Euler Hermes Economic Research

Weekly Export Risk Outlook

14 June 2018

In the Headlines

FIGURE OF THE WEEK

+7.4%

Q1 2018 y/y GDP growth in Turkey

U.S.: Fed raises rates, and could hike 2 more times this year

As expected the Federal Reserve raised the overnight Federal Funds rate by 25 basis points to a range of 1.75%-2%. But what was somewhat less expected was that the Fed now foresees a total of four rate hikes this year vs. previous expectations of only three. The Fed's "dot-plot" which shows the individual members expectations, revealed that the median forecast for the Fed Funds rate by the end of 2018 is now 2.4%, up from the previous 2.1%. The forecast for three rate hikes in 2019 remained unchanged. Economic forecasts were also upgraded, with 2018 GDP going from +2.7% to +2.8%, unemployment going from 3.8% to 3.6%, and core PCE inflation going from +1.9% to +2.0%. There were numerous changes in the statement pointing to strength in the labor market, spending, investment, and the overall economy. In separate reports, inflation also appeared in producer and consumer prices in May. CPI rose from +2.6% y/y to +2.8%, the highest in six years while the core rose +0.1pp to +2.2%. PPI rose from +2.6% y/y to +3.1, the highest in over six years, and in the NFIB survey the percentage of firms raising prices reached a ten-year high.

Eurozone: Pre-commitment to end QE – with some flexibility

In line with our expectations, the ECB announced today the end of its QE program by end-2018 – albeit it retained some flexibility by making the final decision subject to incoming data. After September the pace of monthly purchases will be reduced from 30 to 15 billion euro. Key interest rates are expected to remain at the current level at least throughout the Summer of 2019 in line with our base case of a first rate hike in September of next year, a month before President Mario Draghi completes his eight-year term. The ECB's new round of economic projections confirmed Eurozone growth forecasts at +1.9% and +1.7% for 2019 and 2020, respectively, with the estimate for 2018 cut from +2.4% to +2.1%. Meanwhile the inflation forecasts for the period 2018-2019 were upgraded from 1.4% to 1.7%, driven by higher oil prices, with the 2020 estimate unchanged at 1.7%. Certainly today's announcement came at a convenient moment, with yesterday's message by the Fed to pursue a more aggressive tightening path compared to what markets expected bound to keep a lid on any EUR appreciation.

Turkey: Q1 GDP surges, but sharp slowdown is on the cards

Economic overheating continued in Q1, with real GDP rising by +7.4% y/y. But Q1 growth was unbalanced, driven by strong consumer spending (+11% y/y), fixed investment (+9.7%) and a build-up in inventories (+2pp). Vigorous domestic demand also drove up real imports (+15.6%) while exports grew barely (+0.5%) so that net exports subtracted -4.5pp from Q1 growth. Moreover, the current account deficit continued to widen, posting -USD5.4bn in April, taking the 12-month rolling shortfall to -USD57bn (more than -6.5% of GDP). Crucially, the strong Q1 growth predated the recent financial market turbulence. We expect a sharp slowdown in the coming quarters as a result of the TRY depreciation, rising inflation and tighter financial conditions. The recent drop in the Manufacturing PMI (46.4 in May) and deceleration in industrial output growth (+6.2% y/y in April, after +10% in Q1) underpin our expectation. Last week's 125bp monetary policy rate hike to 17.75% (bringing the cumulative hike to 500bp in the last six weeks) brought only short-term relief – meanwhile the TRY has lost more than the initial gain after that hike. The crucial thing is now what happens to policymaking after the elections on 24 June.

Japan: Positive signs for a pick-up of economic activity in Q2

The second official estimate for Q1 GDP growth was unchanged at -0.2% q/q. Incoming data for Q2, however, support the view that the output contraction was a temporary correction. Industrial production continued to correct the sharp decline at the start of the year in April, picking up +0.5% m/m. All in all, production was +2% above the average level in Q1. Important demand side indicators confirm the turnaround. Above all, the strong April increase in real exports of goods (+5.2% m/m), with imports still weak (-0.7% m/m), suggests that net exports could make a tangible positive contribution to Q2 GDP growth. Private consumption should also overcome its Q1 weakness, as the Cabinet Office's consumption index jumped an impressive +1% m/m in real terms, leaving the April index level 0.8% above the Q1 average. Finally, with a plus of +10.1% m/m, private core machinery orders are on track to meet machinery manufacturers' expectations of a climb of +7.1% q/q in Q2 as a whole (after +3.3% in Q1), which points to a faster expansion in business investment.

