Euler Hermes Economic Research

Weekly Export Risk Outlook

4 March 2015

In the Headlines

FIGURE OF THE WEEK

+2.5%

EH forecast of UK 2015 GDP growth

China: Interest rate cut. Further easing?

Last weekend, the PBoC lowered (by -25bps) the benchmark one-year lending rate (to 5.35%) and the deposit rate (to 2.5%), just a few weeks after a cut (-50bps) in the Reserves Requirement Ratio for banks. The cuts were accompanied by further steps in the liberalisation of interest rates, with the maximum rate on bank deposits extended to 130% of the benchmark rate (from 120%). The impact is likely to be limited in the short term but this new rate cut suggests that the PBoC acknowledges that demand remains weak and that further support is needed to maintain growth at adequate levels (+7% to +7.5% range). In this respect, the official Manufacturing PMI showed some improvement in February, to 49.9 (49.8 in January) but the level below 50 still indicates that the sector is underperforming. Tensions seem exacerbated by downward pressures on prices, with the PPI declining for the 34th consecutive month (-4.3% y/y) and the CPI on a decelerating trend (+0.8% y/y in January). Going forward, we expect the PBoC will ease monetary policy further, with -75bps additional rate cuts in H1 and will maintain the currency at favourable levels for exporters (close to RMB6.25:USD1).

UK: Let it grow!

Q4 2014 GDP growth (+0.5% q/q) was mainly driven by net exports (+0.6pps, exports +3.5%). Some weakness was evident in domestic demand, with private consumption up +0.5% q/q, the slowest since Q4 2013 and total investment down -1.2%. Fixed investment fell -0.5% q/q, with business investment -1.4%, mainly a result of weakness in the oil and gas industry. Overall, manufacturing sector growth remained weak (+0.2% q/q), but immediate prospects are positive, given a strong rebound in the manufacturing PMI (54.1 in February, a 7-month high). Lower oil prices and their associated support for private consumption are yet to influence company profitability as the gross operating surplus for non-financial corporations fell -2.6% in Q4, the second consecutive fall since Q2 2012. With the CPI at its lowest level since its introduction in 1988 (+0.3% y/y in January) and employees' compensation rising only moderately (+1.2% q/q), we believe this allows the BoE to keep interest rates on hold until Q1 2016. We maintain our GDP growth forecasts of +2.5% in 2015 (+2.6% in 2014) and +2.2% in 2016.

Austria & Switzerland: Diverging in 2014, converging in 2015

In **Austria**, Q4 2014 GDP was flat in q/q terms (after stagnation in Q3 and moderate increases of +0.1% q/q in both Q1 and Q2) and declined by -0.2% y/y (average +0.5% y/y in Q1-Q3). In 2014 as a whole, GDP increased by +0.4% (+0.3% in 2013), as a result of modest expansion in private and public consumption (+0.2% and +0.5%) and investment (+0.5%). Net exports contributed negatively with imports (+2.4%) growing faster than exports (+1.5%). We forecast GDP growth will pick up to +0.9% in 2015 as import demand from the Eurozone should improve. In **Switzerland**, Q4 GDP growth remained robust at +0.6% q/q (+0.7% in Q3) and +1.9% y/y (as in Q3), taking the full-year 2014 GDP expansion to +2%, up from +1.9% in 2013. Growth in 2014 was well balanced, with private consumption contributing +0.5pps, public consumption +0.1pps, fixed investment +0.4pps, inventories +0.5pps and net exports +0.5pps. We forecast GDP growth will slow sharply to +1% in 2015 as the outlook deteriorated after the removal of the CHF:EUR cap in January (see also WERO 4 February 2015).

South Africa: Nene but the brave

Last week's budget announced by FM Nhlanhla Nene introduced a measure of fiscal austerity to the policy mix, despite concerns relating to weak overall economic growth. The FY2015/16 budget includes spending cuts and revenue-generating increases that will combine to result in a deficit equivalent to -3.9% of GDP, with a projection of a deficit of -2.5% by FY2017/18. These official forecasts appear challenging but the (continuing) fiscal discipline entailed will provide some investor and rating agency confidence to offset (partially) negative perceptions of potential changes to land policy. The budget calculations assume GDP growth this year of +2% (in line with EH expectations) and revised down from earlier forecasts of +2.5%. Downside pressures on economic activity stem from weakness in key trading partners, including Europe and China, power disruptions (the budget allocates ZAR23 bn to electricity supplier Eskom) and industrial action. The February manufacturing PMI (down to 47.6 from 54.2 in January) suggests a meaningful upturn is not imminent.

