

Economic Overview

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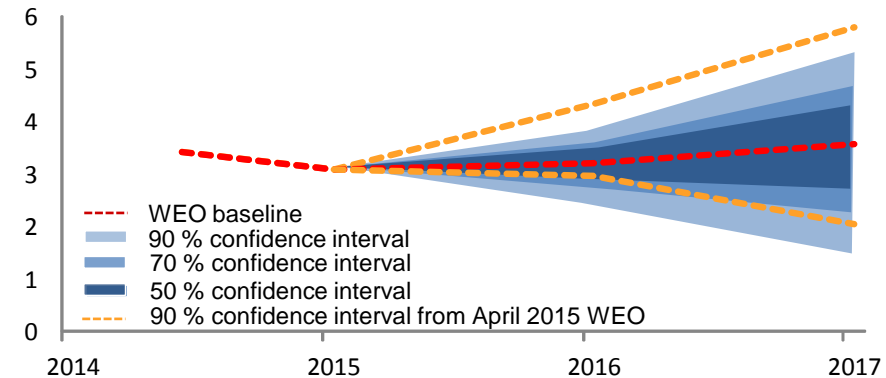
Economic Overview

World economic outlook

- IMF's latest update reprise warnings about risks from a slowdown in emerging market economies
 - lowered its projections (again)
 - "Subdued Demand, Diminished Prospects", January 2016
 - "Too slow for too long", April 2016
 - while it is early to speak of a global recession, the risks surrounding the projections are on the downside

Prospects for World GDP growth

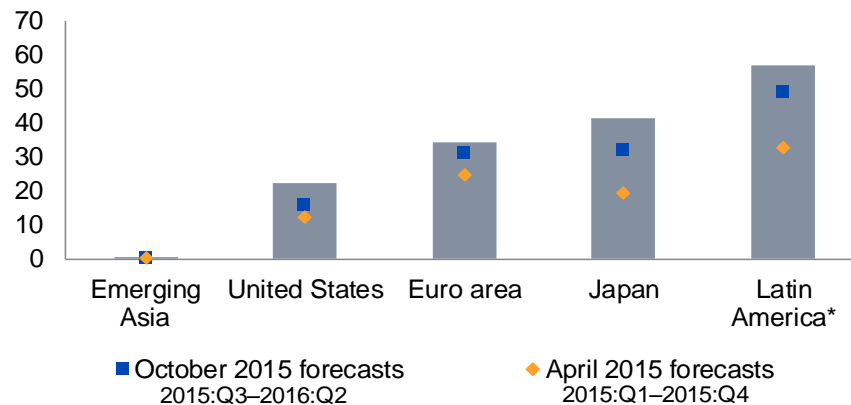
in %



Sources: IMF, Rothschild

Probability of recession

in %, 2016:Q1 - 2016:Q4



* Brazil, Chile, Peru, Columbia, Mexico

Sources: IMF, Rothschild

GDP growth forecasts (in %)	2015	2016			2017		
		oct-15	jan-16	apr-16	oct-15	jan-16	apr-16
World	3.1	3.6	3.4	3.2	3.8	3.6	3.5
United States	2.4	2.8	2.6	2.4	2.8	2.6	2.5
Euro area	1.5	1.6	1.7	1.5	1.7	1.7	1.6
Germany	1.5	1.6	1.7	1.5	1.7	1.8	1.6
France	1.1	1.5	1.3	1.1	1.7	1.5	1.3
Italy	0.8	1.3	1.3	1.0	1.2	1.2	1.1
Spain	3.2	2.5	2.7	2.6	2.2	2.3	2.3
Japan	0.5	1.0	1.0	0.5	0.4	0.3	-0.1
United Kingdom	2.2	2.1	2.1	1.9	2.2	2.2	2.2
Russia	-3.7	-0.6	-1.0	-1.8	1.0	1.0	0.8
China	6.9	6.3	6.3	6.5	6.0	6.0	6.2
Brazil	-3.8	-1.0	-3.5	-3.8	2.3	0.0	0.0

