Euler Hermes Economic Research

Weekly Export Risk Outlook

9 May 2018

FIGURE OF THE WEEK

-19%

Depreciation of Argentine peso in 2018 YTD

In the Headlines

Argentina: Under intense pressure

After spending more than 10% of its FX reserves to defend the ARS, then hiking interest rates three times in a few days, the Central Bank held its policy rate at 40.25% yesterday (up from 27.25% two weeks ago). Yet the ARS continued depreciating and is now -19% down against the USD (YTD). The recent sell-off can be explained by three combined factors: (i) the rise in U.S. yields and strengthening USD, redirecting flows towards the U.S.; (ii) Argentina's distinct vulnerability: a current account deficit at a record high (-5.8% of GDP), still high inflation (+25%) and fiscal deficit, and a large share of FX-denominated public debt (around 65% of the total); (iii) two policy mistakes: relaxing inflation targets and cutting rates unexpectedly earlier this year. The last interest rate hike and a commitment to cut the primary fiscal deficit to -2.7% of GDP (instead of -3.2%) temporarily stabilized the peso. A delegation meets IMF staff today to negotiate a USD30bn credit line; it could help restore confidence, but would impose further constraints on policymaking. A decrease in volatility is conditional on the disclosure of the nature of the credit line. Further fiscal consolidation could also adversely affect growth.

Turkey: Sliding

A range of weak data and bad news has hit Turkey since the start of the month. The Manufacturing PMI dropped to 48.9 points in April (from 51.8 in March and a still very strong 55.6 in February), indicating a slowdown of economic activity in the months to come. After having eased since end-2017, inflation increased again in April, with the headline figure up to 10.9% y/y (10.2% in March) and core inflation up to 12.2% y/y (11.3% in March). Moreover, S&P cut Turkey's long-term sovereign rating deeper into "junk" (to BB- from BB). Combined with the recent strength of the USD, and despite further monetary tightening this week through revised reserve requirements, these bad news sent the TRY to a record low of 4.37 against the USD this morning (down -8% since the start of May and -16% YTD). Later today the TRY recovered the losses and surged to 4.28 per USD in the afternoon on speculation that policymakers will act to support the currency, as President Erdogan was said to have called a meeting with economic heavyweights to discuss the issue. Whatever the outcome, we expect trading in the TRY as well as the exchange rate to remain volatile in the next weeks.

France: Landing

Manufacturing production contracted by -1.8% q/q in Q1 2018. It comes after steady increases in 2017: +2.9% in the year as a whole and +1.1% q/q in Q3 and +1.9% in Q4. But demand did not follow this upward trend in production. Private consumption grew by just +0.2% q/q in Q1, unchanged from Q4, and there was no bonanza in exports (-0.1% in Q1, after +2.5% in Q4). Two weak performances were particularly noticeable, the automotive sector and the construction sector (-3% and -3.7%, respectively). In these two highly cyclical sectors, the bubble of optimism was particularly pervasive in H2 2017; as a result inventories decreased in Q1. Bad weather added to the downturn, but policy took also its toll with a scarcening base of beneficiaries from policy support instruments (zero interest rate loans, Pinel Law on rental investment). There are some signs that the activity should recover in Q2: the expected production component of business confidence surveys is up, and the investment survey showed that corporates intend to increase their investment by +5% (in nominal terms) in 2018.

Emerging Markets: This oil price that hurts

Latest PMI figures showed the need for selectivity in Emerging Markets (EM). The higher oil price is already having some impact. Our aggregate EM Manufacturing PMI eased to 51.7 points in April from 51.8 in March and a peak of 52.2 in November. The main deterioration came from oil importers as the benchmark Brent price is currently approaching USD75/bbl. Our aggregate EM PMI for oil importers (including e.g. India, Poland, Turkey, South Africa) deteriorated the most, from 54.0 in December to 51.6 in April. It had an impact on exchange rates since higher import prices imply more imported inflation. Major exchange rates consequences were visible in Turkey and in South Africa with depreciations above -5% during the last month. Otherwise, strength in East Asia was the other main trend. The aggregate PMI of the region (excluding China) increased to 52.3 in April from 51.8 in March and reached its best level since April 2011. The strength of Chinese imports during the beginning of the year was supportive.

