Euler Hermes Economic Research

Weekly Export Risk Outlook

11 October 2017

FIGURE OF THE WEEK

+35%

September y/y growth of exports in South Korea

In the Headlines

Emerging markets: Open, we trade

Emerging Markets (EM) growth is currently accelerating and this is driven by open economies. Our EM aggregate manufacturing PMI reached 51.9 points in September, the best figure since April 2012. Open economies (from Asia, Eastern Europe and Mexico) saw the best improvement from a month ago, since their sub-index rose to 52.6, a level rarely seen after 2011. For example, South Korea (50.6) and Singapore (52.0) posted their best figures since February 2015 and February 2011, respectively. In these open economies, output and new order indexes are jointly contributing to the improvement. Currently low prices of raw materials and expectations that these prices should increase as a result of accelerating global growth also explain actual good output prospects, since it is also driven by rising inventories (e.g. in South Korea). In contrast, the sub-index of vulnerable economies (e.g. Brazil, Russia, Turkey and South Africa) has leveled off at just over 51.0 for the fourth month in a row (51.2 in September). This suggests that after emerging from recession during the past three quarters, there is no further (significant) growth acceleration to be expected in these economies.

Germany: Broad-based upswing to continue

Latest data on new orders and production demonstrate that the German industrial sector is running at full throttle. In August price-adjusted new orders in manufacturing increased a seasonally and working-day adjusted +3.6% on the previous month. Production in industry was up by +2.6%. Capital goods saw their production increase by a strong +4.8%, while the production of consumer goods expanded by +2.1%. However, the very strong August data on production should be viewed with caution because figures may have overstated the situation somewhat, with plant holidays in the automotive sector this year in July rather than August. So there is at least some backlash potential for September data. But this does not alter the overall upbeat story. The new data supports our view of an ongoing, broad-based upswing in Germany, with both domestic and external demand contributing significantly to growth. We continue to expect real GDP to expand by +0.5% in the third quarter (q/q, in seasonally adjusted terms), slightly below growth rates seen in the first half of this year.

India: What's next after demonetization

The economy is showing signs of improvement. Infrastructure output growth accelerated to +4.9% y/y in August from +2.4% in July. USD-denominated export growth speeded up to +10.3% y/y from +3% in July. Passenger vehicle sales remained strong in September (+11.3% y/y after +13.8% in August). Advanced indicators point to favorable trends in the short term. On financing, bank loan growth improved to +6.8% y/y in the two weeks to 15 September from +6.5% y/y in the two weeks to 1 September. On activity, the manufacturing PMI signals an expansion of the manufacturing sector for the second consecutive month with a reading of 51.2 points in September. The services PMI rose to 50.7 in September (from 47.5 in August). Going forward, we expect a gradual pick-up of economic activity. Monetary policy has become more supportive in the context of moderate inflation (3.4% y/y in August) and weak economic activity growth in the first semester: the RBI cut its policy interest rate by -25bp to 6% in August. Euler Hermes expects real GDP to rise by +6.5% in fiscal year 2017-18.

Congo Republic: The dark side of the moon

As many oil exporters, Congo Republic leveraged the oil price boom in order to foster its production capacity and finance spending. Such economies found quite easily creditors eager to finance the boom since their debt was low and investors were attracted by yields offered by frontier markets. While debt levels still remain manageable in many African economies it seems that Congo Republic went a bridge too far. The evidence was revealed after the country tried to finance its short-term needs with support from the IMF, which brought some hidden debt to light. Adding disclosed and hidden debt statistics shows that public debt increased from 38% of GDP in 2013 to a hefty 117% or so in 2017 (Euler Hermes forecast). Moreover, the need to find a financing agreement with the IMF has raised the issue of a potential debt restructuring, since the Fund is usually asking for some burden sharing when monitoring the situation of indebted economies. The resulting uncertainty poses downside risks to our growth forecast (+0.5% in 2017, after -2.7% in 2016).

