Euler Hermes Economic Research

Weekly Export Risk Outlook

11 April 2018

FIGURE OF THE WEEK

+2.7%

US's March wage growth y/y

In the Headlines

China: A conciliatory speech

On April 10th, President Xi Jinping delivered a keynote speech at the Boao forum for Asia, an annual conference considered to be the "Asian Davos". Amid deteriorating relations with the US, the Chinese leader reiterated plans to open China further. Firstly, he announced that China will open further its financial and manufacturing sectors to foreign investors. This includes the removal of foreign ownership limit on banks, relaxed rules for foreign companies investing in local securities ventures, in insurance and in the manufacturing sector. Secondly, the authorities plan to improve legal intellectual property protection for overseas companies with the restructuration of the State Intellectual Property Office. Thirdly, China will step up measures to support imports by slashing tariffs for consumer related goods such as vehicles. Overall, nothing was really new as most of these measures were already announced last year, and reiterated at this year National People's Congress. Yet, the conciliatory tone of the Chinese president helps ease fears of a trade war for now.

"Food" for thought: Is the trend decline over?

Growth is gradually accelerating in the world economy. World growth is expected to reach +3.3% in 2018, after +3.2% in 2017. And demand for food should follow suit. Is it enough to balance supply and demand? During the last years, a number of food commodities were hit by oversupply and hence saw their prices go down, which in turn reduced inflationary pressures in the world economy. In 2018, worldwide CPI inflation should not particularly accelerate (+2.5%). Increasing food prices would create upward risks to this scenario and help commodity exporters. Are we about to observe more food inflation? Not sure, but grain prices increased a bit in Q1 (up +6% from Q4), after reaching their historical trough in November 2017. Overall, food prices are still much lower than 5 years ago, as they decreased by about -50%. So, inflation is not a risk in the short-run. However, even a little more inflation could cut household purchasing power in the short-run since wage growth is significantly lower today compared to the last decade.

US: Jobs disappoint but the outlook remains solid

The March employment report disappointed with job gains of only +103k vs. expectations of +175k. The miss was due in part to a payback for the very strong +326k in February, and in part to unusually high snowfalls which were confirmed by the first loss of construction jobs in eight months. Manufacturing gained +22k, the sixth straight big increase, and the 16th in the last 17 months. The unemployment rate remained unchanged at 4.1% and wages ticked up +0.1% to +2.7% y/y. In other news, both ISM indexes slipped a bit but remained solidly in expansionary territory. Producer prices rose more than expected in March, from +2.8% y/y to +3.0%, while the core rate rose from +2.5% to +2.7%. Metals tariffs contributed to the price increases as steel mill products rose +1.9% m/m and steel scrap gained +4.3% m/m. The trade deficit widened from -$56.7B to -$57.6B, which will contribute to a soft Q1. However we maintain our forecast of +2.9% GDP growth for 2018.

United Kingdom: Lowest trade deficit in 6 years

On an annual basis, the February trade deficit stood at its lowest level since March 2012 (-GBP27.5bn) thanks to the strengthening of the services surplus (+GBP108.3bn). The goods deficit stood at –GBP135.8bn, broadly stable compared to 2017. The goods trade deficit with the EU stood at a high –GBP108.8bn on an annual basis from –GBP108.1bn at end-2017. Going forward, new export orders suggest a slight acceleration in external demand in the coming months (index at 55.2 in Q1 2017 in the manufacturing sector vs 54.7 on average in 2017). We expect global trade growth (+4.4% in volume terms) to continue to support UK exports (+3.1% expected real growth from +5.7% in 2017). Import growth is expected to remain broadly stable (+3.1% expected real growth from +3.2% in 2017) as the slowdown in domestic demand excluding stocks should remain smooth (+1.6% from +2.0% in 2017) while the sterling should remain broadly stable in real effective exchange rate terms (+0.8% YTD in March 2018).

EULER HERMES
Our knowledge serving your success

Countries in Focus

Americas

Brazil: Low inflation, but political risk is back

The light remains green for the Brazilian consumer. In March, inflation came in lower than market expectations (+0.09% compared to February against a consensus at +0.12%). Compared to a year earlier, it slowed down to +2.68% y/y from +2.84% in February. It remains below target (+4.5% +/- 1.5pps). As a consequence of the prolonged decrease in inflation since the fall of 2016, the central bank was able to cut its policy rate (SELIC) twelve times to support the recovery; it now stands a record low of 6.5%. Recent CPI data hence pushes for an additional cut at the central bank's next meeting in May. Yet, the (returning) cloud in the horizon is political risk: after cheering in January following Lula's upheld conviction, markets are now pricing in heightened uncertainty ahead of the October presidential elections; the Brazilian real depreciated to its lowest level since December 2016 (BRL/USD 3.42). The central bank could put off a rate cut to avoid further weakening of the currency.