Source: IMF

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China

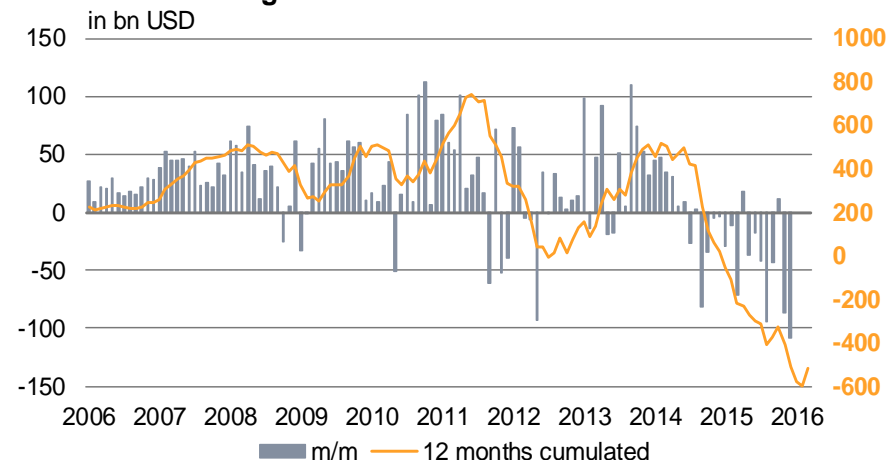
- Improved statistics → confirms for now the no hard landing scenario
 - slight increase in FX reserves
 - manufacturing Markit/NBS and industrial production are up
 - turn around in imports and exports, although imports are still negative yoy
- How can we explain this improvement?
 - good old method: fiscal stimulus and credit growth → should we be worried? Short term gain but long term pain

Indicators - CHINA (y/y change, except PMI)

	10-2015	11-2015	12-2015	01-2016	02-2016	03-2016
Manufacturing PMI - NBS	↔	▼	▲	▼	▼	▲
Manufacturing PMI - Markit	▲	▲	▼	▲	▼	▲
Industrial production	▼	▲	▼	▼	▼	▲
Fixed investment	▼	↔	▼		▲	▲
Imports	▲	▲	▲	▼	▲	▲
Non-manufacturing PMI NBS	▼	▲	▲	▼	▼	▲
Retail sales	▲	▲	▼	▼	↔	▲
New house prices	▲	▲	▲	▲	▲	▲
Total social financing*	▲	▲	↔	▲	▼	▲

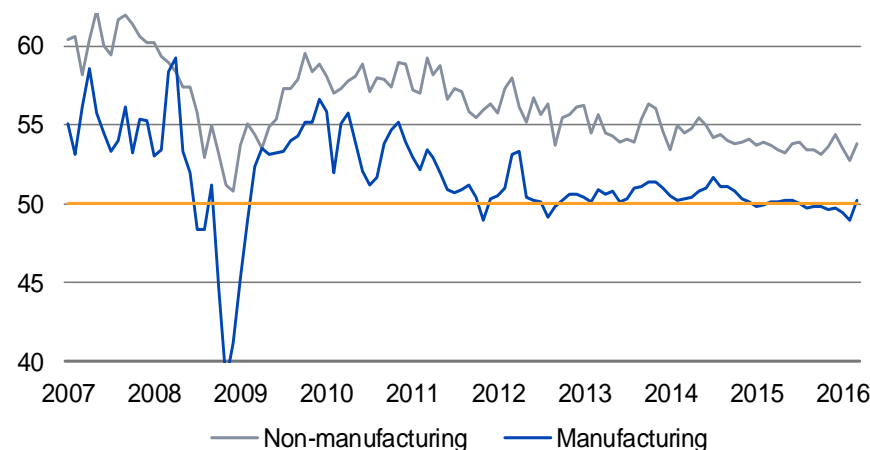
*: adjusted for local government bond issuance

