Euler Hermes Economic Research

Weekly Export Risk Outlook

11 January 2017

FIGURE OF THE WEEK

USD54

Barrel price of benchmark Brent crude oil (+74% y/y)

In the Headlines

U.S.: Wage pressures, rising business confidence

The economy gained +156,000 jobs in December, somewhat below expectations of +175,000. Wages rose +0.4% m/m, driving the y/y rate from +2.5% to +2.9%, the highest in over 7.5 years, helping the Fed hawks argue for faster rate increases. However, Euler Hermes expects 2-3 hikes this year. Manufacturing gained +17,000 jobs, the first increase in five months, confirming strength in the ISM manufacturing report. And the labor force gained +184,000 workers, pushing the labor force participation rate up from 62.6% to 62.7%, and the unemployment rate up from 4.6% to 4.7%. Businesses confidence has soared since the election in November. The NFIB Small Business Optimism survey rose 7.3 points, a record amount, to the highest level since December 2004. The percentage of firms saying now is a good time to expand rose by +12.2%, another record, to the highest level in 11.5 years. And the net percentage of firms expecting the economy to improve in the next six months rose +37.4%, another record, to the highest level since March 2002. The report strongly suggests forthcoming increases in business activity.

UK: Resilient until end-2016. Slowdown in 2017 expected

Manufacturing production increased by +1.2% y/y in November with the pharmaceutical sector, rubber and plastic, machinery and transport equipment being the top contributors. The trade balance widened to GBP4.2bn in November. Imports of goods from both EU and non-EU countries have risen for semi-manufactured and finished goods while exports have increased only modestly. The partial recovery of the GBP in November (+3%) after the -16% fall since the start of 2016 is likely to have supported import growth. Overall, we expect Q4 GDP to increase by +0.4% q/q which will bring full-year GDP growth to +2% in 2016. However, we expect a slowdown of activity going forward as suggested by the household situation: (i) real disposable income fell by -0.6% q/q in Q3 2016 for the first time since March 2014 on the back of higher inflation and slower wage growth; (ii) the savings rate reached a new record low since 2008 (5.6%). Higher uncertainty has already had an impact on incoming new investment while the GBP depreciation has increased the gap between input and output prices which weighs on firms' profitability. Euler Hermes expects GDP growth to fall to +0.9% in 2017.

China: New year, new resolutions?

Latest activity indicators have sent encouraging signals. Both the Caixin manufacturing (51.9) and services (53.4) PMIs pointed to an expansion of activity and a rise in new orders in December. The efforts of the authorities to pull the industry out of deflation are also bearing fruits. Producer prices accelerated for the fourth consecutive month in December, at a strong +5.5% y/y. Consumer price inflation posted a solid +2.1% y/y. Against this backdrop, Q4 GDP growth and thus full-year 2016 growth (forecast at +6.7%) are likely to remain within the government growth target range (+6.5% to +7%) reflecting resilience to domestic (stock market crash in early 2016) and global (e.g. Brexit) turbulences. In 2017, Euler Hermes expects GDP growth to slow to +6.2% due to a modest trade performance, limited private investment growth and more cautious monetary policy. Authorities are set to lower growth expectations (to +6% ± 0.5pp in 2017) and focus more on growth quality. Containing credit risks, managing currency volatility and finding new trade drivers will be among the top policy priorities.

Emerging Markets: TRY and MXN in the spotlight

Exchange rates in Emerging Markets were hit last November by reflationary bets in the World Economy but have now recovered to their former level as global conditions have remained quite favorable (rising commodity prices and improving global activity; see also WERO 15 December 2016). This is true even for some countries stuck in recession (Brazil) or in very-low-growth mode (South Africa) where financial vulnerability has declined after a strong rebalancing (external deficits are narrowing). However, there are two outliers, where external deficits are on the rise, namely Mexico and Turkey, where the policy mix has been pro-cyclical. As economic imbalances are growing, the currencies are still depreciating. That means that financial markets are asking for some additional tightening in these countries. The TRY and the MXN have depreciated by -21% and -17%, respectively, against the USD since the beginning of November. Despite some monetary tightening in the meantime (e.g. +275 bps in Mexico) these two economies are still vulnerable to policy nudges.

