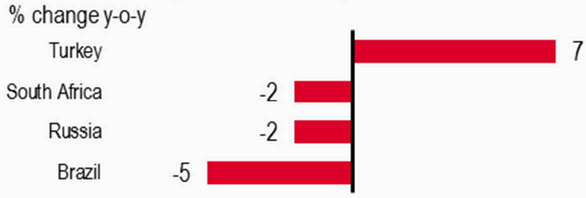
% change y-o-y



* Due to insufficient data, estimates for China and India are not available

4.8 Insolvency outlook - major EMEs 2018*

% change y-o-y



* Due to insufficient data, estimates for China and India are not available

Appendix: forecast tables

Table A1: Macroeconomic headline figures - Developed markets

	GDP growth (% change p.a.)			Inflation (% change p.a.)			Budget balance (% of GDP)			Current account (% of GDP)			Export growth (% change p.a.)		
	2016	2017	2018	2016	2017	2018	2016	2017	2018	2016	2017	2018	2016	2017	2018
Australia	2.5	2.2	2.3	1.3	2.1	2.4	-2.7	-1.6	-1.4	-2.7	-1.5	-1.7	7.3	4.2	6.3
Austria	1.5	2.9	2.2	0.9	1.8	1.4	-1.5	-1.4	-1.1	2.1	1.6	1.0	2.2	5.6	4.1
Belgium	1.5	1.7	1.5	2.0	1.8	2.0	-2.7	-1.3	-1.5	0.1	-1.0	-0.9	7.5	5.2	3.8
Canada	1.5	3.0	2.2	1.4	1.6	2.3	-0.6	-0.8	-1.3	-3.3	-2.5	-2.1	1.0	2.9	3.9
Denmark	1.7	2.3	1.9	0.3	1.9	1.7	-0.9	-0.4	0.0	7.3	7.8	7.2	2.5	4.5	2.1
Finland	1.9	2.6	2.0	0.4	0.6	1.1	-1.8	-1.1	-1.1	-1.4	-0.5	0.0	1.3	7.7	2.1
France	1.1	1.8	1.8	0.2	0.9	0.9	-3.4	-2.9	-2.8	-0.9	-1.1	-1.2	1.9	3.1	4.1
Germany	1.9	2.2	2.1	0.5	1.7	1.8	0.8	0.7	0.6	8.3	7.7	7.5	2.4	3.9	3.3
Greece	0.0	1.1	2.4	-0.8	0.2	-0.1	0.4	0.8	0.7	-1.4	-0.6	0.1	-1.7	5.3	6.5
Hong Kong	2.0	3.6	2.5	2.4	1.7	2.0	1.7	0.8	-0.3	4.6	4.7	3.8	0.9	5.1	3.4
Ireland	5.1	4.1	2.5	0.0	0.8	1.5	-0.7	0.5	0.7	3.4	5.0	3.5	4.7	2.6	1.8
Italy	1.1	1.6	1.4	-0.1	1.0	1.5	-2.5	-2.1	-1.8	2.7	2.4	2.1	2.6	5.1	3.1
Japan	1.0	1.7	1.7	-0.1	0.5	0.8	-4.6	-5.2	-5.6	3.7	3.7	3.7	1.1	6.5	4.9
Luxembourg	3.1	3.7	3.5	0.0	1.7	2.0	1.6	0.3	0.3	4.8	5.5	6.8	2.7	4.8	4.6
Netherlands	2.1	3.1	2.1	0.3	1.1	1.4	0.3	0.9	0.2	9.0	10.0	9.7	4.1	5.2	3.7
New Zealand	3.5	2.5	2.6	0.7	1.6	2.2	1.2	1.6	1.7	-2.5	-2.3	-1.7	1.5	2.7	4.0
Norway	1.0	2.3	2.3	3.6	1.1	1.4	4.9	2.3	1.1	3.9	3.5	2.4	-1.9	1.7	3.4
Portugal	1.5	2.7	2.2	0.6	1.3	1.3	-2.0	-1.4	-1.3	0.9	0.6	0.4	4.1	7.8	4.8
Singapore	2.0	3.0	2.8	-0.5	0.6	1.5	-1.2	-0.1	0.0	19.1	20.0	20.0	1.6	4.5	3.9
Spain	3.3	3.1	2.6	-0.2	1.4	1.2	-4.6	-3.1	-2.5	1.9	1.7	1.4	4.8	6.4	4.9
South Korea	2.8	3.3	3.0	1.0	1.9	1.9	1.0	0.7	0.4	7.0	5.9	5.6	2.1	3.8	4.7
Sweden	3.1	3.1	2.6	1.0	1.9	2.0	1.2	1.2	0.8	4.5	4.1	3.8	3.0	3.5	4.0
Switzerland	1.4	0.9	2.3	-0.4	0.4	0.6	0.3	0.3	0.4	9.4	9.0	10.8	6.8	2.3	4.8
United Kingdom	1.8	1.5	1.5	0.6	3.2	1.6	-3.3	-2.5	-2.0	-5.9	-4.5	-3.2	1.1	4.1	2.6
United States	1.5	2.2	2.6	1.3	2.2	1.6	-5.0	-4.3	-4.1	-2.4	-2.5	-2.8	-0.3	3.3	3.6
Eurozone	1.8	2.3	2.0	0.2	-	-	-1.5	-1.1	-1.0	3.5	3.1	2.9	3.2	4.5	3.6

