

FIGURE  
OF THE WEEK

-17.2%

Ukraine's Q1  
y/y GDP  
contraction

## In the Headlines



### Greece: Financing, political and economic storm of isolation

The political and economic situation deteriorated significantly from last Friday. Negotiations between Greece and EU institutions broke down with no agreement after several meetings. The referendum that PM Tsipras called to be organised on the acceptance of the bailout conditions will be held this Sunday, 5 July. The European Central Bank decided last Sunday to keep its provision of emergency liquidity assistance (ELA) to Greek banks unchanged (at EUR89 bn) and this decision was reaffirmed on Wednesday. As a consequence, and following large-scale withdrawal of deposits, Greece announced a closure of banks and financial markets starting on Monday 29 June until 7 July, while imposing capital controls. Company financing from banks is non-existent and domestic payments rely on existing working capital. Payments abroad are currently frozen, although with a few exceptions. In light of the liquidity shortage, we expect capital controls will be strengthened in the coming days, with a high risk that the bank holiday is maintained after the referendum. Capital controls are expected to remain in place for a couple of months, at least, as once implemented they are very difficult to reverse, given the general lack of confidence; it took Cyprus two years and Iceland seven years to revoke controls. Moreover, we expect them to be removed only gradually. Company payment behaviour is expected to deteriorate significantly, with increasing delayed payments as well as non-payments. DSOs already stand at a very high level. Several sectors have been identified as highly vulnerable to insufficient financing or supply disruption risk – stemming from frozen imports – and these include machinery and equipment, oil and refined petroleum, computer and IT services and vehicles. The risks to the retail sector hinge on the combination of supply disruption and anticipation of fading local demand. Overall, GDP is likely to fall by -1.5% in 2015 as domestic demand contracts and imports are disrupted and there will be further upward pressures on consumer prices. Business insolvencies are expected to rise by +10% from an already high level.



### China: Headwinds prompt the PBoC to act

The PBoC cut its one-year lending rate (-25bps to 4.85%) for the fourth time since November 2014. In addition, it stepped up targeted measures, with a cut in the Reserve Requirement Ratio for banks serving small companies, rural areas and the agricultural sector (-50bps). These moves come while economic tensions are increasing. Data continue to provide mixed signals as profit growth of major industrial companies (annual revenues exceeding RMB20 mn) slowed in May (+0.6% y/y from +2.6% in April). Stock market movements remain volatile, with a strong correction in June; the Shanghai exchange was down -11% between 24-26 June and, at the end of June, the index was -17% compared with its high during the month. More concerning, on the export side, risks are on the downside, with renewed uncertainties about the demand outlook in the EU (main trade partner, with 15.8% of exports). Going forward, after a sluggish Q2 and GDP growth probably below +7%, EH expects a progressive stabilisation supported by further accommodative measures, bringing growth to an average of +7%.



### U.S.: Consumption and housing improving

The economy appears to be picking up momentum. Consumers finally put their income to use in May instead of saving it, adding a strong +0.9% to personal consumption expenditures (PCE), a good sign for Q2 GDP. Core PCE inflation remained tame at only +1.2% y/y. The increased spending was due in part to a jump in consumer confidence, which increased a sharp +6.8 points to 101.4, above the 100 level associated with a strong economy. Consumer assessments of both future and current situations made strong gains. The housing market improved in May as new home sales gained +2.2%, existing home sales increased by +5.6% and pending home sales increased +0.9%. Even manufacturing showed some signs of life as new orders for non-defence capital goods (excluding aircraft) rose +0.4%. Q1 GDP was revised from -0.7% quarterly annualised to -0.2%, driven by increased estimates of consumption and investment, although business investment fell -0.3% for the quarter, the most in four years. EH expects GDP growth of +2.5% in 2015 and +2.7% in 2016.

