Euler Hermes Economic Research

Weekly Export Risk Outlook

24 June 2015

FIGURE OF THE WEEK

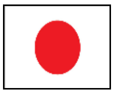
(54.1)

Flash Eurozone PMI hits four-year high

In the Headlines

Eurozone: Continuing the rally

The Composite PMI's quarterly average hit a four-year high in Q2 reflecting strong service activity. Manufacturing performed well too, reaching a 14-month high (52.5). Employment and new orders improved strongly but companies are still exposed to increases in input prices and wage bills and lower EUR, while still facing downside pressures on selling prices. **Germany** remains strong, but its average reading in Q2 was slightly weaker at 53.6 (54.2 in Q1). The Ifo Business Climate Index eased to 107.4 points in June (108.5 in May), mainly because of weakening expectations in manufacturing and wholesaling, but is above the long-term average (102.8 since 2000). Economic sentiment is in line with our Q2 growth forecast of +0.5% q/q. The **French** services (54.1) and manufacturing (50.5) PMI increased markedly in June. However, the INSEE business climate survey paints a slightly less upbeat picture, falling -1pts to 97, slightly below the long-term average (100). These mixed signals are consistent with a steady but slow increase in activity and tally with our GDP growth forecast of +0.3% or +0.4% in Q2. Overall, the **Eurozone** Q2 PMI suggest +0.4% q/q GDP growth (the same as in Q1).



Japan: Economic revitalisation strategy part 2

The government released a revised version of the revitalisation strategy, which is likely to be submitted for cabinet approval next week. It focuses on future economic and fiscal management, giving further guidance on the third arrow of the *Abenomics* reform process. The new strategy does not call for extra fiscal consolidation (additional to the 2% increase in sales tax in 2017) before 2018. The plan is that solid GDP growth will guarantee higher fiscal revenues and thereby improve public finances. The government targets a primary fiscal deficit of -1% of GDP in 2018, with gradual reduction in the debt-to-GDP ratio from 2020 onwards. The revised strategy also seeks to boost competitiveness. The rate of corporate tax was reduced last year to increase investment attractiveness but the current goal is to strengthen productivity. The aim is to boost female labour market participation, increase the number of foreign workers in IT and revamp universities to make them internationally competitive. After the structural reforms, we expect GDP growth will strengthen gradually (+1.2% in 2015).

Cyprus: After rainy days, here comes some sun

The successful completion of the seventh review of the economic adjustment programme, after a blockage on the foreclosures and business insolvencies law since September, saw the disbursement of almost EUR300 mn from the EUR10 bn total programme scheduled to end in December 2016. The next review should take place in September, with two more reviews by the end of the programme. Overall, liquidity and solvency in the banking system improved since last April's end of the remaining capital controls introduced in 2013. GDP growth returned to positive territory in Q1 2015 (+1.6% q/q) after three years of recession, and should reach +0.5% in 2015. However, non-performing loans remain high (at 54% of personal loans and 51% for non-financial corporations) restraining credit availability and increasing cost of credit. Inflation is expected to remain in negative territory throughout this year (-2% y/y in April), placing further pressure on company turnover, which is -30% down since 2010.

Iran: Timetable slippage?

At the end of March, a framework deal between the P5+1, the EU and Iran gave a deadline of June 30 for a full agreement to be achieved through negotiations relating to the country's nuclear program and related economic sanctions. Despite some positive signs coming out of the March announcement, we had early concerns about expectations (See WERO 8 April 2015) and, with little information suggesting a breakthrough, a timetable extension is now appearing increasingly likely. The framework offers to roll-back sanctions in return for transparency in (not removal of) Iran's nuclear infrastructure; Tehran will be allowed to retain a large nuclear capability, with the prospect of expanding it after 15 years. Another outstanding issue is the timing of relief from sanctions; Tehran wants this immediately after agreement is reached but it is doubtful that associated legal, political and multilateral proceedings will be achievable in a short time. Even so, reports suggest that global commercial interest in Iranian markets (including the energy sector, tourism, consumer goods, construction and automobiles) is deepening.

