Euler Hermes Economic Research

Weekly Export Risk Outlook

2 March 2016

FIGURE OF THE WEEK

USD37

Barrel price of benchmark Brent crude oil (-38% y/y)

In the Headlines

China: Easy does it

The official manufacturing PMI in February was down to 49.0 (49.4 in January) with a broad-based deterioration and the non-manufacturing PMI declined to 52.7 (53.5). The Markit/Caixin manufacturing PMI confirmed this trend, registering 48 (from 48.4). The PBoC lowered its Reserve Requirement Ratio (RRR) by -0.5bps to 17% for the largest lenders. This cut, the first since October 2015, is intended to boost liquidity by USD100bn, thereby stimulating economic activity. Going forward, we believe the government will increase its support, being more aggressive in relation to fiscal assistance and providing gradual help on the monetary front. Further pro-growth measures will be unveiled at the next top legislature meeting, particularly on the fiscal side, with further tax cuts for companies and increased spending on infrastructure and social welfare. The projected fiscal deficit will be increased to around -3.5% of GDP (the target last year was -2.3%). Accommodative monetary policies will be maintained, with scope for further interest rate cuts (-50bps for the policy rate and -50bps for the RRR). However, to limit potential financial volatility, policy adjustments are likely to be more gradual than during last year.

Sweden: Growth in 2015 the highest in five years

GDP increased by +1.3% q/q in Q4 2015, above expectations. Growth was mainly driven by domestic demand (+0.9pps) with net exports contributing +0.4pps. While private consumption continued to be dynamic (+0.9% q/q after +0.6% in Q3), government spending picked up (+0.9% q/q/ compared with +0.3% q/q in the previous quarter) mainly as a result of the inflow of migrants. Investment growth (mainly in equipment) also accelerated in Q4 2015, to +2.3% q/q from +1.5% in Q3. The Q4 data put the 2015 growth rate at +3.8%, one of the highest rates in the EU-28, which is the strongest pace in five years. Meanwhile, unemployment decreased to 7%, gradually easing back to pre-crisis levels. Going forward, we expect growth will slow to +3% in 2016 (below the long-term average of +3.3%) and to +2.5% in 2017, with consumer spending the main contributor to expansion. Inflation returned to positive territory in September and the Central Bank reinforced its very dovish stance by further lowering its deposit rate in February (-15bps to -0.5%).

U.S.: Welcome strength

Recent data are mostly positive. Real personal income and expenditure both beat expectations in January, gaining +0.4% m/m to +2.8% y/y and +2.9% y/y, respectively. The core PCE deflator moved up to +1.7% y/y, the highest since July 2014. Durable goods orders increased by a sharp +4.9% m/m as core orders gained +3.9%. The ISM manufacturing index improved for the second consecutive month, to 49.5 and close to signalling expansion. Five of the ten components improved, new orders remained unchanged at 51.8 and employment increased for the first time in three months. Construction spending increased by +1.5% m/m (expectations of +0.5%) and the previous month was revised up to +0.6% m/m from +0.1%. Other data were more negative. Q4 2015 GDP was revised up to +1% q/q annualised (from +0.7%) but a large inventory build was responsible and this will weigh on Q1 GDP, as will the trade deficit, which widened to -USD62.2bn from -USD61.5bn. Meanwhile, new home sales in January were much weaker than expected, falling to an annual rate of 494,000 (-9.2% m/m).

France: Waiting for Godot (Mario?)

Q4 2015 GDP growth was revised upwards +0.1pps to +0.3% q/q (full-year remaining +1.1%) but the economy failed to gather speed. The Composite Markit PMI fell to 49.8 from 50.2 and the INSEE business climate fell -1.5pts, almost back to its long-run average (100.5). A breakdown reveals that manufacturing confidence was unchanged at 103, while services fell -1pts to 99. The global environment is taking its toll on retail trade, with confidence declining another -2pts to 103 in February (110 in October 2015). Meanwhile, the consumer confidence index shed -2pts to 95. Even so, consumption is holding up, particularly in durable goods (still rising +4.5% y/y). We continue to believe that consumption and company investment will prove resilient but our GDP growth forecast of +1.4% for 2016 is now at risk. Inventories contributed strongly to growth in the last two quarters (+0.7pps each) suggesting a negative contribution in 2016. Additionally, manufacturing turnover also failed to reach “escape velocity”, growing only +0.2% in 2015; we expect a moderate +2% increase in 2016.

