Euler Hermes Economic Research

Weekly Export Risk Outlook

20 June 2018

FIGURE OF THE WEEK

8.5%

Eurozone unemployment rate in April

In the Headlines

U.S. and China: Protectionist saber-rattling and impacts

The trade dispute between the U.S. and China recently took another dimension. President Trump asked his administration to consider the case of a 10% tariff on USD200bn worth of products, should the Chinese government retaliate to the first wave of protectionist measures (25% tariff on USD50bn of imports, to be effective on 6 July). The U.S. government is convinced that there is nothing to lose in a trade war with China. In 2017, the U.S. economy registered a USD375bn deficit with China on the basis of USD130bn of exports being more than offset by USD506bn of imports. These numbers suggest that China could not even match the U.S. total nominal amount of targeted imports. However, looking at past strategies of the Chinese government, options to retaliate are diverse: implementing non-tariff measures (environmental, technical norms for safety and nationals security reasons, red tape), limiting U.S. FDI, tightening the procurement policy, restricting the access to China's markets for U.S. financial institutions, developing third party sanctions on countries producing in the U.S., boycotting U.S. brands in the consumer market, reducing U.S. Treasuries purchases.

We still consider that a scenario of a trade war will be avoided but the probability of an intermediate situation characterized by a significant blow to global trade and growth has now increased. Whatever the conclusion of ongoing transactions, President Trump's era has already produced radical changes, as mirrored by the significant progress of the EU in promoting further integration (banking union, Euro-zone budget, military cooperation) or recent improvements in the economic dialogue between China and Japan. Trade diversion and defensive coordination are now at work everywhere in the world.

Eurozone: Towards higher purchasing power for consumers

The unemployment rate fell to 8.5% in April, the lowest level since 2009, and should continue to fall to 7.9% at end-2019. Moreover, firms' employment intentions reached their highest level since 2007 in all sectors. Job vacancies continued to rise and reached 2.1% in Q1 2018, the highest level since the 2000s, with higher tensions in the services sector (2.4%). The ongoing labor market recovery is benefit-ing wage growth: nominal labor costs rose +2% y/y in Q1 (+1.6% on average in 2017). Meanwhile, inflation is expected to peak in early summer at +2.2% as base effects from expected lower oil prices will bring it to +1.7% on average in 2018 and 2019. Hence, real purchasing power growth should stay positive which together with strong confidence and still accommodative financing conditions (until H2 2019) should remain supportive for investment and consumer spending. We expect the latter to edge up from +1.6% in 2018 to +1.7% in 2019. While more expansionary fiscal policy will support domestic demand, slower external demand should reduce GDP growth to +1.9% in 2019 from +2.1% in 2018.

Ukraine: Gradual growth recovery set to continue

Real GDP grew by +3.1% y/y in Q1, up from +2.2% y/y in Q4 and +2.5% in 2017 as a whole. Fixed investment was the main growth driver in Q1, surging by +17% y/y (only slightly below the average +18.2% in 2017). Consumer spending rose by a robust +5.6% y/y in Q1, though this was down from +7.8% in full-year 2017. In contrast, public spending declined by -1.4% y/y in Q1 (+3.3% in 2017). External trade activity weakened sharply in Q1, with exports contracting by -9.9% y/y (+3.5% in 2017) and imports by -5.4% (+12.2% in 2017). Euler Hermes projects full-year GDP growth of +2.8% in 2018. Meanwhile, CPI inflation fell to 11.7% y/y in May (from 13.1% in April), supported by a moderate recovery in the exchange rate: the UAH has gained +6% against the USD in 2018 YTD.

Russia: Early indicators point to uptick in growth in Q2

Second official estimates confirmed that the economy grew by +1.3% y/y in Q1, up from +0.9% in Q4 2017. Production-side details indicate a modest recovery in industrial activity in Q1, with manufacturing up by +1.9% (from -2.8% in Q4), mining +0.7% (from -0.9%), energy +2.1% (from -4.1%) and utilities +0.2% (from -1.8%). In contrast, construction (-5.1%) and agriculture (-0.1%) contracted in Q1, while most services sectors showed a robust performance. Meanwhile, monthly activity data suggest a further strengthening of the economy in Q2. In April-May, industrial production growth picked up to an average +3.8% y/y, driven by strong manufacturing output (+5.4%), retail sales were up by +2.6%, construction by +3.5% and agriculture by +2.4%. Euler Hermes forecasts full-year GDP growth of +1.8% in both 2018 and 2019.

