Euler Hermes Economic Research

Weekly Export Risk Outlook

15 June 2017

In the Headlines

FIGURE OF THE WEEK

+5%

Q1 2017 y/y GDP growth in Turkey

U.S.: On course to continue tightening despite weak inflation

The Federal Reserve raised interest rates by 25 basis points to 1% - 1.25%, still low by historical standards. Participants expect one more hike in 2017 and three in 2018. The Fed also released details of its plan to pare the balance sheet which would cut it in half over five years. The inflation outlook for 2017 was marked down sharply with the y/y forecast going from 1.9% to 1.6%, an acknowledgement that inflation measures are trending lower; both the Producer Price Index and the Consumer Price Index (CPI) for May came in lower than expected, driving the y/y rate down on the CPI from 2.2% to 1.9% (it was 2.8% in February). However the Fed's assertion that "Household spending has picked up in recent months…" is contrary to hard data; May retail sales came in much weaker than expected, falling -0.3% m/m, driving the y/y rate down from +4.6% to +3.8%. Core sales were flat as the y/y rate fell from +3.5% to +2.9%. We retain out forecast that the Fed will hike rates in December of 2017, and 2-3 times in 2018, and that GDP will continue its modest pace of +2.2% in 2017.

UK: Coalition building and pragmatism

The Conservatives won 317 seats, 9 seats short of a majority (and -13 seats vs. 2015) in the legislative elections on 8 June. Labour won 262 seats (+30 vs. 2015). Several pain points pushed for a retaliation vote: (i) the strong GBP depreciation of -12% vs. the EUR since the Brexit vote; (ii) the rise in inflation to +2.9% y/y in May 2017; (iii) the fall in real wages since February 2017; and (iv) the rise in business insolvencies (+3.6% y/y in Q1 2017). Any governing coalition, or minority government, should last at least 12 months despite its fragility as it cannot afford to waste time, unless the EU countries agree by unanimity on an extension of the 2-year timeframe of the Brexit process. In the short-term, political uncertainty and noise could trigger an increase in financial volatility and further GBP swings which pose downside risks to our GDP growth forecast of +1.4% for 2017. However, a supportive Bank of England and a possible countercyclical fiscal policy effort (to respond to growing domestic concerns) would offset the cost of uncertainty and will be beneficial for a common voice for negotiations with the EU. In the medium term, a softer Brexit could be an upside risk to our forecasts.

Turkey: Q1 GDP surprises on the upside

Q1 real GDP grew by +5% y/y, beating consensus and our expectations. Unexpectedly strong rises in private consumption and exports were the main triggers for the surprising Q1 gains. Private consumption was up by +5.1% y/y (after +5.7% in Q4) on the back of accelerating credit expansion and strong wage gains, although the strong increase surprised, given the deepening drop in retail sales, at -2.3% in Q1 (after -1.7% in Q4), and ongoing weak consumer confidence (TurkStat's index averaged 66.8 in Q1, vs. 68.8 in Q4 and an average 73.0 since 2011). Public spending re-surged by +9.4% y/y in Q1 after the pause in Q4 (+0.8%) while fixed investment edged up slightly to +2.2% y/y (+2% in Q4). The TRY's slide and new automobile production sent real exports soaring by +10.6% y/y in Q1 (+2.3% in Q4), much faster than leading balance-of-payment data had suggested. In contrast, import growth was weak at +0.8% y/y (+3.3% in Q4) despite booming domestic demand. As a result, net exports added +2.1pp to Q1 growth (-0.3pp in Q4). We have revised up our full-year growth forecasts to +3.7% in 2017 and +3% in 2018.

Emerging Markets: Whenever, wherever growth is returning

Growth is back in Emerging Markets (EM), including in the riskier ones. Our EM aggregate manufacturing PMI shows further evidence that growth is broadening. The aggregate index improved from 51.1 in April to 51.6 in May, back to its March level and being above the 50-threshold (indicating expansion) for nine months in a row. Moreover, the main drivers behind this fresh improvement are now the countries which lagged the overall momentum during the last years. In Brazil, at 52.0, the PMI showed the best figure since February 2013 (just before the Fed tapering announcement). This return of growth in the manufacturing sector is driven by a partial rebalancing (more net savings in the private sector), by a recovery in trade, and by the return of risk appetite in the world economy since last November. Expectations that the Fed may become more dovish added to this risk-taking stance and should help EM to grow further – we currently expect +4.5% in 2018, the best figure since 2013 – but mind regime shifts.