China - Foreign reserve assets



Sources: Datastream, Rothschild

China - PMI indexes



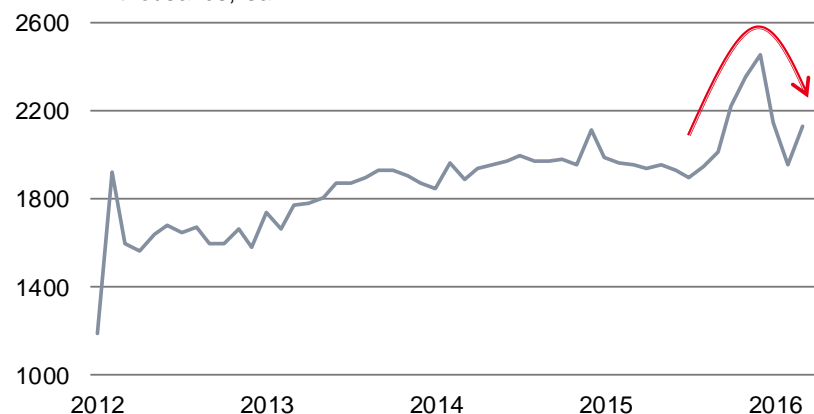
Sources: NBS, Datastream, Rothschild

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- Effects of fiscal policy can be felt in:
 - certain assisted sectors – namely automobiles
 - public investment → will the private investment take over in an environment of excess capacity?
- Monetary policy has pushed up credit growth
 - to almost 17 % yoy
 - less intensive efforts from the authorities to dampen shadow banking which represents ≈ 45 % of recent new credit creation vs ≈ 25 % in 2014 and 2015

China - Auto sales

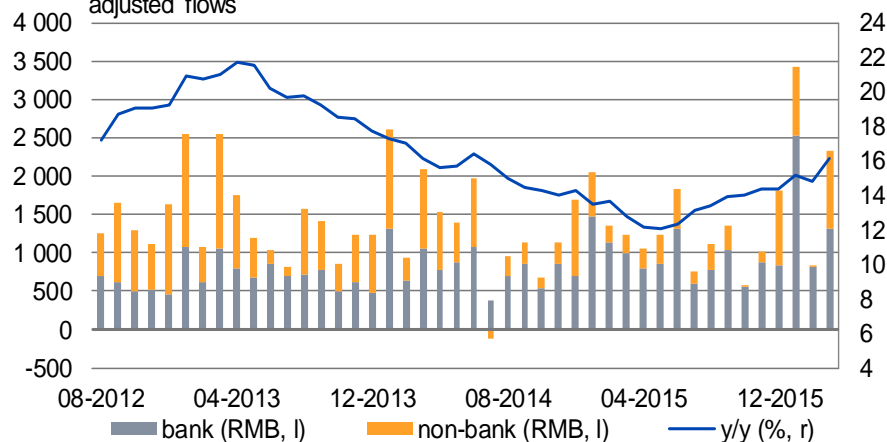
in thousands, sa



Source: Datastream, Rothschild

China - New credits

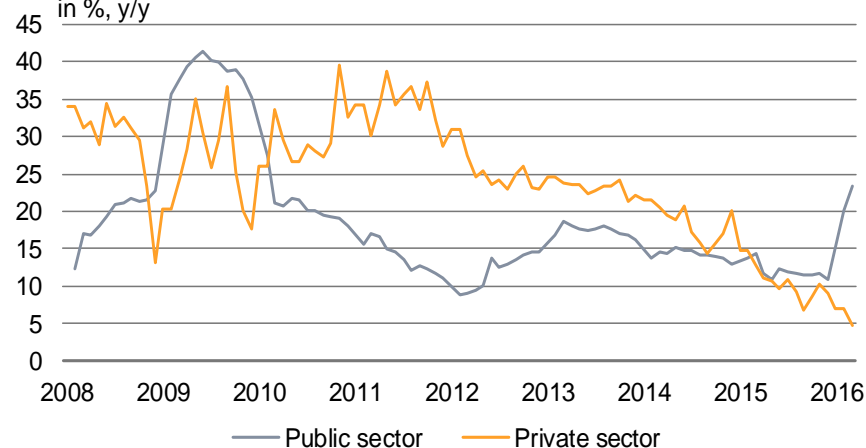
adjusted flows



Sources: Datastream, GS, Rothschild

China - Fixed investment

in %, y/y



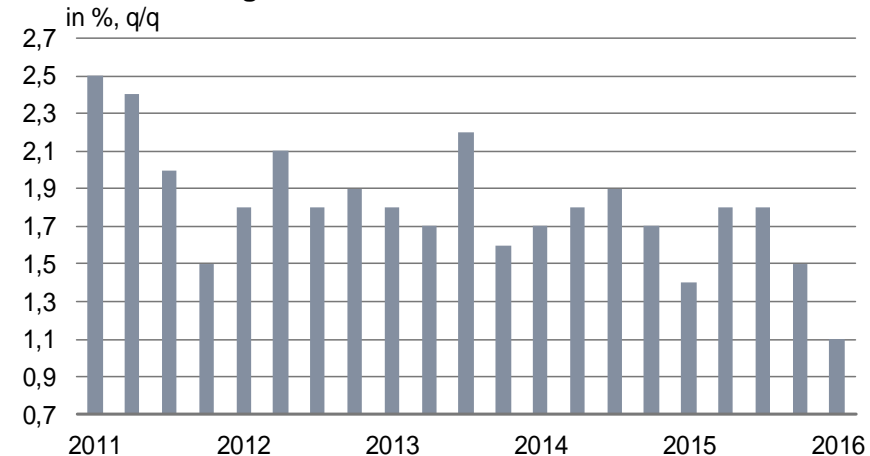
Sources: Capital Economics, Datastream, Rothschild

