Euler Hermes Economic Research

Weekly Export Risk Outlook

12 April 2017

FIGURE OF THE WEEK

USD56

Barrel price of benchmark Brent crude oil (+29% y/y)

In the Headlines

Greece: Closer to an agreement

The Eurogroup meeting on 7 April indicated a positive outcome of the second program review in the upcoming weeks which should allow the disbursement of the next funding tranche needed in order to avoid a default on the bond market in July when EUR6.2bn of bonds are maturing. Creditors approved that Greece intends to carry out a reform package worth 2% of GDP over the following years, 1% of which will fall upon 2019 mainly based on pensions and 1% upon 2020, in principle, focusing on personal income tax. Should the economy perform better than expected and allow some fiscal space, it was agreed that the Greek government can implement some fiscal stimulus. The medium-term path and debt sustainability are still to be discussed once the second review is completed, which is a decisive element for IMF participation in the bailout. The next Eurogroup meetings are on 22 May and 15 June. Meanwhile, capital controls have been markedly eased but are still in place. A lifting of controls is possible in H2 2017, after more than two years since their introduction, which should be supportive for external trade activity. GDP growth is forecast to recover to +1.7% in 2017 (-0.1% in 2016).

Czech Republic: CZK cap exit

On 6 April the Czech National Bank (CNB) removed the exchange rate floor of EUR1:CZK27. The cap was imposed in November 2013 to fend off deflation which it successfully did. The removal was widely expected, given the recent acceleration of inflation (2.6% y/y in March) and the surge in official foreign exchange reserves (EUR122bn in March 2017, up from EUR43bn in November 2013). Following the lifting of the cap, currency volatility has increased but at between +1% and +2%, the CZK appreciation against the EUR has been far from disorderly – in contrast to the CHF advance after a similar cap removal by the Swiss National Bank in 2015. Volatility is likely to continue in the short term; a temporary weakening is also possible as investors may close speculative positions built up in recent months. In the medium term we expect a gradual strengthening of the CZK to a new equilibrium rate. In any event, expect the CNB to be prepared to mitigate potential excessive exchange rate fluctuations, if needed. As the cap exit was anticipated, we maintain our GDP growth forecast of +2.8% in 2017.

Spain: Unemployment gradually improving but still high

For the first time in six years, the Spanish unemployment rate fell below 20% in 2016, although it still remains the second-highest in the EU. Long-term unemployment accounts for more than half of the total. The employed population is 2.2mn below the pre-crisis level and the total number of hours worked has contracted by -13%. Spain's 30-year average unemployment rate exceeds 17%, while the employment rate is over 15pp below European top performers. The labor market shows a marked duality in terms of protection and wages. The country also comes second with regard to temporary contracts which account for about one fifth of employees, twice as high as the regional average. In addition, the share of involuntary part-timers climbed to more than 60% in recent years. Compared to their older peers, the incoming workforce has lagged behind in terms of human capital. The 15 to 24 age group ranked 56th out of 124 countries, compared to the 25 to 54 cohort that ranked 38th. Altogether, the share of high-skilled employment is over 10pp below European top performers.

Emerging Markets: Confidence clears up the skies

In March, our proprietary Euler Hermes aggregate EM Manufacturing PMI improved to 51.6 points (up from 50.9 in February), the best figure since April 2012, growing for the seventh consecutive month. The novelty this month was that the improvement was broad-based. Out of the total increase of +0.7 points, nearly +0.5 points were explained by an improvement of the "Unbalanced Four" (Brazil, South Africa, Mexico, Turkey). In particular Brazil's PMI advanced to 49.6 in March, up from 46.9 in February, thus accounting for 43% of the total EM PMI improvement. The first increases in the output and order books sub-components in 26 months produced the best PMI since February 2015 in Brazil, suggesting the exit from a 2½-year recession is near. Turkey's PMI signaled a recovery in manufacturing after standing below the 50.0 threshold for one year, driven by the fastest output growth in over three years and strong job creation. Apart from the Unbalanced Four, India is the other main contributor to the EM PMI improvement (+0.2 points), with an acceleration of the production, order books and exports sub-components amid slowing inflation rates.