Countries in Focus

Americas

Argentina: A decisive year

President Macri will be playing for high stakes in 2017. In politics, he will seek majority in Congress in the legislative elections in October. Disagreements over economic policy led the President to request the resignation of the Finance Minister and split the Department into two distinct Finance and Treasury Ministries. Confidence in the Government remains resilient despite the impact of the corrective measures that deepened the recession and postponed the recovery of the economy. The recession showed signs of bottoming out in Q3 as the fall in real GDP moderated to -0.2% q/q and -3.5% y/y. Investment plunged -6.5% y/y so far this year and has been the worst performing component, together with private consumption which contracted by -0.8%. In November, the deceleration in regulated and seasonal prices enabled inflation to continue its downward trend to 1.9% m/m and 41.5% y/y. The moderation in prices prompted consumer confidence to rise +1.2% m/m in December.

Europe

Russia: Recession eases – return to moderate growth in 2017

Second official estimates confirmed that the economy contracted by -0.4% y/y in Q3, the seventh consecutive quarter of decline, after -0.6% in Q2 and -1.2% in Q1. Rosstat also published the demand side breakdown, showing that the decline in consumer spending moderated to -3.1% y/y in Q3 (-5.2% in Q2) while the decrease in public spending stabilized at -1.1% y/y. Gross capital formation dropped by -4.8% y/y in Q3 (after a +5.7% rise in Q2) reflecting a negative contribution of -1pp by inventories (+1.9pps in Q2) while the decline in fixed investment eased to -0.5% y/y (-4.3% in Q2). Net exports mitigated the overall contraction of Q3 GDP, making a positive contribution of +2.6pps as real exports grew by +6.9% y/y (flat in Q2) while imports fell by -3% y/y (-6.7% in Q2). Early indicators for Q4 indicate that the recession may end soon. EH expects moderate growth of real GDP by about +1% in full-year 2017 (after -0.6% in 2016) on the back of recovering investment and consumer spending.

Africa & Middle East

Kenya: Resilience will be tested in 2017

Q3 2016 GDP expanded by +5.7% y/y, down from +6% y/y in Q3 2015. The manufacturing sector's performance was especially disappointing, with growth decelerating to +1.9% y/y compared with +3.3% a year earlier. Meanwhile, a decline of growth in the financial sector from +10.3% y/y in Q3 2015 to +6.1% in Q3 2016 confirms that private sector credit growth has been slowing due to the newly introduced interest rate cap on banks, which has led banks to shy away from certain sectors (see also WERO 31 August 2016). For 2016 and 2017, growth is forecast at +6% and +6.5%, respectively, driven by a steady expansion of exports, services and construction. Kenya's import cover remains fairly comfortable at five months, and a two-year USD1.5bn precautionary facility by the IMF will provide a further buffer to external shocks. Downside risks to the growth outlook include foreign demand (sluggish world trade) and uncertainties around the upcoming presidential elections.

Asia Pacific

India: Growing at a slower pace

The economy is struggling after the demonetization initiative. Infrastructure output growth decelerated to +4.9% y/y in December (from +6.6% in November). Business sentiment deteriorated in December: The manufacturing PMI fell to 49.6 (from 52.3 in November) i.e. below the 50.0 mark which indicates activity in the sector is declining. And the services PMI, at 46.8, continued to signal a contraction of activity. In that context, growth is likely to decelerate in the short run, hindered by cash shortage and weak private sentiment. In the longer term, the magnitude of the rebound will depend on the ability and the willingness of the authorities to boost growth and confidence. The demonetization move should help strengthen macro-policy buffers as the intended shift of activity from the informal to the formal sector should result in higher bank deposit growth and higher fiscal revenues. GDP growth is forecast to recover gradually to +7.5% in FY2017-18 from below trend growth of +7.2% in FY2016-17.

What to watch

- January 12 – Brazil monetary policy decision
- January 12 – France December CPI
- January 12 – Germany 2016 GDP growth (1st est.)
- January 12 – Romania November industrial output
- January 13 – Poland and Spain December CPI
- January 13 – U.S. December consumer sentiment
- January 13 – U.S. December producer prices
- January 13 – U.S. December retail sales
- January 17 – Germany January ZEW survey
- January 17 – Russia Q4 current account balance
- January 17 – UK December CPI, PPI, RPI
- January 18 – Canada monetary policy decision
- January 18 – Colombia November industrial production
- January 18 – Eurozone, Germany December CPI
- January 18 – Russia Q4 consumer confidence

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