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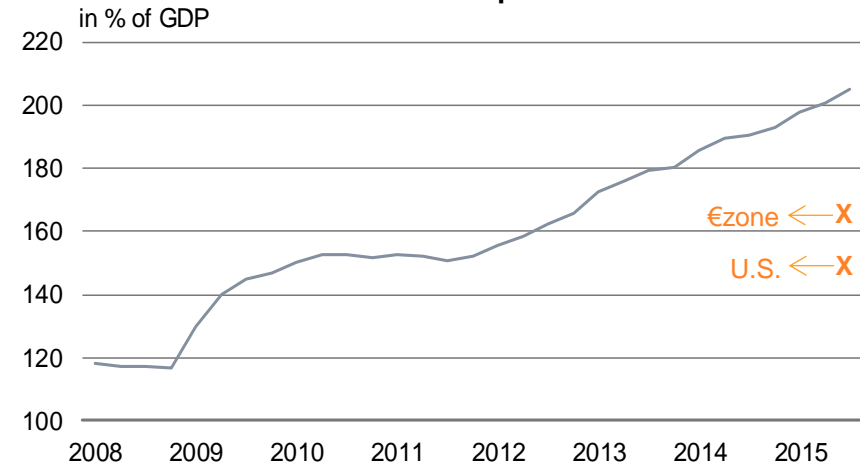
- Despite credit growth acceleration, GDP growth in Q1 2016 – at +1,1% – was the lowest since 2008-2009 Global Recession
- Authorities are concerned about divergence in housing prices and the formation of bubbles in certain areas ...
- ... in a context of an increasingly weak corporate sector: payables days have increased, more-leveraged firms now account for almost 60% of total debt (doubling from 2007) and debt at risk* is estimated at 1.3 trillion USD
 - represents 15% (vs 4% in 2010) of total bank debt, with real estate and manufacturing among the most highly indebted and least profitable
 - IMF estimates potential bank losses of 756 bn USD ≈ 7% China GDP ≈ 2 years of projected banking system pretax profits
- **Bottom line:** Continued strong growth in lending to an increasingly weak corporate sector could undermine actual and potential growth as an increasing share of new credit is used just to roll over existing debts, instead of being used to finance new projects and investment and thus contribute to the dynamism of the corporate sector

*: borrowing by companies unable to generate sufficient earnings to cover debt interest payments

