Euler Hermes Economic Research

Weekly Export Risk Outlook

4 October 2017

FIGURE OF THE WEEK

+1.5%

Eurozone y/y inflation in September

In the Headlines

France: Year Zero

After a lost decade, 2017 is probably the first year in a new growth cycle for France. Crisis legacies are widespread: the national income and corporate investment were only marginally higher in 2016 than in 2007 (in comparable volume terms). However, growth is currently accelerating and broadening, with household (+4.4% in 2017) and corporate (+3.6%) investment being aligned. Euler Hermes expects GDP growth to reach +1.7% in 2017 (up from +1.1% in 2016). The most recent good news is that the government will post a fiscal deficit below the -3% of GDP Maastricht threshold (first time since 2007). What about policies to push growth further? The priority will be to let more money in private sector cash vaults, but with sequencing.

Households will be the firsts to see some improvement in 2018 as their contribution to social taxes will decrease (transferred to the CSG, which has a broader tax base) and some of them will see their housing tax decline. This should help to cope with the paradox that private consumption is currently growing by just +1% y/y (12-month cumulus in August) despite consumer confidence being on a high level (103 in August) last seen ten years ago. The reason is simple: as households are no longer worried about unemployment and see some opportunity to make major purchases their priority goes to investment and durable goods. But in the short-run they have less money to spend in day-to-day consumption. The fiscal stimulus decided for 2018 should help consumer spending to grow by +2.2% in 2018 (after a forecast +1.4% in 2017).

The corporate sector is also a key priority for the new government. But implementation of the complete overhaul of the CICE and its replacement by a permanent cut of corporate social taxes by -6pp was delayed to 2019. In our view, it was needed in order to comply with the fiscal target in 2018. But it also means that corporates will have to wait in order to recover their pre-crisis margins (from 31.6% in Q2 2017, vs. an average 32.5% before the crisis).

U.S.: Consumption stumbles, manufacturing runs

The U.S. consumer is lagging, but manufacturing is strong. Real personal consumption expenditures (PCE) fell -0.1% m/m in August. At this rate Q3 PCE may range between +1.8% and +2.0% q/q annualized, well shy of the +3.3% pace set in Q2. PCE is struggling because real disposable personal income (DPI) is weak, falling -0.1% m/m, bringing the y/y rate to just +1.2%. Consumers have been spending out of savings, driving the savings rate down to a slim 3.6%. The same report also showed weak inflation as wage growth was flat, and the Fed's favored inflation gauge, the PCE core, ticked down from 1.4% y/y to 1.3%, the lowest in 22 months.

The manufacturing side of the economy is strong as the ISM manufacturing index gained 2 points to 60.8, the highest in over 13 years, driven in part by new orders which gained 4.3 points to 64.6. Hurricane effects appeared as supplier deliveries leapt 7.3 points to 64.4 and prices jumped 9.5 points to 71.5. Core orders for durable goods rose for the seventh time in eight months to a +3.6% y/y rate.

Eurozone: Inflation back to normal although below target

According to a flash estimate, Eurozone inflation remained mired at 1.5% y/y in September. At 1.3% y/y, core inflation (excluding energy and unprocessed food) was also unchanged compared with August. We are forecasting similar figures for the coming months. Currently it is striking that services inflation at 1.5% is markedly higher than for industrial goods ex energy at 0.5%. In our view this shows that in the global economy price-dampening forces are still at work. By contrast, in the services sector, which is influenced more by domestic economic factors, the trend in prices is returning to normal. Wage growth is also showing signs of perking up and the latest results of the EU Commission survey show consumer inflation expectations climbing back to the elevated level seen early in the year although current inflation is now lower than at the start of the year. In our opinion, this all suggests a return to a healthy price environment in the Eurozone. Even if the ECB's inflation target has not yet been met, the central bank can be content with the picture, especially as the buoyant economy points fundamentally to a further pickup in inflation.