Countries in Focus

Americas

U.S.: Employment report mixed, but Fed notes inflation

The April employment report disappointed with job growth of only +164k vs. expectations of +175-200k. But some details were positive, including a +30k upward revision to the prior two months and widespread gains in almost all industries. Job growth so far in 2018 has averaged a very strong +200k. The unemployment rate fell from 4.1% to 3.9%, the lowest in 17 years, but part of the decline was due to the second straight drop in the labor force. Perhaps most importantly, wages again refused to budge, gaining only +0.1% m/m and putting the y/y rate to +2.6% for the third consecutive month. However inflation has appeared in other measures recently, such as oil and gasoline rising +15% YTD, steel rising +35% YTD, and core PCE inflation jumping from +1.6% y/y to +1.9% last month. The Fed has taken notice, and last week changed its policy language from reading that "inflation continued to run below 2 percent" to reading that inflation "moved close to 2 percent". The shift temporarily raised market odds of three more hikes this year to nearly 50%.

Europe

Germany: Growth likely to have decelerated in Q1

The latest data on production and foreign trade paint a mixed picture. In March, output in industry recorded a seasonally adjusted increase of +1% compared to February. In the first quarter of 2018, output thus stagnated compared with the preceding quarter. Overall, the German economy is expected to have grown significantly less in the first quarter than in previous quarters. We expect GDP growth of +0.3% q/q, after an increase of +0.7% in the third quarter and +0.6% in the fourth quarter of 2017. Only limited growth impulses are likely to have come from net exports. Both exports and imports increased by close to +3% y/y in the first quarter. German exports developed very differently from region to region. While exports to the Eurozone grew strongly by almost +7%, exports to third countries even recorded a slight decline of -0.3% – an indication that Europe is currently doing quite well compared to the rest of the world from an economic point of view.

Africa & Middle East

Kenya: Turn it on again

Growth decelerated to +4.9% in 2017. Poor agriculture output growth (+1.6%) was the main drag (low rains), but the noisy electoral process also took its toll on manufacturing activity. Financial sector activity (+3% in 2017) weakened as well, impacted by the cap on interest rates. Overall, the growth momentum improved at the end of the year, as Q3 was the weakest quarter (+0.8% q/q) and Q4 showed some acceleration (+1.3%). Inflation steadily decreased from 11.7% y/y in May 2017 to 4.2% in March 2018 (5-year low) and should decline further. The exchange rate pressure eased, as the KES has appreciated by +3% since the start of the year. In our view, GDP growth should accelerate to +6.5% in 2018, based on four assumptions: agriculture output recovery (+5% is expected), monetary policy easing (-50bps already implemented in March, to +9.5%), export growth (+10%) and a better business climate in Kenya (the Manufacturing PMI hit its best level in the last two years, at 56.4 in April).

Asia Pacific

Indonesia: One swallow does not make a summer

Real GDP growth eased to +5.1% y/y in Q1 2018 (from +5.2% in Q4 2017). External trade underperformed due to a stronger rise in imports (+12.7% y/y) than exports (+6.2 y/y). Private consumption growth was almost stable (+4.9% y/y after +5% in Q4 2017) and government consumption growth decelerated (to +2.7% y/y, from +3.8%). The good news is that investment continued to accelerate (+7.9% y/y in Q1, from +7.3% in Q4). Advanced indicators suggest a positive momentum going forward. Loan growth gained some traction in March (+8.5% y/y, after +8.2% in February). Consumer confidence rose to 122.2 points in April (from 121.6 in March). The manufacturing PMI rose to 51.6 in April (from 50.7 in May). Against this background, we expect economic growth to gain some traction in 2018 and reach +5.3% in the year as a whole (after +5.1% in 2017).

What to watch

- May 10 – Brazil April inflation rate
- May 10 – U.S. April consumer prices
- May 11 – Brazil March retail sales
- May 11 – Canada April employment report
- May 11 – Hong Kong Q1 GDP growth
- May 11 – Mexico March industrial production
- May 15 – Argentina April inflation rate
- May 15 – Portugal Q1 GDP growth (prel. estimate)
- May 15 – U.S. April retail sales
- May 16 – Brazil interest rate decision

View all Euler Hermes Economic Research online
http://www.eulerhermes.com/economic-research

Contact Euler Hermes Economic Research Team
research@eulerhermes.com

Publication Director
Ludovic Subran, Chief Economist
ludovic.subran@eulerhermes.com