

FIGURE
OF THE WEEK

+0.3%

Q2 GDP
growth for the
Eurozone (q/q,
first estimate)

In the Headlines



Eurozone: Q2 GDP growth moderated, as expected

The first official estimate for GDP growth in Q2 is in line with our expectations; +0.3% q/q following an exceptionally strong Q1 (+0.6%) due to the mild weather that generated accelerating activity in the construction sector. Q2 growth is expected to have been driven largely by domestic demand, even if growth is expected to have slowed compared with Q1. The monthly data suggest that there will be a positive contribution to overall growth from external trade. For Q3, business confidence for July (Composite PMIs) suggests growth at +0.3% q/q, with no material negative impact from the Brexit. With this quarterly pace in Q3 and Q4, the +1.6% expected growth in 2016 seems realistic. The next data release is on 12 August and this will provide details for most of the individual countries, notably Germany and Italy for which we expect GDP growth of +0.4% q/q and +0.3%, respectively. The French and Spanish GDP data, already published, point to divergent trends; weaker-than-expected growth in France (0% q/q) but expansion above expectations for Spain (+0.7%).



Brazil: A false start?

As with the FIFA World Cup in 2014, this year's Olympic Games will only have a marginal impact on the economy. We estimate that additional investment and consumption linked to the Olympics will generate only +0.05pps of GDP growth. Moreover, the recession will continue, with GDP contracting by -3.5% in 2016 after -3.8% in 2015. While additional jobs will be few and short-lived, inflationary pressures will be visible and long-lasting. Annual inflation in 2016 is projected at 8.6%, of which +1pps relates directly to the sporting mega-events and +0.4pps specifically to the Olympics. Public finances will also deteriorate, with the debt-to-GDP ratio rising to 89% in 2016 (+0.4pps resulting from the Olympics). After the Olympics, weaker economic activity will inflate corporate insolvencies by +5% in the Rio de Janeiro State in 2016 and for SMEs it could be as high as +12%. For the country as a whole, we expect insolvencies will increase by +22% in 2016, after +25% in 2015. [For further details see our Economic Insight [The Olympics: A false start for Brazil](#).]



France: A soft patch will not disrupt the trend

GDP growth in Q2 was a disappointing +0% q/q, mainly reflecting a decline in inventories. Industrial production was depressed by many shocks, particularly in June (including strikes and floods). The oil market provides another explanation. As in 2015, oil prices hit a trough during the first quarter, with a rebound in the second and the relatively lower prices in Q1 2016 fuelled an impressive private consumption surge (+1.1% q/q). In contrast, private consumption in Q2 was almost stable, as it had been in 2015. However, consumer confidence hit a peak (98 in May) and decreased only marginally thereafter because structural growth drivers are strong (increasing purchasing power, stabilising unemployment and low interest rates). As a result, we consider that zero economic growth during Q2 was a cyclical issue and that trend growth is still around +1.5% a year.



South Africa: Policy and political perturbations

SARB kept the policy interest rate (repo) unchanged at 7%. This was expected, given the dynamics of weak growth (contraction in Q1 GDP of an annualised -1.2% q/q) and relatively high inflation (above the target range of 3-6% and unlikely to fall within target any time soon). SARB has a tightening bias, given its primary role of controlling inflation, and a further increase in the policy rate (+25bps) is likely this year. Against this background, and with political/policy uncertainties, there remains a possibility of a further downgrade by the rating agencies (junk status is still possible later this year). The IMF now forecasts GDP growth of only +0.1% in 2016 and SARB suggests that annual growth could remain below +2% through to end-2018. We forecast GDP growth of +0.5% in 2016 and +1.5% in 2017.

NOTE: WERO is taking a break. The next issue will be 18 August 2016.