China - GDP growth

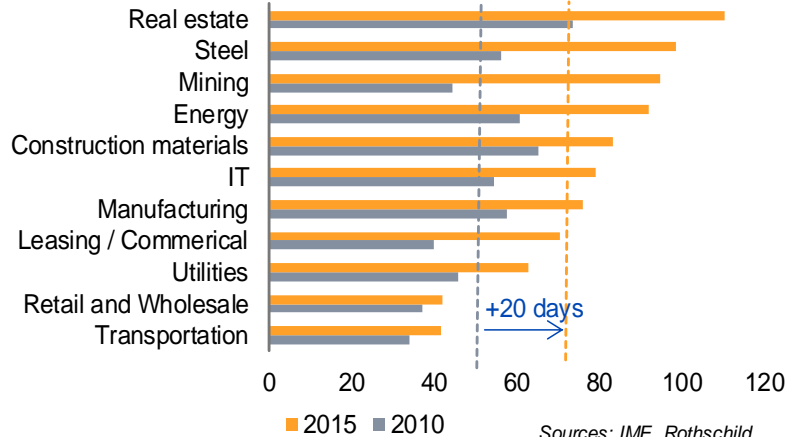


China - Credit to non-financial private sector

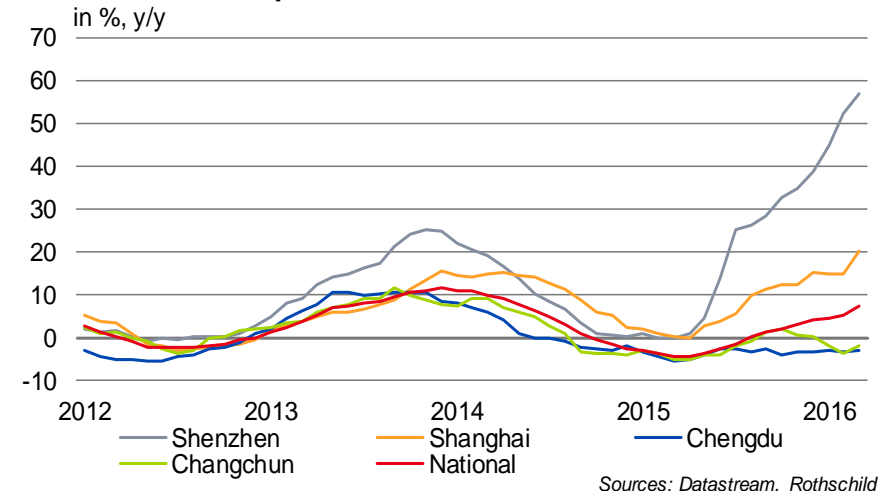


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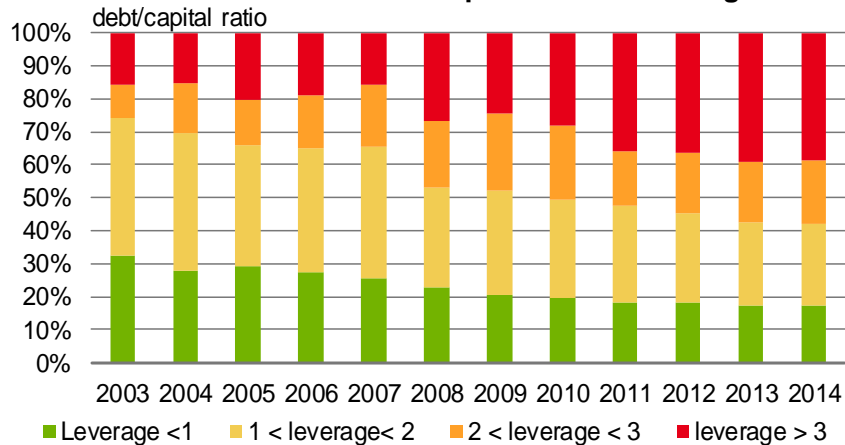
China - Corporate payable days by sector