Source: Oxford Economics

Table A2: Macroeconomic indicators - Developed markets

	Private cons. (% change p.a.)			Fixed investment (% change p.a.)			Government cons. (% change p.a.)			Retail sales (% change p.a.)			Industrial prod. (% change p.a.)		
	2016	2017	2018	2016	2017	2018	2016	2017	2018	2016	2017	2018	2016	2017	2018
Australia	2.7	2.4	2.3	-2.7	1.9	-1.1	4.2	3.1	3.1	2.2	2.0	2.6	1.3	1.1	2.0
Austria	1.6	1.2	1.7	3.6	4.3	3.4	2.1	1.2	1.4	0.8	1.5	1.7	2.0	3.7	3.5
Belgium	1.7	1.4	1.7	3.6	0.8	2.6	0.5	1.2	2.1	-0.7	0.1	2.6	4.3	2.6	1.8
Canada	2.3	3.5	2.2	-3.1	1.7	1.9	2.0	1.3	1.6	4.0	5.9	2.7	-0.1	6.3	2.1
Denmark	2.1	2.3	2.1	5.6	1.9	2.3	0.4	1.4	2.1	0.5	0.7	1.9	3.5	1.4	1.4
Finland	1.8	2.5	2.4	7.2	9.3	4.2	1.2	0.8	1.0	1.1	2.3	1.2	2.2	3.1	2.4
France	2.1	1.2	1.9	2.7	3.5	2.8	1.2	1.4	1.3	3.2	3.3	2.3	0.2	1.8	1.9
Germany	1.9	2.0	1.8	2.9	3.9	4.2	3.7	1.6	1.8	2.1	3.1	1.6	1.2	3.2	2.6
Greece	1.4	0.9	1.5	0.0	-0.9	2.2	-2.1	2.7	3.2	-0.6	1.3	2.1	2.5	5.0	1.6
Hong Kong	1.8	4.3	2.5	-0.3	4.6	2.9	3.4	3.2	2.9	-7.1	1.2	2.5	-0.4	2.7	1.0
Ireland	3.1	2.8	3.3	60.4	-19.5	-11.6	5.2	1.9	1.5	5.4	6.6	5.0	0.7	-2.1	3.5
Italy	1.5	1.4	1.2	3.0	3.0	3.6	0.5	0.7	0.3	0.6	0.7	1.1	1.9	3.1	1.6
Japan	0.4	1.5	1.1	1.0	3.3	3.0	1.3	0.2	1.2	-0.3	1.6	0.9	-0.2	4.5	2.2
Luxembourg	2.4	2.2	2.9	0.5	5.9	3.9	2.0	2.1	2.3	-53.9	-20.5	2.7	0.4	-2.4	6.1
Netherlands	1.5	2.1	2.0	5.2	5.5	3.7	1.1	1.1	1.3	1.1	2.8	1.3	2.1	0.8	1.7
New Zealand	4.2	3.8	2.2	5.5	2.6	3.2	2.2	3.2	1.2	4.9	4.7	2.1	4.4	2.0	2.8
Norway	1.3	2.7	3.1	-0.4	4.7	5.7	2.1	1.9	2.0	-0.8	2.4	3.2	-1.7	3.4	2.7
Portugal	2.1	2.1	2.2	1.6	8.8	4.1	0.6	0.0	0.7	2.8	3.8	2.3	2.3	4.5	3.0
Singapore	0.6	0.3	1.6	-2.5	-2.9	4.1	6.3	6.1	4.6	1.2	0.8	0.8	3.5	10.4	5.9
Spain	3.0	2.6	2.2	3.3	4.4	3.2	0.8	1.0	1.1	3.5	1.7	2.0	2.0	2.1	2.1
South Korea	2.5	2.4	2.6	5.2	9.4	2.7	4.3	4.1	5.6	4.2	2.1	2.6	0.7	1.8	3.3
Sweden	2.1	2.7	2.6	5.3	9.0	6.1	3.0	0.3	1.1	3.0	2.9	3.4	1.0	5.2	4.0
Switzerland	1.5	1.3	1.6	3.1	1.5	2.9	1.6	1.4	1.3	-1.1	-0.3	0.7	0.3	2.9	3.1
United Kingdom	2.9	1.5	0.9	1.3	2.1	1.8	1.1	0.5	0.4	4.6	2.2	2.3	1.3	1.5	1.8
United States	2.7	2.7	2.6	0.6	3.0	3.9	1.0	0.0	0.4	4.6	3.5	3.4	-1.2	1.6	2.9
Eurozone	2.0	1.8	1.8	4.3	2.5	3.1	1.7	1.2	1.3	1.4	2.5	1.9	1.5	2.4	2.2