Countries in Focus

Americas

U.S.: Falling prices, tepid activity

Q4 2014 GDP growth was revised down to +2.2% q/q annualised (advance estimate +2.6%). Consumption was strong, growing at +4.2%, but the rising USD increased the trade deficit and net exports subtracted -1.2pps from overall GDP growth. Personal incomes increased by +0.3% m/m in January but personal consumption declined by -0.3%. However, as prices fell, the real growth rates were a strong +0.8% and a moderate +0.3%, respectively. The January CPI fell a sharp -0.7% m/m (-0.2% y/y), the first negative since October 2009. Ex- energy and food prices, y/y core inflation remained a lacklustre +1.6%. Meanwhile, the February ISM manufacturing index and its new orders component both fell for the fourth consecutive month, with the former, at 52.9, uncomfortably close to the 50 level indicating the cut off between expansion and contraction. Manufacturers' new orders - a proxy for future business spending - gained +0.6, the first increase in five months.

Europe

Nordics: Regional divergence

In **Sweden**, GDP growth increased by +1.1% q/q in Q4 2014, with consumer spending the main contributor (+0.9%). Investment growth slowed to +1.9%, reflecting contraction in investment in construction (-4.3%, for the second consecutive quarter). We expect GDP growth of +2.4% in 2015, driven by domestic demand. In **Norway**, GDP increased by +0.9%, mainly driven by net exports (+2.4pps) and private consumption (+0.4pps). We expect GDP growth will slow to +1.5%, given weaker oil prices. In 2014, **Finland's** economy contracted for the third year in a row (-0.1%). Q4 GDP was down -0.2% q/q, with private consumption down -0.5%, investment -2.6% and net exports contributed -0.1pps. We expect recession to continue throughout 2015 given the high exposure to Russia. Q4 2014 GDP growth in **Denmark** beat expectations (but remained weak at +0.4% q/q) largely because of a rebound in consumer spending and modest gains in investment. We expect growth of +1.1% in 2015.

Africa & Middle East

Ghana: A pause in the rapid expansion?

Agreement was reached with the IMF for a three-year financial support package of approximately USD1 bn, although formal board approval is required in April. The facility is intended to offset the negative economic effects of weak gold and cocoa prices and to support reforms aimed at limiting fiscal and current account deficits. Fund support will restore some investor confidence, although an effective reform strategy (and implementation) will be required to carry that over in to the medium term. The local authorities have agreed to introduce a 17% petroleum tax, to freeze public sector employment levels and to curtail energy subsidies. The overall fiscal consolidation plan suggests that a challenging period will ensue and the rate of overall growth (ten-year average to end-2014 +7.4%) will slow, but not collapse. Ghana's previously good track record of economic management and governance will aid it in the near term and oil and gas output will provide a boost from 2017.

Asia Pacific

India: Growth strategy of delayed fiscal consolidation and rate cut

Tax and spending plans for the next financial year (starting 1 April) were released last week. These aim to reduce the pace of fiscal consolidation while increasing investment in the country's infrastructure (more than USD11 bn in upgrading the country's overloaded roads, railways, ports and power plants). The authorities plan to delay by one year their official target to bring down the fiscal deficit to -3% of GDP by FY2016/17. As a result, the deficit target for the next fiscal year will be -3.9% of GDP (compared with -4.1% in FY2014/15). Meanwhile, government and central bank officials agreed on adoption of a formal inflation target and the RBI now has now a legal mandate to target inflation. For the year ending March 2017, the inflation target is 4% (+/-2pps). This policy directive was followed by an interest rate cut (the second since the beginning of the year) of -25bps. With slowing fiscal consolidation and a more accommodative monetary policy, EH expects GDP growth of +7.7% in FY2015-16.

What to watch

- March 05 – UK BoE monetary policy meeting
- March 05 – ECB monetary policy meeting
- March 06 – Eurozone Q4 2014 GDP (2nd estimate)
- March 06 – Germany January industrial production
- March 06 – U.S. February jobs report
- March 06 – U.S. January trade balance
- March 06 – South Africa February intl. reserves
- March 09 – Germany January trade balance
- March 09 – Ghana Q4 2014 GDP
- March 09 – Japan Q4 2014 GDP details
- March 10 – France January industrial production
- March 10 – Israel Q4 2014 GDP (annualized)

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