

FIGURE  
OF THE WEEK

+3.0%

UK inflation  
rate y/y

## In the Headlines



### China: Communist Party Congress - 3 priorities for 5 years

The 19th National Congress of the Communist Party of China opens on October 18th. The event aims at determining the future makeup of the Chinese leadership and economic policy priorities for the next five years. Three themes will focus the attention on the economic front.

First, accelerating the economic rebalancing remains pivotal. The authorities have made good progress in pivoting the economy from exports to domestic demand, from industry to services. Yet low growth in private investment may act as a drag in the long run. Supportive fiscal measures and further efforts to upgrade the economy such as the Manufacturing 2025 strategy will be crucial.

Second, corporate debt reduction and State Owned Enterprises (SOEs) reform will be of greater focus. While non-financial corporate debt is high (165% GDP) SOEs reform could generate fairer competition and diminish market distortions. Financial authorities tighten regulation to reduce leverage growth and the government launched a debt-equity swap to help corporate deleveraging. It also announced a mixed-ownership reform to diversify large companies' shareholdings and orchestrated SOEs mergers. Yet these measures yield few tangible results so far due to limited implementation and continuing state intervention.

The third theme relates to trade strategy and financial liberalization. On trade, authorities will stress the benefits of the Belt and Road Initiative (BRI). This will help Chinese companies internationalize, reduce overcapacity and improve access to local suppliers (Mongolia, Myanmar, e.g.). It will also position China as a globalization champion. On financial liberalization, there is room for improvement. As a reaction to the 2015 stock market turbulence and capital outflows, capital controls were beefed up to prevent the renminbi from depreciating. Lately, the economy is doing better and pressures on the RMB have diminished. Thus, the authorities could become less "defensive" and embrace further reforms to open the economy.

EH expects economic growth to remain firm in the short run (+6.7% in 2017).



### US: Hurricanes mask underlying tepid conditions

The effects of Hurricanes Harvey and Irma have distorted recent economic data. Consumer inflation rose a sharp +0.5% m/m in September, driven by a +6.1% m/m spike in energy prices, and as a result, the y/y rate rose to +2.2% from +1.9%. Yet the core rate rose only +0.1%, leaving the y/y rate unchanged at +1.7% where it has been for five straight months.

Producer prices also rose sharply, gaining +0.4% m/m again driven by a +3.4% m/m spike in energy prices. On a y/y basis headline (+2.5%) and core rates (+2.2%) are the highest in over five years. Hurricanes affected retail sales with big gains in gasoline of +5.8% m/m, autos of +3.6%, and building and garden equipment supplies +2.1%. But the core group which excludes those items rose only +0.4% to +3.2% y/y, well below the long-term average of +4.1%.

Manufacturing industrial production (IP) rose only +0.1% m/m in September, after falling the last two months, to a weak +1.0% y/y. The IP report contrasts with regional Fed reports and anecdotal evidence which indicate a much stronger manufacturing environment.



### UK: Rate hike in sight as inflation reaches 5 year high

In September the UK's key inflation rate reached +3% y/y - the highest in more than five years. The acceleration in inflation (up from +1% a year ago) has been largely driven by the sharp depreciation of the pound. This followed last year's Brexit vote which has made imports more expensive. Increases in food and transport prices further pushed headline inflation up from 2.9% y/y in the previous month. For 2017 as a whole we expect UK inflation to come in at 2.7% before somewhat moderating to 2.6% next year.

The pronounced pick-up in consumer price inflation is raising the probability of the Bank of England (BoE) increasing the benchmark interest rate for the first time in over a decade. The rate currently stands at a record-low of 0.25%. The BoE has long tried to strike a balance between supporting the British economy and ensuring price stability. But with inflation now registering a full percentage point above the BoE's 2% price target the latter will now take priority. An interest rate hike could be announced as early as this year.

