Euler Hermes Economic Research

Weekly Export Risk Outlook

9 July 2014

In the Headlines

FIGURE OF THE WEEK

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Germany – Brazil in the FIFA World Cup semifinal

ECB: EUR 2 trillion needed to reverse disinflation

The ECB announced that that it will hold meetings every six weeks (instead of every month) and introduce minutes, both starting in January 2015. Monetary policy remained on hold last week, but President Draghi provided more details about the measures announced in June: (1) around EUR1 trillion could be generated by the TLTROs when banks will be able to borrow up to EUR400bn in two operations in September and December 2014 and to take additional EUR600 billion thereafter if they keep or increase loan portfolios (conditions are looser for banks that deleverage until June 2015); (2) the Governing Council has started to “intensify” preparatory work related to the ABS market for SMEs, and first purchases could be possible as soon as 2015; (3) the door has been kept open for a broad-based QE and the trigger remains the medium-term outlook for inflation. We expect the latter to remain below or close to 1% until end-2015. Although these measures are positive, we estimate that an additional EUR1 trillion to what has been already announced (if there is a 100% distribution to the real economy) is needed to reverse the present disinflationary tendency (and help inflation increase to 1.5-2.0%) and to consistently stimulate credit.

U.S.: After the storm here comes the sun

Recent data points to a marked improvement in the second quarter compared to the dismal performance of the first quarter. The economy created 288,000 jobs in June, much more than expected, with revisions to the prior two months adding another 29,000. Manufacturing continued its rebound, adding 16,000 jobs, the 11th straight gain. The unemployment rate dropped to +6.1%, the lowest of the recovery. While the labor market is definitely improving, there are still nagging details which are hindering more rapid growth. The labor force participation rate remains at a recovery low of 62.8%, and compared to previous recessions the economy should have created 5-10 million more jobs by now. The ISM non-manufacturing index slid 0.3 but remains at a very solid 56, well above the 50 level indicating expansion. The new orders component is very strong at 61.2, and both the employment and new export orders rose a solid 2.0. The trade deficit shrank from USD47 billion to USD44.4 billion in May as exports rose and imports fell, boosting prospects for Q2 GDP.

Indonesian election: Towards a fragile victory

Following the presidential election on July 9, both Joko Widodo, actual governor of Jakarta's province, and Prabowo Subianto, an ex-general, claimed victory. However, most preliminary exit polls suggest a Widodo win by approximately 5 percentage points. In a wave of growing discontentment, Mr Widodo represents change and transparency for many Indonesians, whereas his rival represents the traditional political elites. Regarding economics, the two candidates lacked detailed plans but they seem to differ somewhat on government support to the costly but popular fuel subsidies given the background of a rising fiscal deficit (EH estimates -2.5% of GDP in 2014) and high inflation (7.3% y/y in May). Mr Widodo, in particular, would like to reduce them. Widodo is also considered more open to foreign investments than his rival while the country suffers from an important lack of investment in infrastructure and from a weak investment climate. With a narrow victory, the next government will not have a strong mandate to push for strong reforms. EH expects GDP growth to gradually recover in the next quarters (after +5.2% y/y in Q1), reaching +5.5% GDP in 2014 and +6.0% in 2015.

Ireland: (Artificially) towards less austerity?

The Irish Statistical Institute (CSO) published its preliminary estimates for Q1 GDP. It strongly rebounded (+2.7% q/q) thanks to net trade contribution (+1.2pps) on the back of dynamic exports while private consumption surprisingly declined by -0.1% q/q, despite the strength of retail sales over the past quarter and the continued recovery of the labour market (unemployment fell to a 5-year low of 11.6% in June). 2013 GDP has been revised by almost +7% (to EUR174.8 billion), in line with the new European rules, ESA 2010, that take into account (1) R&D spending as capital investment and no longer as cost to the main production of an enterprise; (2) illegal activities. The overall figure for GDP growth in 2013 was also revised to +0.2% growth from the original -0.3% contraction. This technically cut the fiscal deficit to 6.7% of GDP (vs. 7.2% previously) and public debt to 116% of GDP (vs. 123.7% previously), making the target of 3% of GDP in 2015 more achievable. The government estimates that the needed adjustment would not exceed EUR2 billion of spending cuts in 2015 because of higher-than-expected income tax and VAT receipts. Financial independence was achieved last December and Irish long-term bond yields stand below those of Spain and Italy. EH revised upwards its GDP growth forecasts to +2.0% in 2014 (+0.4pp) and to +2.3% in 2015 (+0.3pp).