Countries in Focus

Americas

Chile: Copper-backed upswing

Chile has been surfing the cyclical momentum since Q4 2017. The election of pro-business candidate and former president Sebastian Piñera triggered a positive sentiment shock in the economy; in May the business confidence index (IMCE) reached its highest level in five years. More importantly, the cyclical rebound (Q1 real GDP grew +1.2% q/q and +5.1% y/y) can be attributed to higher copper prices and the recovery in production from a poor 2017 (after a strike in the country's largest copper mine in Q1 2017). Indeed, 12-month production surged to 5.82mn tons in April 2018 from 5.37mn in June 2017, the highest since December 2015. This benefited Chile's trade balance which reached +USD10bn for the first time since 2012. With this upswing, inflation has begun to converge to the target (+2.5%) again; in May it came in at +2.0% y/y after +1.9% in April and +1.8% in March. The Central Bank is expected to tighten policy rates next year on the back of stronger internal demand.

Europe

Romania: Growth slows but signs of overheating remain

Real GDP growth decelerated to +4% y/y in Q1, down from +6.7% in Q4 and the recent peak of +8.8% in Q3 2017. Domestic demand moderated but remained firm in Q1, with consumer spending up by +5.3% y/y, public spending by +2.4% and fixed investment by +4.8%. External trade activity eased slightly in Q1 as compared to the 2017 average, with exports expanding by +8% y/y and imports by +9.1%, so that net exports subtracted -0.7pp from Q1 growth. Despite the growth slowdown in Q1, clear signs of economic overheating remain in place. Headline inflation continued to rise to 5.4% y/y in May, well above the 2.5% ± 1pp target range of the National Bank of Romania (NBR; the central bank), driven by rapid nominal wage growth (+12.7% y/y in Q1). The NBR has raised its policy interest rate by a cumulative 75bp this year to 2.25 in May. This appears too timid to reduce macro imbalances and facilitate a soft landing of the economy. If policy tightening remains too slowly, imbalances will build up further, requiring a more abrupt tightening later which may result in a hard landing in 2019.

Africa & Middle East

Bahrain: Rebalancing will reduce growth

The economy grew by +3.9% last year, by far the highest rate in the GCC region, even though real GDP growth moderated to +3.4% y/y in Q4 from an average +4.1% in the first three quarters. The slowdown at the end of the year came against the backdrop of an emerging financial crisis – Bahrain reportedly asked Saudi Arabia and the UAE for financial aid in order to replenish its depleted FX reserves. In the wake of low oil prices, Bahrain had posted large fiscal and current account deficits in 2015-2017, on average -17% and -4% of GDP, respectively. With oil prices currently above 70 USD/bbl, the external shortfall is set to wane in 2018 but the fiscal deficit should remain high as Bahrain's fiscal breakeven oil price is estimated at close to 100 USD/bbl. Support from the GCC neighbors is likely to come as needed, however, on the condition of fiscal consolidation. We expect this to curb GDP growth in the short term and forecast +2.4% for 2018.

Asia Pacific

Australia: Strong growth but not broad-based

Economic growth accelerated to +1% q/q in Q1 2018 (from +0.5% in Q4), driven by an increase in private investment (+1.2% q/q) and robust government consumption (+1.6% q/q). However, private consumption was weak (+0.3% q/q) and public investment contracted in Q1 (-2% q/q). Exports advanced by +2.4% q/q in Q1, supported by solid demand from China. Looking ahead, there is room for cautious optimism. PMI figures suggest that business sentiment is still firm: the Manufacturing PMI came in at 57.5 points in May, the Services PMI at 59.0 points. And this is underpinned by an improved corporate financial health: private non-financial corporation's gross operating surplus was up +6% q/q. Pockets of vulnerability stem from the household sector where debt is elevated (the household's debt to income ratio is at 188.6%). In that context, we forecast a modest acceleration of economic growth to +2.7% in 2018 (from +2.2% in 2017).

What to watch

- **June 14 – Russia FIFA Football World Cup**
- June 15 – Croatia May inflation
- June 15 – Kazakhstan May industrial production
- June 15 – Russia monetary policy meeting
- June 15 – U.S. May industrial production
- June 17 – Colombia presidential election, second round
- June 18 – Belarus May industrial production
- June 18 – Singapore May exports
- June 19 – Hungary monetary policy meeting
- June 19 – Poland May industrial production
- June 19 – Ukraine Q1 GDP
- June 19 – U.S. May housing starts and permits

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