Countries in Focus

Americas

Venezuela: Default is in the air

Despite last week's payment of USD1.5bn of obligations to international bondholders, a restructuring or default of public debt cannot be ruled out. International reserves (including gold) registered a 17-year low of USD13.5bn in late February, providing import cover of less than three months. Approximately USD6.5bn in capital and interest on external public debt is due for repayment in 2016. A difficult financing position is compounded by weak export earnings as a result of the fall in oil prices that turned a traditional current account surplus into a deficit of around -4% of GDP in 2015 (-USD20bn). A tentative agreement by some oil producers to freeze output at January levels appears to have foundered, leaving Venezuela with few policy options. Last week, the government devalued the VEF by -37% against the USD and announced increased gasoline prices for the first time in almost two decades. This will heighten inflationary pressures; we forecast that inflation will exceed 400% in 2016, after 180% in 2015.

Europe

Switzerland: Moderate growth in 2015 after CHF appreciation

Q4 real GDP increased by +0.4% q/q (-0.1% in Q3) and also by +0.4% y/y (+0.8%), taking full-year 2015 GDP growth to +0.9%, a slowdown from +1.9% in 2014 that was expected following the strong CHF appreciation after the removal of the CHF:EUR cap in January 2015. Despite this latter move, net exports made a positive contribution of +0.7pps to full-year growth as real exports expanded by +3.1% while imports were up by +2.5%. However, excluding transit trade and valuables, which account for around 25% of Swiss external trade and fluctuate strongly and rather uncorrelated with the business cycle, exports expanded by just +0.2% and imports by +1.7% – providing a clearer picture of the economic impact of the CHF appreciation. Domestic demand was solid in 2015, with private consumption up by +1%, government consumption +1.7% and investment +1.4%. However, inventory destocking subtracted -0.9pps from growth. EH forecasts full-year GDP will rise by +1.3% in 2016.

Africa & Middle East

Iran: Democracy in action? It's all relative

It appears that "moderates" made gains relative to "hardliners" in last week's elections for parliament and the Assembly of Experts. The political system embodies checks and balances through a variety of institutions and power bases but formal political parties do not exist, so the outcome of this perceived swing is difficult to gauge. The Supreme Leader, Ayatollah Ali Khamenei, remains the ultimate authority but there are other non-elected power bases, including the Revolutionary Guards. For now, President Hassan Rouhani has a window of opportunity to progress reforms (mainly economic as social and political will come up against strong opposition). Two further features complicate the outlook: (i) presidential elections in 2017. Rouhani has a limited time to prove to the electorate that removal of some sanctions will provide benefits for the majority and (ii) the health of Khamenei is a concern, with potential for uncertain policy direction under a new Supreme Leader.

Asia Pacific

Asia: Waning manufacturing points to further policy responses

In **Japan**, the Nikkei manufacturing PMI declined to 50.1 in February (50.2 in January), just remaining in expansionary territory. In **Taiwan** (49.4 in February), **South Korea** (48.7), **Malaysia** (47.8) and **Indonesia** (48.7), the manufacturing indicator signalled contraction. There are few signs of upturn in the short term. Declining **South Korean** exports in February (-12.2% y/y) indicate that the trade cycle is not recovering. Demand growth is decelerating in **China** and that economy's refocus on growth through expansion of services rather than industry is less import intensive. Moreover, demand in high-income economies is improving, but at a very gradual pace. As a result, domestic demand is likely to remain the main regional growth driver. In Q1, private consumption may slow, reflecting weak sentiment in the wake of volatile financial markets and waning industrial activity but strong policy responses in Q2 may reverse that trend, particularly in **Japan**, **South Korea** and **Indonesia**.

What to watch

- March 03 – U.S. February ISM non-manufacturing
- March 03 – France Q4 unemployment
- March 03 – Turkey February CPI
- March 03 – Ukraine interest rate decision
- March 04 – U.S. February employment
- March 04 – U.S. January international trade
- March 04 – Russia February CPI
- March 04 – Brazil January industrial production
- March 07 – Eurozone finance ministers meet
- March 07 – Hungary January industrial production
- March 07 – Germany January factory orders
- March 08 – China February international trade
- March 08 – Germany, Spain & Turkey January IP
- March 08 – Hungary February CPI
- March 09 – Canada BoC policy announcement
- March 09 – Mexico February inflation
- March 09 – UK January industrial production
- March 10 – France January industrial production
- March 10 – Eurozone ECB monetary policy meeting
- March 10 – Germany & Turkey January BoP

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