Countries in Focus

Americas

Argentina: Election uncertainties

Incumbent President Cristina Fernández announced this week that she will not seek any elected office in the upcoming elections after her second term ends in December; polls are scheduled for October. However, the influence of Fernández may be extended as the leading candidate to succeed her, Daniel Scioli, announced that Carlos Zannini, Fernández's legal adviser, will run as his vice-president. The other leading presidential candidate is Mauricio Macri, the centre-right mayor of Buenes Aires, who is seen as offering a change in policy direction from the Fernández era. Polls show Scioli and Macri are evenly matched and the outcome may depend on whether a third candidate, Sergio Massa, opts to lend his support to one of the other two runners. Election uncertainties add to the country's mounting economic and financial problems and to investor concerns, with little scope for improvement in the short term (See WERO 15 April 2015)

Europe

Czech Republic: On track for continued recovery

Q1 real GDP growth picked up to +4.2% y/y from +1.2% y/y in Q4 and +2% in full-year 2014. However, the strong acceleration was largely due to a one-off effect from inventories, which drove up gross capital formation by +11.4% y/y, despite more moderate growth of +3% y/y in fixed investment. Inventories were pushed upward mainly by restocking of tobacco products after a sizeable drop in late 2014 in connection with an excise tax adjustment. Household and government consumption increased by +3% y/y and +1.4% y/y in Q1, respectively. Exports expanded by +7.8% y/y and imports by +9% y/y so that net exports provided a small negative contribution to Q1 growth. Even though the Q1 surge in inventories will not continue in the coming quarters, the domestic demand-driven economic recovery is expected to retain momentum. Euler Hermes forecasts full-year growth of +3% in 2015 and +2.7% in 2016.

Africa & Middle East

United Arab Emirates: Rates highly

Largely as a result of weaker oil prices (oil and gas account for 60-80% of government receipts, depending on the strength of oil prices), the fiscal balance is expected to turn negative this year for the first time since 2009; Euler Hermes projects the deficit at -2.5% of GDP. With a large financial asset base (SWFs are estimated at over USD1,188 bn), fiscal consolidation is likely to be moderate and designed to minimise its impact on economic activity. We expect GDP growth of around +3.5% in 2015 (+4.2% in 2014), reflecting a temperate slowing in public expenditure growth, weaker market sentiment and some competitiveness losses arising from USD appreciation (the AED is pegged to the USD). The banking sector is resilient, with capital and liquidity buffers strong enough to withstand adverse external shocks. Overall, the UAE, which is relatively diversified compared with other regional economies, is strongly positioned to withstand a period of lower oil prices.

Asia Pacific

China: Converging surveys signal stabilisation in Q2

Market News International's Business Survey indicates a pick-up (+7.6% m/m) in Business Sentiment to 53.5 in June, the highest level in 2015. The survey reveals that companies are more optimistic as credit conditions have eased somewhat after the Central Bank cut its policy rate and reserve requirement on deposits (the second time this year). Activity increased in June compared with May but the level is still below the level in December 2014. Although less bullish, the HSBC/Markit survey also gives positive signals. The flash manufacturing PMI increased in June (49.6 from 49.2 in May) driven by increasing new orders. Employment and output price components remained on a downward trend. Going forward, economic activity is set to strengthen from Q3. Export orders are set to recover gradually as growth in advanced economies picks up and domestic authorities will support demand through further rate cuts (-25bps and -50bps for the Reserve Requirement Ratio) and further fiscal stimulus.

What to watch

- June 25 – Germany June GfK consumer confidence
- June 25 – Austria April industrial production
- June 25 – Argentina June industrial production
- June 25 – Argentina Q1 GDP
- June 26 – EU leaders' summit begins
- June 28 – Egypt Q1 GDP
- June 29 – Germany June CPI
- June 29 – Germany May retail sales
- June 29 – Japan May retail sales
- June 29 – Ireland Q1 GDP
- June 30 – Saudi Arabia Q1 GDP
- July 1 – Russia June manufacturing PMI
- July 1 – Ireland June manufacturing PMI
- July 1 – Turkey June manufacturing PMI
- July 1 – Brazil June CPI
- July 1 – China June manufacturing PMI

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Contact Euler Hermes Economic Research Team
research@eulerhermes.com

Publication Director
Ludovic Subran, Chief Economist
ludovic.subran@eulerhermes.com