Countries in Focus

Americas

Ecuador: Timid recovery underway amid persistent risks

Q2 real GDP rose by +3.3% y/y (up from +2.2% in Q1) and by +1.9% q/q, posting a third consecutive quarter of positive growth. The economy shows first signs of a recovery after a contraction of -1.6% in 2016 due to the global slump in oil prices and a major earthquake. Growth was driven by stronger household consumption (+2.3% q/q), especially in financial services, transport, and communications. Higher household spending was also linked to the highest y/y import growth in seven years, at +13.2% (+ 3.7% q/q). This was supported by the removal of import surcharges (used to correct the previously deteriorating balance-of-payments position) and a trade agreement with the EU (since 2017). Fixed investment increased by +0.1% q/q after contracting by -1.8% in Q1, indicating that the recovery is not broad-based yet. GDP growth should reach +0.6% in 2017 and +1.4% in 2018; but risks are tilted to the downside due to persistently low oil prices, a growing debt burden and fragile external buffers.

Europe

Germany: Brisk labor market

The decline in the jobless total accelerated appreciably in September, dropping -23,000 on the previous month in seasonally adjusted terms. Over the preceding four months the decline had averaged a mere -5,000. Jobs growth remains strong. In August the number of people in work in Germany was +1.6% up on a year earlier. According to the Federal Employment Agency, the ongoing jobs growth stems exclusively from the increase in jobs liable to social insurance. Here the number of people in work was up by +888,000 on a year earlier, an increase of +2.8%. Other forms of employment such as self-employed and those exclusively in mini-jobs recorded a decline. Sentiment surveys point to an ongoing economic upswing. Dark clouds are currently not on the horizon. We therefore see the positive trend on the labor market continuing next year. However, the momentum is likely to be somewhat weaker than this year.

Africa & Middle East

Ethiopia: Mind the fifth element

Despite sizeable annual current account deficits in recent years (around -10% of GDP, or about USD4.5bn), Ethiopia has exhibited the four elements needed to grow. Fire, in the manufacturing sector projects needed to increase energy production and the development of the consumer (e.g. car plants) drove GDP growth to +9% during fiscal year (FY) 2016/17. Air, since increasing foreign direct investment is financing the boom (USD3.8bn in FY 2016/17, +73% y/y). Land and human resources are also among the growth factors as Ethiopia is home to 13.5% of the Sub-Saharan Africa population. Finally, water should also be among future growth factors since Ethiopia is finalizing the Renaissance Dam needed to increase power generation. However, one factor is missing. This fifth element is about regional divergence: drought in the agricultural sector and regional divides fuel remaining pockets of vulnerability. It is a reminder that the sovereign and sub-sovereigns are not exactly the same, despite overall good GDP growth prospects (we forecast +7.5% in 2018).

Asia Pacific

China: Manufacturing sector – slowing or accelerating?

The official manufacturing PMI and the Caixin manufacturing PMI sent mixed signals in September. Both pointed to a continued expansion of manufacturing activity but the pace suggested was different. A rise in the NBS index to 52.4 in September (from 51.7 in August) indicates an acceleration of activity growth while the decrease of the Caixin indicator to 51.0 (from 51.6) suggests a deceleration. Our take is that these two indices reflect two different realities. The official index relates to the situation of larger firms and state-owned companies, while the Caixin indicator reflects the sentiment in private and smaller companies. As credit conditions have tightened, private and smaller companies tend to be impacted more while larger firms and public corporates have more leeway to catch growth opportunities thanks to easier access to credit, more financial buffers and more pricing power.

What to watch

- October 5 – U.S. August foreign trade
- October 6 – Canada September employment report
- October 6 – France August foreign trade balance
- October 6 – Germany August factory orders
- October 6 – Hungary August industrial production
- October 6 – Russia Q3 consumer confidence
- October 6 – Russia September inflation
- October 6 – U.S. September employment report
- October 9 – China September Caixin Services PMI
- October 9 – Germany August industrial production
- October 9 – Mexico September inflation
- October 9 – Turkey August industrial production
- October 10 – Argentina BCRA meeting
- October 10 – Ukraine September inflation
- October 11 – Spain September inflation
- October 11 – Turkey August balance of payments

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