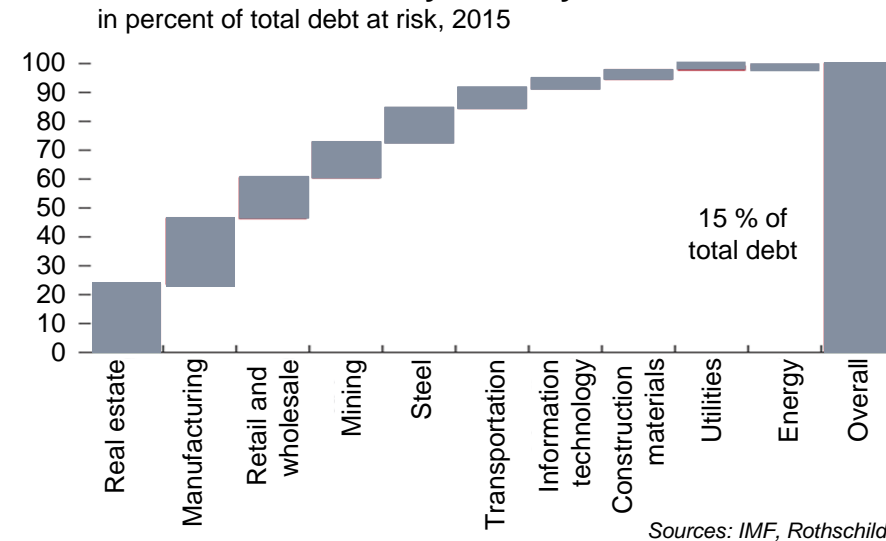
China - House prices



China - Breakdown of enterprises¹ as of leverage



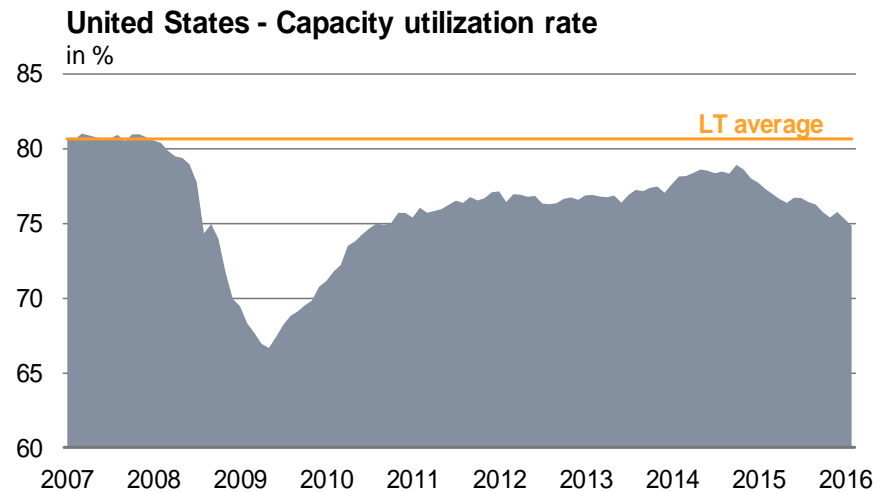
China - Debt at risk by industry



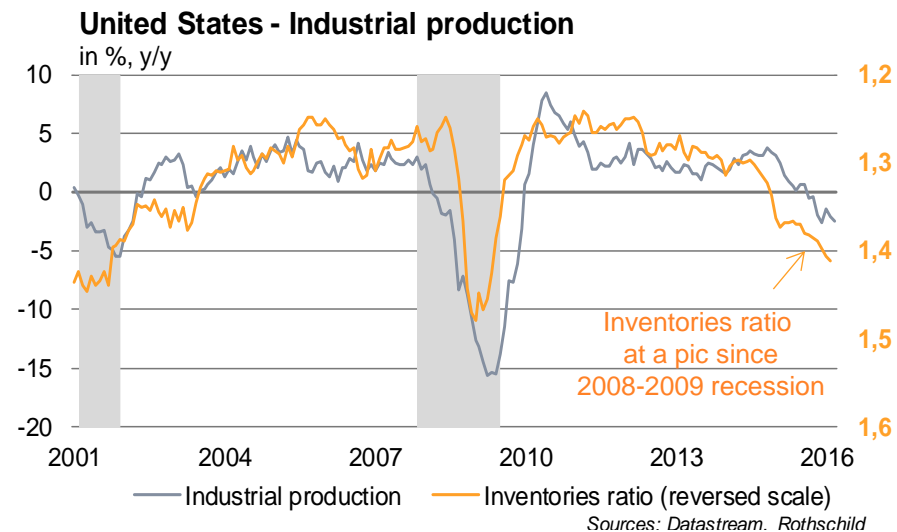
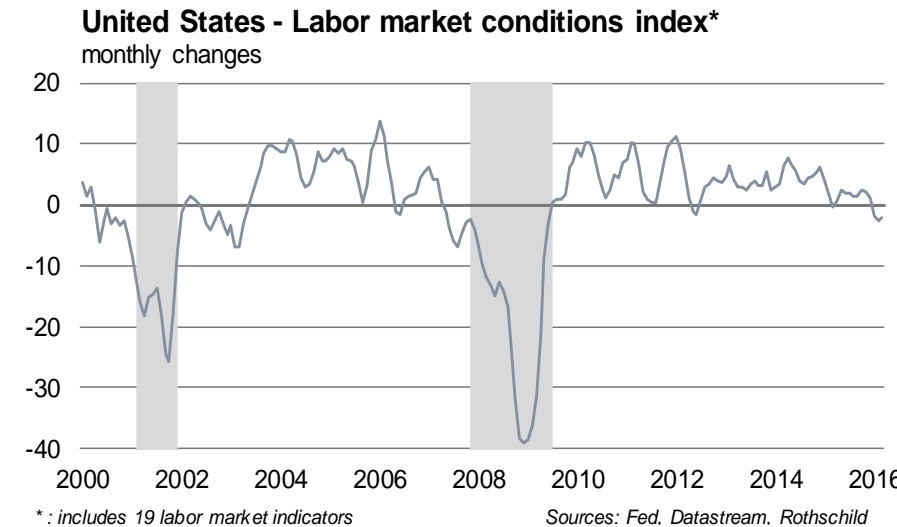
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United States

