



Weekly Export Risk Outlook



EULER HERMES
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In the Headlines

FIGURE OF THE WEEK: -24.5% FALL IN THE GOLD PRICE SINCE THE START OF THE YEAR

► Eurozone: ESM – the devil is in the detail

On 21 June, the Eurogroup established the technical details for the ESM's direct bank recapitalisation instrument, which aims at avoiding a sharp rise in public debt if a banking system has to be recapitalised (the Spanish banking system bailout, for example, represents 10% of Spain's GDP). This is an important step forward in reducing the feedback loop between sovereign debt and banking system crises. However, the eligibility criteria will be very strict and the funds available are limited to EUR60 billion initially given the need to preserve the ESM's creditworthiness. Stakeholders, creditors and depositors will also be expected to participate in any banking system bailout, although an appropriate level of the resolution scheme ('bail-in procedure') has still to be agreed, and the member state involved will also have to share in the bailout. Retroactivity is to be agreed on a case-by-case basis but, given that amounts already disbursed to the financial sectors in Spain, Ireland, Portugal and Greece total EUR140 billion, the initial cap may dilute the potential impact of the instrument.

► US: Fed speak

Fed Chairman Ben Bernanke rattled financial markets last Wednesday when he unexpectedly said that, if the Fed forecasts prove correct, the Bank could taper bond purchases later this year and end QE by the middle of 2014. The Fed has become more optimistic, issuing stronger forecasts and describing the "downside risks ... as having diminished since the fall." The housing market provided support, with existing home sales increasing by +5% mo/mo in May and prices increasing by +8.6% (+12.7% and +15.8% y/y, respectively). Also in May, housing starts increased by +6.8% mo/mo and +28.6% y/y. In addition, May leading indicators edged upwards, as did the Philadelphia Fed's business conditions survey. Overall, while the financial markets may not like the idea, economic data appear to justify the Fed becoming less accommodative.

► China: Monetary policy

The central bank yesterday indicated that it will take steps to manage the liquidity squeeze that has seen interbank interest rates spike sharply. The liquidity shortage has stemmed from seasonal money demands and a change in supply as capital inflows have fallen away. The striking feature, however, has been the lack of intervention from the central bank and absence of comment on the reasons for such abstention. Although a potentially risky tactic, the most likely explanation is that policymakers want to reinforce their intention to curb credit growth, which has been expanding rapidly, particularly the broader measure of total social financing. This also seems to fit with the new leadership's apparent focus on re-balancing of the economy and preparedness for lower short-term economic growth.

► Germany: External trade predominantly in EUR

Exports to non-European countries totalled EUR 340.2 billion in 2012 (+10.4% y/y), representing a share of around 31% of total exports of goods. In Q1, exports to these countries declined moderately, by -0.7% y/y, to reach EUR 82.6 billion. According to the Federal Statistical Office, the EUR continued to be the most widely used currency in exports with non-European countries in 2012, with 64.6% of the total being transacted in that unit (down from 67% in 2011). A further 25.6% was conducted in USD (up from 24% in 2011) and the rest (9.8%) in other currencies. On the import side, inward movements of goods from non-European countries were also most frequently denominated in EUR, with a share of 51% of the total, followed by USD (43%) and with the remaining 6% in other currencies.

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► Mediterranean, Africa & Middle East – *Qatar: Succession*

Sheikh Hamad bin Khalifa al-Thani announced on 25 June that he is in the process of standing down and that his son, Sheikh Tamim bin Hamad al-Thani, will be the new emir. This had been signposted earlier in the month and had probably been planned well in advance. It also represents a smooth transition of power to a younger generation at a time when regional regimes are seeking to strengthen their power bases and appease calls for change. Approximately half of Qatar's nationals are aged under 20 years. The world's largest exporter of LNG (and with a sovereign wealth fund of around USD115 billion) is unlikely to adopt radically different policies under its new leadership. Expect Sheikh Hamad and the outgoing PM Sheikh Hamad bin Jassim al-Thani to remain as advisers.



► Americas – *Brazil: Government response*

The government's response to protests in many cities in the past 2-3 weeks—another example of societal risk stemming from the ability to organise mass demonstrations with modern communication systems—has been largely conciliatory and responsive. After meeting some of the protest leaders, President Dilma Rousseff proposed a plebiscite on political reform and improvements to spending on education, health and public transport. It remains to be seen if these proposals and the end of the FIFA Confederations Cup will temper the protests, but systemic stability should prove durable, although Rousseff will need to deliver on her proposals, ahead of the football World Cup and elections next year. She must also trust that the so far lacklustre economic recovery picks up and inflation eases.



► Asia-Pacific – *Indonesia: Fuel price hike*

After years of delay, but still earlier than expected and despite nationwide protests, the government last week moved to implement a highly controversial reduction in fuel subsidies, which have put a strain on the budget over a long period. President Yudhoyono is likely to approve the decision as he had a leading role in pushing for the cut in subsidies. As a result, the prices of gasoline (+44%) and diesel (+22%) will increase sharply, raising inflationary pressures. Expect headline inflation to rise from 5.5% y/y in May to just below 10% in the next few months. Even though fuel subsidies have benefited disproportionately wealthy Indonesians, reductions have been highly unpopular overall. As a result, cash handouts will be distributed to the poorest households to help offset the effect of the fuel price hike.



► Europe – *Croatia: New EU member in protracted recession*

On 1 July, Croatia will become the 28th member of the EU. However, the economy is struggling to exit a protracted recession. Real GDP contracted by -1.5% y/y in Q1, declining for the sixth consecutive quarter. More significantly, GDP fell in 15 of the past 17 quarters. Domestic demand remained weak in Q1 because of continued tight credit and fiscal austerity, with private consumption down by -3% and investment by -2.3%, while government consumption shifted to marginal growth of +0.3%. External trade activity dropped sharply in Q1 but had no impact on the change of overall GDP as both exports (-4.9%) and imports (-5.6%) declined markedly, the latter affected by domestic demand weakness and the former by muted demand from the EU. EH expects full year 2013 GDP to contract by -0.2%.

Worth Knowing

► Israel

The Bank of Israel (BoI, central bank) announced that its key policy interest rate for July will be unchanged at 1.25%, citing annual inflation currently near the lower end of the target range but expected to increase to mid-range, primarily reflecting a VAT rate increase. Meanwhile, the governor of the BoI, Stanley Fischer, is to step down and he will be succeeded (subject to Knesset approval) by Jacob Frenkel, who previously held the post between 1991 and 2000.

► Gold

The current gold price of USD1,279/ounce is the lowest since September 2010 and is down -24.5% since the start of the year and -32.5% from the peak in September 2011. Retail buying (jewellery and coins) may be sparked at current low prices but the metal's outlook appears negative, with downside risks to mining companies and to key producers, including South Africa, Peru, Ghana, Indonesia and Uzbekistan.

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