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Countries in Focus

Americas

Colombia: Befriending markets

Last Sunday, Iván Duque (right-wing, 54% of the vote) beat Gustavo Petro (left-wing, 42%) in the run-off at the presidential election. The victory of the market-friendly Duque – who will be sworn in for a four-year mandate on 7 August – is yet another positive sign for the economy (see also [WERO 30 May 2018](#)). Colombia is one of a few major emerging markets whose currency has appreciated in 2018 year to date (+2.2%). This has been facilitated by oil price developments which are encouraging for Colombian oil exports that account for one third of total exports. It should also support the country's ongoing fiscal consolidation. Yet Duque's challenges are numerous: dealing with the Venezuelan migrant crisis, restoring state capacity in power vacuum areas left by the FARC after the peace deal, curbing cocaine production and attracting investment while diversifying the economy.

Europe

Hungary: Too loose monetary policy poses risk of overheating

Q1 real GDP rose by +4.4% y/y, the same pace as in Q4 2017, driven by strong domestic demand. Consumer spending was up by +5.1% y/y in Q1, public spending +4.6% and fixed investment +17.1%, though a reduction in inventories subtracted -2.3pp from growth. External trade activity weakened overall and made a neutral contribution to Q1 growth, with exports up by +3.5% y/y and imports +3.8%. Strong consumer spending has been fueled by falling unemployment (3.8% in April) and rapid nominal wage growth (+12.4% y/y in Q1). However, the latter combined with higher oil prices has pushed up CPI inflation to a 15-month high of 2.8% y/y in May, and we expect it to rise further in the coming months. Nonetheless, the Monetary Council kept its key policy interest rate (3-month deposit rate; +0.9%) and the overnight deposit rate (-0.15%) again unchanged this week. However, markets appear to have realized the emerging overheating risk: the HUF has fallen by -3.4% against the EUR since end-April, more than any other currency in Central Europe. We expect monetary tightening to come in early-2019, at the latest.

Africa & Middle East

Zambia: Moment of truth approaching?

The government of Zambia signaled last week that new debt issuance would be postponed indefinitely, in order to reach a financing agreement with the IMF. Zambia repeatedly did not qualify for an IMF loan on a fundamental precondition, data transparency. The current debt level is the key issue. Officially, public debt should reach 66% of GDP in 2018, a major increase from 27% in 2013. Despite that, the hidden debt debate has not really faded since then. In Zambia, independent estimates show that public debt may be +20pp higher, at 86% of GDP (less than Mozambique in 2016 and Congo Republic in 2017 where the revisions were by +50pp), including bilateral debt to China in the ratio. Some of this debt was originated by SOEs, but since there is a state guarantee this debt should be considered as public. Overall, we do not see this issue as a major risk to our current growth forecast (+4.5% in 2018) but a debt rescheduling would help to free up more growth potential in the medium-run.

Asia Pacific

China: Signs of a gradual deceleration are building up

After broadly stable activity figures from January to April, signs of a deceleration have emerged. Firstly, nominal urban investment growth moderated to +6.1% y/y in January-May (from +7% in January-April) as capital expenditure expanded less in both the primary and tertiary sectors. The weaker performance was mainly driven by slower growth in public investment. Secondly, industrial production growth slowed to +6.8% y/y in May 2018 (from +7% in April). Thirdly, retail sales growth weakened to +8.5% y/y in May 2018 (from +9.4% in April). These figures indicate that economic growth in Q2 is heading for +6.6% to +6.7% (after +6.8% in Q1). Going forward, there is further room for deceleration due to a tightening of financing conditions and increased trade tensions with the U.S. Overall, we expect growth to decelerate to +6.6% in 2018 (from +6.9% in 2017).

What to watch

- June 21 – France June business confidence
- June 21 – Turkey June consumer confidence
- June 21 – Mexico monetary policy meeting
- June 22 – Colombia April economic activity
- June 22 – Mexico April economic activity
- June 23 – Poland May retail sales
- June 23 – Poland June business confidence
- June 24 – Turkey presidential and legislative elections
- June 25 – Germany June Ifo Business Climate Index
- June 25 – Turkey June business confidence
- June 27 – China May industrial profits
- June 27 – France June consumer confidence
- June 27 – Ghana Q1 GDP
- June 27 – Czech Republic monetary policy meeting
- June 27 – Ukraine May industrial production

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