- Mixed statistics
 - ISM manufacturing jumped above the 50 threshold, but recent data show it might fall back
 - disappointing retail sales, lower confidence from SMEs, very high level of inventories, low capacity utilization rate → represents a deterrent factor to any pick up in business investment
 - Robust labor market?
 - labor market conditions index – derived from a model that extracts the primary common variation from 19 labor market indicators – is trending lower



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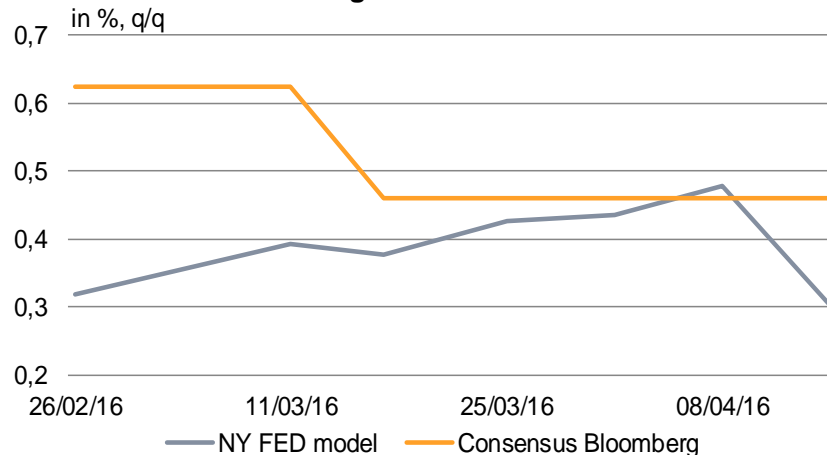
- Measures of economic surprises have remained in negative territory → over optimism
- Mediocre Q1 GDP growth (+0,1 % q/q) and the Q2 rebound could be very limited → seems to confirm clear drop in 2016 growth
- Limited inflationary pressures and asymmetric risks
 - if the Fed is leaving the door open to a June 15th hike amid improvements in the global economy and financial markets → gave no signal that such a move is likely and Brexit referendum (June 23rd) will probably weigh on its decision

United States - Economic surprise index



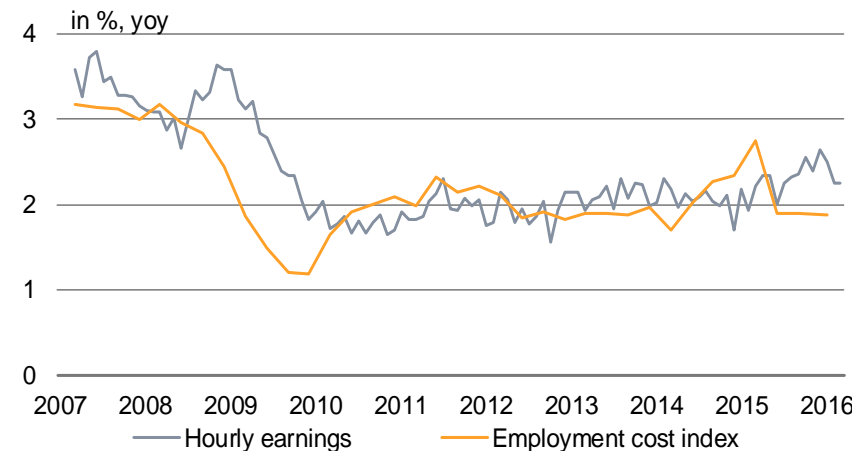
Sources: Bloomberg, Citigroup, Rothschild