Countries in Focus

Americas

U.S.: Employment report distorted, but the economy is not

The September employment report was marred by distortions from Hurricanes Harvey and Irma, obscuring the underlying trend. The economy lost -33,000 jobs, the first drop in seven years. The biggest loss came in food and drinking places, where jobs fell by -105,000. Hourly wages rose a sharp +0.5% m/m, driving the y/y rate from +2.7% to +2.9%, tying the December 2016 reading for the highest in almost eight years. The unemployment rate dropped from 4.4% to 4.2% while the participation rate rose from 62.9% to 63.1%, the highest in four years (neither one of those rates is thought to be distorted by the hurricanes). We do not believe that the hurricanes will significantly affect the underlying economy, and given the strength of the ISM reports earlier in the week, we still forecast GDP growth of +2% this year and +2.3% in 2018. Puerto Rico, where Hurricane Maria caused much worse damage, is not counted in the jobs report.

Europe

Turkey: Old and new concerns

The current account deficit narrowed to –USD1.2bn in August, a 22-month low, but still took the January-August 2017 shortfall to –USD27.2bn which is +19% up from the same period in 2016. The merchandise trade deficit rose by +23% y/y to –USD34bn in the first 8 months of this year while the services surplus increased by +25% to +USD12.1bn, largely thanks to a partial recovery in tourism. Euler Hermes expects the annual current account deficit to rise to -4.7% of GDP in 2017 (from -3.8% in 2016). Meanwhile, net foreign direct investment (FDI) inflows fell to +USD4.9bn in January-August 2017 (-USD0.7bn y/y), covering a meager 18% of the current account deficit, reflecting ongoing weak investor sentiment. The latter got a new hit this week amid an escalating diplomatic dispute between Turkey and the U.S. which has resulted in reciprocal visa bans, for now. The TRY has lost -3% against the USD and EUR since last Friday. Expect financial markets to remain highly volatile.

Africa & Middle East

Saudi Arabia: In recession

Data released last week by the General Authority for Statistics (GAS) show that real GDP contracted by -1% y/y in Q2 2017, moving the economy into recession after it had already declined by -0.5% y/y in Q1. Demand-side details are not available as yet. Supply-side data show that the oil sector shrank by -1.8% y/y in Q2 while the non-oil sector grew by +0.6%. Within the oil sector, oil extraction dropped by -2.5% y/y, impacted by the November 2016 OPEC agreement to cut oil output, while oil refining rose by +5.8%. Within the non-oil sector, construction (-1.6% y/y) and domestic trade (-0.1%) declined in Q2 while financial and business services (+1.9%), utilities (+1.1%), transport and communication (+0.8%) and agriculture (+0.6%) expanded. We expect the economy to resume growth in H2 due to state spending programs and the slight uptrend in oil prices and forecast full-year GDP growth of +0.5% in 2017, followed by +2% in 2018.

Asia Pacific

South Korea: When exports go well so does the economy

South Korea's exports (in USD terms) surged by +35% y/y in September, after +17.3% in August, marking a new monthly record of USD55.1bn. The improvement was driven by a strong performance in the semi-conductor industry which posted exports of USD9.7bn, another monthly record and the first time exceeding USD9bn. In general, the export performance has improved since the end of 2016, helped by a strengthening of global trade. From a destination perspective, exports to China (+23.4% y/y), the U.S. (+28.9%) and the EU (+23%) rose rapidly. Meanwhile, manufacturing sentiment improved in September, reflected by the manufacturing PMI climbing to 50.6 points, up from 49.9 in August. While downside risks are still elevated owing to high tensions with North Korea, we expect the currently strong trade momentum to continue to support the economy. We forecast real GDP to increase by +2.8% in 2017.

What to watch

- October 12 – Argentina September inflation
- October 12 – Canada Sept. Teranet Home Price Index
- October 12 – Eurozone August industrial production
- October 12 – Poland September inflation
- October 12 – U.S. September producer prices
- October 13 – U.S. September consumer prices
- October 13 – U.S. September retail sales
- October 16 – China September inflation (CPI and PPI)
- October 16 – Peru August economic activity index
- October 17 – Colombia August retail sales
- October 17 – Germany October ZEW survey
- October 17 – Italy August trade balance
- October 17 – Russia September industrial production
- October 17 – U.S. September industrial production
- October 18 – Brazil August economic activity index
- October 18 – Poland September industrial production

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