Countries in Focus

Americas

U.S.: March employment report not as bad as it looked

The March employment report was disappointing, contributing to a weak outlook for Q1 GDP, but it was not as bad as it looked. The economy created only +98,000 jobs vs. expectations of +175,000. Winter storm Stella was responsible for part of the disappointment as construction gained only +6,000 jobs while retail jobs fell for the second straight month, confirming the carnage in that sector. On the positive side, March was the fourth consecutive month of gains in the labor force, suggesting economic strength that is drawing people back to work. The unemployment rate fell from 4.7% to 4.5%, the lowest of the recovery and the lowest in almost 10 years. Wage growth of +2.7% y/y was stable and will keep the Fed on course. Separately, the NFIB small business optimism index slipped for the third straight month as hopes waned for a rapid implementation of President Trump's agenda. The index was dragged down by expectations of future sales which have fallen to 17.6, well below December's 31.4.

Europe

Turkey: Weak start into the year

In February, growth of industrial production slowed to +1% y/y (from +2.6% in January) while the contraction in real retail sales picked up again, to -4.4% y/y (from -2% in January) indicating that overall economic activity will be weak in Q1. Meanwhile, the current account deficit widened to –USD5.3bn in January-February, from –USD4.2bn in the same period a year ago. Imports of goods and services (+6.9% y/y) grew faster than exports (+4.2% y/y), with exports of services (-8.6% y/y) still falling as the slump in tourism continued. We expect the current account deficit will rise from -3.8% of GDP in 2016 to -4% in 2017. On the political front, Turkey will hold a controversial referendum on a new constitution on 16 April, which, if passed, will turn the country into a presidential republic. Irrespective of the outcome, expect increased currency volatility in the aftermath of the poll. Early elections would be possible in 2017 as well, a presidential one following a 'yes' vote, a legislative one in the event of a 'no' vote.

Africa & Middle East

Bahrain: Weakening oil sector curbs growth

Recently released official data show that real GDP growth decelerated to +1.1% y/y in Q4 2016, down from +3.9% in Q3, +2.5% in Q2 and +4.5% in Q1, taking full-year 2016 GDP growth to +3%. The main driver of the sharp slowdown in Q4 was a -10.5% y/y contraction of the oil sector, following an average increase of +3.8% y/y in Q1-Q3, reflecting a drop in both oil production and refining activity in the final quarter. The oil sector has now edged down by -0.1% for two consecutive full years. Meanwhile, the non-oil sector grew by a robust +3.7% y/y in Q4 as well as in 2016 as a whole, slightly up from +3.6% in 2015. We forecast full-year GDP growth to slow down to +2% in 2017 since the oil sector should continue to decline as Bahrain is expected to comply with oil production cuts agreed under the OPEC deal from November 2016 while the non-oil sector should moderate as financial services (+5.2% in 2016) and social and personal services (+9.1%) are likely to decelerate after peaking last year.

Asia Pacific

China: Normalizing macro-policies will not be easy

Latest indicators suggest that the economy will continue to need accommodative macro-policies to achieve the authorities' +6.5% growth target this year. Vehicle sales growth slowed rapidly to +4% y/y in March from +22.4% in February, after a sales tax hike on small-engine vehicles in January (from 5% to 7.5%). Consumer price inflation remained low in March, at +0.9% y/y, well below government expectations of +3%. While the central bank pointed out that it will keep its monetary policy stance neutral and focus on reducing financial risks, low inflation puts the institution into a dilemma: accommodate further in a bid to boost inflation or accommodate less to reduce financial risks. A mix of both will likely be chosen, with a selective approach on credit supply thanks to a tightened regulatory framework and a policy rate at a low level to keep credit affordable. On the fiscal policy side, policymakers will likely remain accommodative to spur growth. We expect GDP to rise by +6.3% in 2017.

What to watch

- April 13 – Germany March CPI and HICP (final)
- April 13 – Slovakia March CPI
- April 13 – Ukraine Central Bank meeting
- April 13 – U.S. March PPI
- April 14 – Croatia March CPI
- April 14 – U.S. March CPI and retail sales
- April 15 – Kazakhstan March industrial production
- April 16 – Turkey constitutional referendum
- April 17 – China Q1 GDP growth
- April 17 – Colombia February industrial production
- April 18 – Serbia February industrial production
- April 18 – U.S. March housing starts and permits
- April 18 – U.S. March industrial production
- April 19 – Eurozone February trade balance
- April 19 – Eurozone March CPI and core inflation
- April 19 – South Africa March CPI