United States - GDP growth forecasts - 2016:Q2



Sources: NY Fed, Bloomberg, Rothschild

United States - Private sector labor cost



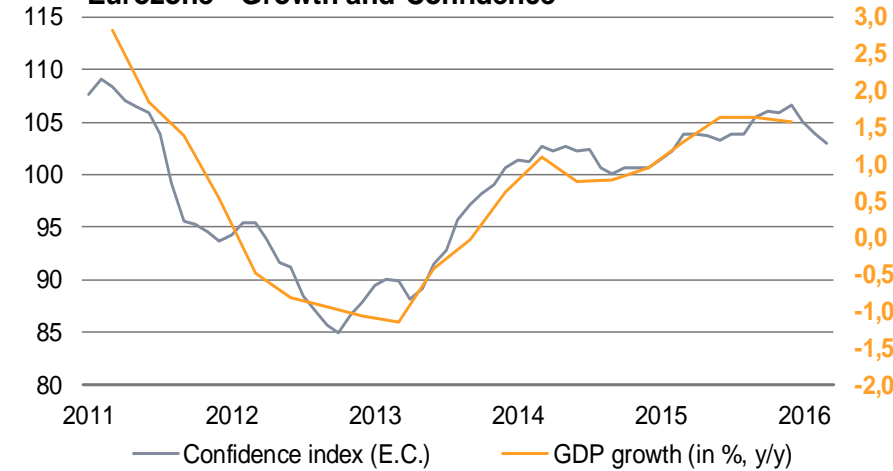
Sources: Datastream, Rothschild

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Eurozone

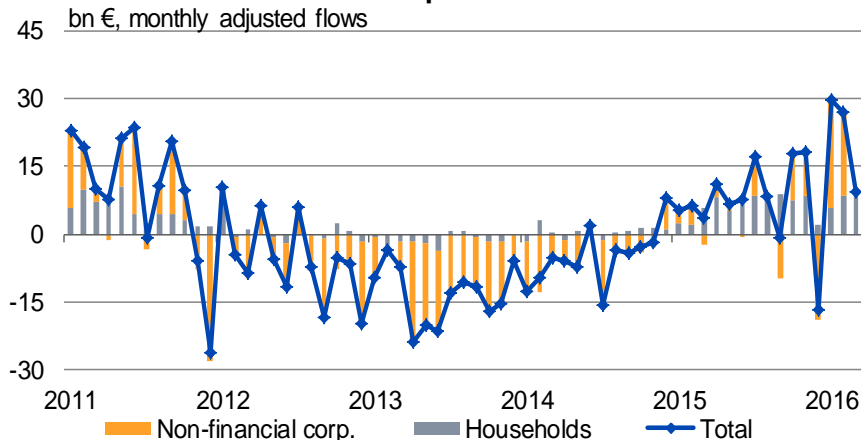
- Employment is improving and reflects better domestic fundamentals—> no deceleration in economic activity, yet no acceleration either
- Latest ECB Bank Lending Survey shows improving loan supply conditions for enterprises but credit standards on loans to households for house purchase tightened
 - results particularly disappointing for Spain and political deadlock could hurt growth more than expected—> June election highly likely, almost at the same time as Brexit referendum

Eurozone - Growth and Confidence



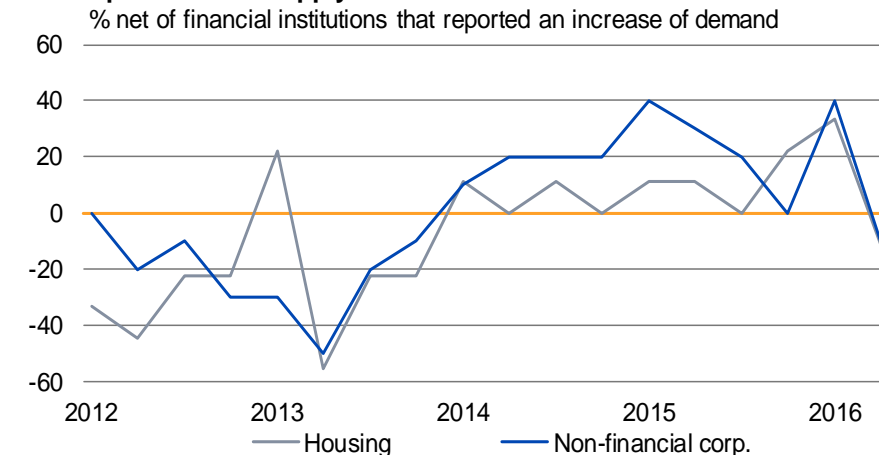
Sources: Datastream, Rothschild

Eurozone - Bank credit to private sector



Sources: Datastream, Rothschild

Spain - Credit supply conditions*



*: does not take into account magnitude of the change

Sources: Datastream, Rothschild