Countries in Focus

Americas

U.S.: Recent data mixed, Fed on hold

At its latest monetary policy meeting, the Fed left the key policy interest rate unchanged but issued a slightly more hawkish statement, leaving open the possibility of a September rate hike. However, financial markets are suggesting that the increase in interest rates will not be until December. EH believes the Fed will hike, at most, once in 2016. Perhaps reflecting this ambivalence, recent data have been mixed, with durable goods orders falling by -4.0% m/m in June and by -6.4% y/y. After stripping out volatile defense and aircraft components, orders gained +0.2% m/m, although on a y/y basis such orders were still down -3.7%. In addition, in June, unit sales of both new and existing homes reached their highest levels of the recovery, gaining +3.5% m/m and +1.1% m/m, respectively. To add to the uncertainty mix, consumer confidence was virtually unchanged in July, slipping -0.1 to a still firm 97.3.



Europe

UK: Joy before turbulence?

GDP increased by +0.6% q/q in Q2, above expectations. The acceleration from growth of +0.4% in Q1 mainly derives from a rebound in manufacturing, which expanded by +1.8% in Q2, compared with a contraction of -0.2% in the previous quarter, most probably linked to stock rebuilding prior to the Brexit vote. However, growth in services continued to decline, reaching +0.5% q/q in Q2 from +0.6% in Q1. Construction remained in negative territory in Q2 (-0.4%, after -0.3% in Q1). Following the Brexit vote, a period of prolonged uncertainty and lack of confidence on the part of businesses and consumers may be negative for growth in H2, with a high risk of recession. In this context, the policy mix may be reconfigured as the new Chancellor of the Exchequer has indicated that fiscal policy may be reset as early as October, while the next BoE monetary policy meeting on 4th August is very likely to decide on an interest rate cut (the key policy rate is currently 0.5%).



Africa & Middle East

Morocco: Roc solid?

Last week, the IMF Board approved a two-year USD3.47bn Precautionary and Liquidity Line (PLL), which Rabat is unlikely to draw down but which will act as insurance against unforeseen external shocks and as a confidence boost for domestic and external investors. While the overall picture remains positive, GDP growth in Q2 was +1.4% y/y, compared with +1.7% in Q1, with the downturn reflecting a weak agricultural sector negatively affected by drought. Indeed, the official GDP forecast for this year was cut to +2% (previously +3%) after indications of a much-reduced cereal harvest because of the worst drought in three decades. We retain our forecasts of GDP growth of +2% in 2016 and recovery to +4.5% in 2017 based on a boost to agricultural output but also continuing development of the autos, electronics, aeronautics and chemicals sectors and further expansion of the country as a regional trade hub with strong links with Europe (markets for >60% of Moroccan exports).



Asia Pacific

Japan: Policy adjustments, with more to come

Expect further economic policy announcements as the authorities continue in their attempts to move the country away from its protracted low inflation environment. Inflation was -0.4% y/y in May, 10-year yields hit fresh all-time lows (-0.3% today) and the JPY appreciated from JPY123:USD1 in early December 2015 to JPY100:USD1 just after the Brexit. Japanese policymakers need to act in order to avoid the constraints of remaining in a safe haven trap and the ruling majority's victory in the upper-house election on 10th July provides a new mandate to do just that. The government will announce next week the details of a JPY28trn plan, including JPY13trn of "fiscal measures" (equivalent to 2.5% of GDP). The government has fiscal manoeuvrability because, although public debt is approximately 250% of GDP, the BoJ programme of asset purchases means that the Central Bank currently buys more than twice the amount of new public debt net issuances each month.



What to watch

- August 01 – U.S. July ISM manufacturing index
- August 01 – Eurozone July manufacturing PMI
- August 02 – U.S. July personal income & spending
- August 03 – U.S. July ISM non-manufacturing index
- August 03 – Egypt July international reserves
- August 03 – Eurozone July services & composite PMI
- August 04 – UK monetary policy meeting
- August 05 – U.S. July employment report
- August 05 – Canada July employment report
- August 08 – Germany June industrial production
- August 09 – Mexico July CPI
- August 10 – Brazil July CPI
- August 10 – France June industrial production
- August 11 – South Africa June mining & manufg. output
- August 11 – Russia Q2 GDP
- August 12 – Eurozone Q2 GDP
- August 15 – Japan Q2 GDP



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 authorised and regulated by the Financial Markets Authority of France.

© Copyright 2016 Euler Hermes. All rights reserved.