# Countries in Focus

## Americas

### Colombia: Coping with weaker oil prices

Last week, the Central Bank's monetary policy committee decided unanimously to maintain its more neutral policy stance by keeping the key interest rate unchanged at 4.5% (since September 2014). The decision was taken against a background of current price pressures that are perceived as temporary ([see also WERO 18 June 2015](#)); inflation was 4.41% in May after 4.64% in April, although it remains above the Central Bank target of 3% +/-1pps. Despite current weak oil prices (petroleum products account for over 55% of total exports and 10% of fiscal revenues), domestic demand will drive economic growth, albeit at somewhat lower levels than in 2013 (+4.7%) and 2014 (+4.6%). Consumption and investment, particularly related to civil works and infrastructure, will sustain annual GDP growth above +3% and inflation will fall back within the target range (averaging 3.9% in 2015 and 3.1% in 2016). EH expects GDP growth will be above the regional average, at +3.3% in 2015 and +3.5% in 2016.



## Europe

### Ukraine: Deepening recession and rising sovereign default risk

A second estimate by the statistical office confirmed that the recession deepened further in Q1, with real GDP declining by -17.2% y/y and -5.3% q/q. Both external and domestic demand were hit hard. Exports fell by -26.2% y/y, outpacing imports, which were down by -20.1% y/y, so that net exports made a large negative contribution to Q1 growth. A +5% y/y increase in government consumption did not compensate for sharp plunges in fixed investment (-25.1% y/y) and household consumption (-20.7% y/y). The latter is likely to fall further in Q2 as inflation accelerated to around 60% y/y in April-May from 46% in March, driven by large one-off increases in energy tariffs, which are part of an IMF programme. Euler Hermes forecasts full-year 2015 GDP will decline by at least -9%. Meanwhile, three-month long talks with creditors on a 40% writedown on USD23 bn of sovereign debt have remained unsuccessful, to date, raising the risk of another default in Europe.



## Africa & Middle East

### Egypt & Tunisia: No respite from attacks on the state

The recent attack on a beach resort in Sousse in Tunisia and the assassination of Egypt's leading prosecutor provide further evidence of: (i) the vulnerability of the economies and security systems in these countries and (ii) the fragility of the ongoing political transitions, despite some advances. Indeed, terrorist targeting of Tunisia's tourism sector (14% of GDP, 12% of the labour force and 20% of FX earnings) is intended to undo some of the positive advances in political consolidation and security. Similarly, Egypt's new regime has established itself and is attempting to boost economic activity but tight security and strict limits on the Moslem Brotherhood are providing a feeding ground for opposition to become more militant. Expect further but sporadic (except in the Sinai where militancy is more entrenched) terrorist activity throughout the region. As a result, forecasts of GDP growth are tenuous and EH's 2015 projections of +3.5% (Tunisia) and +4% (Egypt) may require downward revision.



## Asia Pacific

### South Korea: Slow recovery ahead

Nominal exports contracted for the sixth consecutive month in June (-1.8% y/y, -10.9% in May) reflecting still weak global demand. Inflation accelerated moderately but remains low (0.7% y/y, 0.5% in May) and below the Central Bank's annual inflation target (2.5%-3.5%). Meanwhile, domestic demand indicators deteriorated recently, partly because of the development of the "Middle East Respiratory Syndrome". In May, retail sales (0% m/m) and industrial production (-1.3%) both showed signs of weakness. In June, business sentiment deteriorated; the Nikkei/Markit Manufacturing PMI posted its lowest reading in 33 months and in the Bank of Korea Survey, the future tendency component posted its lowest in 30 months. The key policy interest rate was cut to a record low 1.5% in early June and the government unveiled a KRW15 trn fiscal stimulus package. After a slowdown in Q2, GDP growth will recover gradually from Q3 onwards and EH expects growth of +2.6% in 2015 and +3.5% in 2016.



## What to watch

- July 02 – U.S. June employment report
- July 02 – South Africa May electricity output
- July 03 – China June services PMI
- July 03 – Eurozone June PMIs (final)
- July 03 – UK June services PMI
- July 06 – U.S. June ISM non-manufacturing index
- July 06 – Germany May factory orders
- July 06 – Ireland Q1 GDP
- July 07 – U.S. May international trade
- July 07 – South Africa June foreign reserves
- July 07 – Germany & Hungary May industrial output
- July 07 – UK May industrial production
- July 08 – Hungary June CPI
- July 08 – Japan May current account balance

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