Europe

Italy: Upswing starting to lose steam

Italian industrial output declined in February for the second consecutive month. Production declined by -0.5% compared to the previous month after a sharp -1.8% drop in January. On an annual basis Italian industrial output now registers at +2.5% – the smallest increase since April last year. In our view recent setbacks in economic sentiment and activity indicators do not constitute the beginning of the end of the current economic upswing. With economic momentum still proving very strong we interpret the current soft-patch as a gradually unfolding normalization of recent above-potential growth rates. Hence we continue to stick to our forecast for the Italian economy of +1.4% and +1.2% growth in 2018 and 2019 respectively. That the upswing in Italy is showing signs of cooling makes a swift solution to Italy's political impasse and broad agreement to a growth boosting reform agenda all the more urgent.

Africa & Middle East

Senegal: A simple plan that works

Senegal posted in 2017 its fastest GDP growth rate since 1999 at +7%. For the third consecutive year, growth hovered around 6.5-7%. This growth cycle coincides with the Emerging Senegal Plan, launched in 2014 and designed to prioritize the needs associated with urbanization. It consists of 5-year plans with a final target in 2035. As urbanization is the overarching goal, the construction sector was among the key winners (+11.2% growth in 2017). Health and education, the key priority of the current 5-year plan (10% of GDP) also grew by +9.7%. Overall, this growth is quite sustainable. Domestic credit growth was estimated at +9.5% in 2017 by the IMF, about the nominal growth rate of the economy. Moreover, inflation pressures should stay muted (we expect +1.5% for 2018), and the fiscal deficit is gradually diminishing (-3.5% of GDP in 2018). Investment and the reform momentum should hold the line in 2018. As a result, GDP growth is expected to accelerate further, to +7.2%.

Asia Pacific

Philippines: Ready to tighten monetary policy

The economy continues to show signs of strength. Industrial production rose by +23.6% y/y in February (after +17.2% y/y in January). Business sentiment is still well oriented. The manufacturing PMI rose to 51.5 in March (from 50.8 in February) driven by a rise in output and new orders. Consumer inflation accelerated to +4.3% y/y in March (from +3.8% in February), above the central bank inflation target of +2% to +4%. Going forward, there is room for continued optimism. The economy benefits from a strong growth in domestic demand fueled by a solid growth in private consumption, investment and a supportive fiscal policy. The government intends to increase infrastructure spending as part of the "Build, Build, Build" program to 7.2% GDP in 2022 (from 4.5% in 2016). Against this background, we expect inflation to increase to +4% in 2018. We pencil in an interest rate hike of 25bps to 3.25% in 2018.

What to watch

- April 12 – ECB March meeting minutes
- April 12 – Bank of England Q1 Lending Conditions
- April 12 – Brazil February retail sales
- April 12 – Mexico interest rate decision
- April 13 – Eurozone February balance for February
- April 13 – China March trade figures
- April 13 – Singapore Q1 GDP preliminary estimate
- April 16 – US April retail sales
- April 16 – Brazil February economic activity index
- April 17 – US April housing starts, industrial production
- April 18 – UK March inflation
- April 18 – Bank of Canada policy announcement
- April 18 – South Africa March inflation
- April 18 – South Africa February retail sales

DISCLAIMER
These assessments are, as always, subject to the disclaimer provided below.
This material is published by Euler Hermes SA, a Company of Allianz, for information purposes only and should not be regarded as providing any specific advice. Recipients should make their own independent evaluation of this information and no action should be taken, solely relying on it. This material should not be reproduced or disclosed without our consent. It is not intended for distribution in any jurisdiction in which this would be prohibited. Whilst this information is believed to be reliable, it has not been independently verified by Euler Hermes and Euler Hermes makes no representation or warranty (express or implied) of any kind, as regards the accuracy or completeness of this information, nor does it accept any responsibility or liability for any loss or damage arising in any way from any use made of or reliance placed on, this information. Unless otherwise stated, any views, forecasts, or estimates are solely those of the Euler Hermes Economics Department, as of this date and are subject to change without notice. Euler Hermes SA is authorized and regulated by the Financial Markets Authority of France.
© Copyright 2018 Euler Hermes. All rights reserved.

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