Countries in Focus

Americas

Brazil: Time to reflect

After the defeat in the World Cup, it is time for Brazil to come back to reality and cope with economic challenges. Inflation remains a concern. While FGV, a Brazilian think tank, estimated last week that inflationary pressures were easing, official data released yesterday showed that prices accelerated in June, as we expected (see [2014 World Cup: more inflation than growth for Brazil]). Driven by the increase in prices for transportation, airline tickets and hotel stays, the inflation rate went up to +6.5% y/y in June (against +6.4% in May and +5.6% in January), reaching the upper limit of the Central bank target (4.5% +/- 2pp). Despite the tightening in monetary policy implemented over the past months, inflationary pressures are expected to remain strong. EH expects consumer prices to rise by +6.3% in 2014 and by +6.0% in 2015. Meanwhile, economic activity is likely to remain subdued, with real GDP to expand by +1.8 % in 2014 and by +2.0 % in 2015, a very moderate pace compared to an annual average growth rate of around +5% between 2003 and 2008. Risks remain on the downside.

Europe

Germany: Early indicators point to less buyout GDP growth in Q2

Latest high frequency indicators signal weakening economic momentum. In May, seasonally adjusted industrial production declined by -1.8% m/m, new orders in manufacturing by -1.7% m/m and retail trade by -0.7% m/m. External trade activity also decreased, with goods exports down by -1.1% m/m and imports by -3.4%. However, compared with May 2013, all these indicators showed reasonable expansion, except for goods imports which fell by -0.4% y/y. The Ifo business climate survey fell slightly by -0.7% in May and -0.6% in June, but the June level of 109.7 compares with a long-term average of 101.3 and points out that economic activity remains well above average. Overall these indicators suggest that real GDP growth, after accelerating to +0.8% q/q in Q1, will moderate but remain robust in Q2. The contribution of net exports in Q2 is likely to be less negative than in Q1 (-0.9pps in q/q terms) and domestic demand is expected to remain the main contributor to growth. EH expects full year growth of +1.9% in 2014 and +2% in 2015.

Africa & Middle East

South Africa: Economic activity dampened by recurrent strikes

Economic activity remains in contraction for the fourth consecutive month, with HSBC PMI falling to 49.5 in June (from 49.7 in May). This decline was mainly due to a fall in output and new orders with foreign demand falling to its lowest level in two years. Inflationary pressures (6.6% y/y in May, up from 6.1% in April) bring additional concerns to businesses, leading to rising input costs. While the five-month long strike in the platinum sector ended at the end of June, a new strike of metal workers started at the beginning of July. According to the Steel and Engineering Industries Federation of South Africa (Seifsa) the current strike is costing the South African manufacturing industry about USD28 million per day. Nonetheless, after a sharp fall in May, the SACCI business confidence index increased slightly in June (from 88.9 to 89.7), suggesting a moderate improvement. EH forecasts GDP growth to reach +2% in 2014, followed by +3% in 2015.

Asia Pacific

India: New budget – critical test for growth

Signs of a rebound in activity are increasing. Domestic and export car sales increased in June (+11.2% y/y and +16.6% y/y respectively). Business sentiment is accelerating as suggested by the strong rise of the HSBC composite output PMI (to a 16-month high at 53.8 in June). The FY2014-15 budget which should be presented on July 10 will be a critical test for the new government, showing its willingness to make structural reforms. This is even more important as the release of the separate railway budget on July 8 disappointed: while a modernization of the current infrastructure with the use of foreign investors' funds was promised, no clear details on the process were given; and planned expenditures for 2014-15 were revised up by +1.8% (from an interim budget set in February) to 654.45bn rupee. The main FY2014-15 budget should have a clearer policy direction and more details on the plan. EH expects GDP growth to pick up to +5.6% in FY2014-15 and +6.1% in FY2015-16.

What to watch

- July 10 – UK BoE meeting
- July 10 – France, Netherlands, Ireland June inflation rate
- July 11 – Germany, Spain June inflation rate
- July 11 – Mexico May industrial production
- July 11 – Mexico Interest rate decision
- July 13 – Slovenia early parliamentary election
- July 13 – FIFA Football World Cup final
- July 14 – ECB Draghi speech in the European Parliament
- July 14 – Eurozone May industrial production
- July 15 – Juncker election as the European Commission President in the European Parliament
- July 15 – UK June inflation rate
- July 15 – U.S. June retail sales
- July 16 – U.S. June industrial production
- July 16 – U.S. July housing market index
- July 16 – UK May unemployment rate
- July 16 – Brazil interest rate decision
- July 16 – Brazil May retail sales