# Countries in Focus

## Americas

### Mexico: From inflation to NAFTA concerns

After inflation culminated in August at +6.7% y/y, latest figures could be pointing to a trend reversal. In September (+6.3% y/y) the 15-month long acceleration in inflation finally halted. The Mexican central bank stated it is confident that after 4 hikes this year to 7% the policy rate is high enough to achieve disinflation. Yet, further hikes would be needed if risks stemming from a more aggressive US Fed and uncertainty surrounding NAFTA negotiations materialize. The past two weeks have already seen the peso depreciate to its lowest level in 5 months (MXN/1USD=19.1). The end of the fourth round of negotiations saw both Mexico and Canada reject US proposals. In the short term, the risk of NAFTA falling apart is reduced as negotiations are extended until March 2018. In the medium-term, this results in greater uncertainty around the ratification process. It could indeed take place after Mexican presidential elections (July 2018) and US midterm elections (November 2018).



## Europe

### Russia: Economic outlook improves

Second official estimates confirmed that the economy grew by +2.5% y/y in Q2, the third consecutive quarter of increase (+0.5% in Q1 and +0.3% in Q4 2016) after two years in recession. Rosstat also published the demand-side breakdown. It shows that rebounding consumer spending (+4.4% y/y) and fixed investment (+6.3% y/y), as well as inventory restocking (contribution of +2.1pp), fueled the growth acceleration in Q2. Consumption is supported by low inflation (3% y/y in September) and improving confidence while investment is driven by large infrastructure projects (mainly energy and transportation sectors). Strengthening domestic demand also fueled real import growth (+20.7% y/y) while export expansion eased (+3.3%) so that net exports subtracted -3.3pp from Q2 growth. Early data for Q3 indicate continued momentum though growth should moderate due to base effects. We expect full-year real GDP growth of +1.5% in 2017, followed by +1.9% in 2018.



## Africa & Middle East

### Saudi Arabia: Aramco deal in focus

Saudi Aramco was at the center stage this week. Media reports claimed the giant energy company could envisage a U-turn on its IPO project, the largest in history. The Saudi government intended to offer shares representing 5% of the company's capital. Estimates of the theoretical value of Saudi Aramco fluctuate between 1 and 2 trillion USD. Proceeds from the IPO were to fund Vision 2030, the massive government plan aiming at transforming the Saudi economy away from the oil sector and stabilizing public deficits. A private placing, if transpired, might be due to various reasons. These include transparency as government strategy and the real amount of reserves have a strategic dimension, risks on the valuation price of the IPO and complex listing legislation in the US or UK. Selling stakes privately would allow for better control of the price and information. It could also open the door to a strategic partnership with the most important buyer of Saudi oil: China.



## Asia Pacific

### Japan: Business investment firming ahead of election

The total value of orders for machinery continued to increase in August, jumping by 8.5% m/m. In a sign that business investment is firming, core domestic private machinery orders also continued to advance solidly for a second consecutive month. With an increase of 3.4% m/m, the average for the first two months of the third quarter was a good 7% above the Q2 level. Outside of core orders, higher foreign orders pointed to solid external demand which had already been visible in the July and August trade data. The upward momentum in business investment and exports is welcome news, as private consumption will likely ease in Q3. Whereas the Cabinet Office's real private consumption index recovered in August (+0.4% m/m), the July/August level was still below the Q2 average. Overall, Q3 real GDP looks set to increase only slightly, following solid growth in Q2. Investors will be watching the October 22 election outcome with a view to its implications for the fiscal consolidation stance.



## What to watch

- October 18 – US Sep housing starts and permits
- October 19 – China GDP Q3
- October 20 – US Sep existing home sales
- October 20 – Eurozone Aug balance of payments
- October 22 – Japan Lower House General Election
- October 23 – Turkey October consumer confidence
- October 24 – Hungary Central Bank meeting
- October 24 – Germany Ifo business climate
- October 24 – Japan October Flash Manufacturing PMI
- October 24 – Eurozone October PMI (mfg. and serv.)
- October 24 – Poland September retail sales
- October 25 – Turkey October business confidence
- October 25 – South Africa Budget balance
- October 26 – South Africa September PPI
- October 26 – ECB rate announcement



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