Countries in Focus

Americas

Colombia: Looser monetary policy to support (low) growth

The Central Bank governor, Juan Jose Echavarria, asserted that further cuts in the key policy interest rate are likely as economic growth is disappointing and inflation is decelerating. The key rate has already been reduced by 325bps since September 2016, to 6.25% in May, its lowest level in 13 months. Real GDP grew by just +1.1% y/y (-0.2% q/q) in Q1, the slowest pace since 2009, dragged down by a decline in oil and tourism activities. The production of crude oil has fallen to 120bbl/day in May, from a peak of 130bbl/day in early-2016, while tourism-related activities fell by -0.5% y/y in Q1 as a result of the rise in VAT from 16% to 19% at the beginning of this year. After a peak of +9% y/y in June 2016, consumer price inflation moderated to +4.7% y/y in April, still above the 3% ±1pp inflation target range of the Central Bank. The monetary authorities expect inflation will converge to the central target by 2018.

Europe

Czech Republic: Broad-based rebound of Q1 GDP growth

In Q1 2017, real GDP rose by +1.3% q/q (seasonally adjusted; up from +0.4% in Q4 2016) and +2.9% y/y (calendar adjusted; +1.9% in Q4), driven evenly by both domestic and external demand. Private consumption increased by +2.8% y/y and government consumption by +2.4% y/y. Fixed investment was still down by -0.6% y/y in Q1, however, the improvement from -6.9% y/y in Q4 and -3.9% in full-year 2016 indicates that capital spending is on course of a gradual recovery in 2017 as EU co-financed investment activity should rise under the 2014-2020 programming period. Real exports increased by +5.4% y/y in Q1, outpacing real imports at +3.9% y/y, so that net exports contributed +1.5pp to Q1 growth. We expect full-year GDP growth to pick up from +2.4% in 2016 to +3% in 2017, before slightly easing to +2.8% in 2018. Meanwhile, after three years of near-deflation, inflation is back on track, reaching 2% at end-2016 and averaging 2.3% y/y in January-April 2017.

Africa & Middle East

Oman: Growth forecast to ease further in 2017

The collapse in global oil prices significantly impaired Oman's economy in 2016, with GDP growth losing -1.7pp to +2.5%. Sluggish non-hydrocarbon activity is forecast to further pull down growth to a six-year low of +1.5% in 2017. Mounting fiscal strains will indeed bear a considerable weight on households' purchasing power and corporate earnings, as private consumption is usually a key growth driver. Moreover, the extension of the OPEC deal to limit oil production until March 2018, announced in May 2017, will impede oil-related growth. Meanwhile, the government raised various tax rates and removed a number of tax exemptions in February 2017 in order to cope with the steep contraction in fiscal revenues on the back of the oil price crisis. As a result, we expect the fiscal deficit to improve from -20% of GDP in 2016 to -9% in 2017. Combined with rising energy prices, these fiscal austerity measures are forecast to push up annual average inflation to about 2.5% in 2017 (1.1% in 2016).

Asia Pacific

China: Monetary tightening starts to dent economic growth

Latest activity indicators point to a slower economic momentum. While nominal retail sales proved resilient (stable at +10.7% y/y in May), real industrial production remained below the growth performance recorded in March (+7.6% y/y) with an expansion of +6.5% y/y in May. Fixed asset investment growth decelerated to +8.6% y/y in the first five months of 2017 (from +8.9% y/y in the first four months) with slower growth in private investment (+6.8% y/y). Meanwhile, producer price inflation continued to ease to 5.5%y/y in May (from 6.4% in April). Going forward, the economic growth pace is set to slow gradually from +6.9% y/y in Q1. Credit conditions are becoming less favorable as authorities tightened regulation in order to curb (i) rising corporate debt, (ii) expanding shadow banking activities, and (iii) high property prices. In that context, private investment is set to grow at a limited pace, dragging growth downwards. Real GDP is forecast to increase by +6.7% in 2017.

What to watch

- June 15-16 – Eurogroup/Ecofin meeting on Greece
- June 16 – Croatia May industrial production
- June 16 – Eurozone May CPI (final)
- June 16 – Russia Central Bank meeting
- June 16 – Russia Q1 GDP with production side details
- June 16 – U.S. May housing starts and permits
- June 17 – Singapore May external trade
- June 18 – France legislative election (2nd round)
- June 19 – Russia May industrial production
- June 19 – Ukraine Q1 GDP
- June 19-22 – Brexit negotiations to start
- June 20 – Hungary Central Bank meeting
- June 20 – Poland May industrial production
- June 21 – Lithuania May industrial production
- June 21 – South Africa May CPI
- June 21 – U.S. May existing home sales