Source: Oxford Economics

Table A3: Macroeconomic headline figures - Emerging markets

	GDP growth (% change p.a.)			Inflation (% change p.a.)			Current account (% of GDP)			Private cons. (% change p.a.)			Export growth (% change p.a.)		
	2016	2017	2018	2016	2017	2018	2016	2017	2018	2016	2017	2018	2016	2017	2018
Emerging Asia	6.0	6.0	5.9	2.8	2.4	3.3	-	-	-	-	-	-	-	-	-
China	6.7	6.8	6.4	2.0	1.6	2.3	1.8	1.3	1.1	7.9	7.7	7.3	1.8	7.2	4.7
India	7.9	6.5	7.5	4.9	3.3	5.5	-0.5	-1.7	-1.9	9.2	7.0	8.8	1.2	4.9	4.8
Indonesia	5.0	5.1	5.3	3.5	3.9	4.2	-1.8	-1.5	-1.2	5.0	5.0	5.1	-1.7	8.8	5.9
Malaysia	4.2	5.6	4.8	2.1	3.8	2.9	2.3	2.9	2.5	6.0	6.9	5.3	1.1	9.2	3.3
Thailand	3.2	3.9	3.2	0.2	0.7	1.9	11.9	11.2	12.5	3.1	3.7	3.1	2.1	6.5	5.2
Latin America	-1.5	1.1	2.5	12.2	6.5	5.7	-	-	-	-1.7	1.5	2.7	-	-	-
Argentina	-2.2	3.0	3.9	41.4	26.2	18.5	-2.7	-4.4	-4.4	-1.4	4.8	4.5	3.7	-1.2	4.4
Brazil	-3.6	0.8	2.4	8.7	3.4	3.9	-1.3	-0.6	-1.5	-4.3	0.5	2.3	1.7	4.7	3.3
Mexico	2.0	2.3	2.3	2.8	6.0	3.9	-2.2	-2.0	-2.2	2.4	3.2	2.0	1.3	5.0	3.4
CIS	0.3	2.3	2.2	8.3	5.6	5.7	-	-	-	-	-	-	-	-	-
Czech Republic	2.5	4.8	3.5	0.7	2.4	2.4	1.2	1.4	0.2	3.5	4.3	3.7	4.3	7.9	6.6
Hungary	1.9	3.7	3.3	0.4	2.3	2.6	6.2	4.2	3.3	5.0	4.2	3.8	5.8	7.0	5.7
Poland	2.6	4.3	3.4	-0.6	2.0	2.5	-0.3	-0.9	-1.7	3.7	5.0	4.0	8.9	5.2	5.6
Russia	-0.3	2.1	1.8	7.0	3.9	4.0	2.1	2.3	2.6	-4.5	4.0	2.9	3.1	4.5	3.3
Turkey	3.3	5.0	3.5	7.8	10.8	9.1	-3.8	-4.7	-4.4	3.7	4.1	3.0	-1.9	11.0	3.1
Africa	0.8	2.3	3.2	11.7	12.1	10.5	-	-	-	-	-	-	-	-	-
Nigeria	-1.6	1.1	2.3	15.7	16.6	14.3	0.7	1.6	1.7	-1.1	0.3	1.0	-3.8	6.1	7.6
South Africa	0.3	0.7	1.4	6.3	5.3	5.2	-3.3	-2.5	-3.2	0.8	0.9	1.5	-0.1	1.6	1.8
MENA	4.2	2.2	3.3	6.9	13.0	11.0	-	-	-	-	-	-	-	-	-

Source: Oxford Economics

Table A4: Insolvency growth (% per annum)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017f	2018f
Australia	-4	18	3	-1	5	1	4	-22	10	-12	-8	-5
Austria	-6	0	9	-8	-8	3	-10	-1	-5	1	-6	-6
Belgium	1	10	11	2	7	4	11	-9	-9	-6	7	-4
Canada	-10	-7	-2	-11	-9	-4	0	-1	3	3	-4	0
Denmark	21	54	54	13	-15	0	-8	-19	0	66	-22	-6
Finland	-1	16	25	-13	3	0	6	-5	-14	-6	-12	-7
France	7	7	14	-5	-1	3	3	0	0	-8	-7	-7
Germany	-15	0	12	-2	-6	-6	-8	-7	-4	-7	-7	-4
Greece	-6	10	15	25	35	28	10	3	8	3	-5	-5
Hong Kong	7	-3	50	-43	-13	2	15	3	1	-9	-13	-4
Ireland	19	100	50	10	7	3	-19	-15	-10	-2	-9	-3
Italy	-37	18	29	21	7	14	14	11	-6	-7	-12	-5
Japan	6	11	-1	-14	-4	-5	-10	-10	-8	-6	-2	-2
Luxembourg	5	-13	17	33	5	8	2	-20	5	14	-6	-3
Netherlands	-13	-14	53	-9	0	19	10	-22	-24	-19	-23	-4
New Zealand	-5	-35	45	-5	-12	-7	-13	-7	4	1	-12	-2
Norway	-6	41	47	-17	0	-13	18	6	-3	-1	0	-2
Portugal	-12	54	36	21	-5	46	1	-13	10	-6	-16	-11
Singapore	-7	-16	-12	-25	-1	14	14	-12	1	1	-8	-6
South Korea	-9	19	-27	-21	-13	-10	-18	-16	-14	-23	-7	-3
Spain	18	188	88	-4	15	32	10	-27	-21	-9	3	-4
Sweden	-5	7	20	-4	-4	7	4	-6	-11	-5	7	-4
Switzerland	0	1	-2	17	4	8	-1	-3	5	3	3	-5
Taiwan	68	-23	-58	-21	-4	-1	-18	-37	23	25	-14	-8
United Kingdom	-10	33	14	-18	2	-5	-22	8	8	-11	2	4
United States	42	52	41	-7	-15	-16	-17	-19	-8	-2	-4	-2

Sources: National bureaus, Economic Research; f=forecast

Table A5: Insolvency level, index (2007 = 100)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017f	2018f
Australia	100	118	121	120	126	127	133	104	115	101	93	88
Austria	100	100	110	101	93	96	87	86	82	83	78	73
Belgium	100	110	123	125	133	138	153	140	127	119	128	123
Canada	100	93	91	81	74	71	71	71	73	75	72	72
Denmark	100	154	238	269	228	227	208	169	168	278	217	204
Finland	100	116	145	127	131	131	139	132	114	107	94	87
France	100	107	123	117	115	118	122	121	122	112	105	97
Germany	100	100	112	110	103	97	89	83	79	74	69	66
Greece	100	110	127	159	214	275	302	312	337	347	329	313
Hong Kong	100	150	214	245	258	332	353	326	316	296	264	246
Ireland	100	200	300	330	354	364	295	252	227	223	203	197
Italy	100	118	151	183	197	223	255	284	267	249	219	208
Japan	100	111	110	95	90	86	77	69	64	60	59	58
Luxembourg	100	87	102	135	142	154	156	124	131	149	140	136
Netherlands	100	86	132	119	120	143	157	122	92	75	58	55
New Zealand	100	65	94	89	78	73	63	59	61	62	54	53
Norway	100	141	207	171	172	150	176	186	180	179	179	176
Portugal	100	154	210	253	241	351	355	308	338	316	265	236
Singapore	100	123	164	158	149	150	153	142	131	148	138	131
South Korea	100	108	130	128	128	137	140	132	127	118	109	102
Spain	100	288	540	520	598	791	866	635	501	458	472	453
Sweden	100	107	128	123	118	126	130	122	108	103	111	106
Switzerland	100	101	99	115	120	129	128	124	130	134	138	132
Taiwan	100	104	115	93	89	89	89	79	80	73	67	65
United Kingdom	100	133	151	125	128	122	95	103	111	99	101	105
United States	100	152	215	199	169	142	118	95	88	85	82	80

Source: National bureaus, Economic Research; f=forecast

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