Euler Hermes Economic Research

Weekly Export Risk Outlook

28 June 2018

FIGURE OF THE WEEK

USD71

Average barrel price of bench-mark Brent crude oil in H1 2018

In the Headlines

Greece: Debt relief deal another step in the right direction

Greece and its European creditors brokered a grand bargain on further debt relief that sees Greece get the desired "clean exit" from its EUR86bn ESM program in exchange for accepting continued post-program surveillance. Together with the improving economic and fiscal outlook the deal should provide a good basis for Greece returning to financial markets on a sustainable basis in August. In addition to a credible upfront commitment to lighten Greece's debt load via an extension of maturities and deferred interest on official loans, measures include a transfer of Eurozone central banks' profits accrued on Greek bonds as well as the cancellation of an increase in the EFSF's interest margin on one of the tranches. The latter two measures are conditional on Greece completing a series of reforms as well as meeting fiscal targets in the coming years – a primary surplus of +3.5% until 2022 and +2.2% until 2060 – with progress tracked in quarterly reviews. Meanwhile thanks to additional cash funds Greece's cash buffer now stands at EUR24bn – equivalent to about 85% of sovereign financing needs until end-2020 – and should provide a sizeable backstop in the case of adverse market conditions.

Turkey: Erdogan will assume strengthend presidency

Last Sunday, simultaneous presidential and parliamentary elections were held. As expected, incumbent President Erdogan won the presidential election with 53% of the vote, thus avoiding a second round run-off. In the parliamentary election, Erdogan's ruling AKP lost its majority, winning 43% of the vote, 7pp less than in the previous election at end-2015. But Erdogan was saved by an alliance of the AKP with the nationalist MHP which surprised with gaining 11%. AKP and MHP had already teamed up last year to win approval in a constitutional referendum on the introduction of a new presidential system. Following these elections, that system will now come into effect, providing Erdogan's with a much strengthened executive presidency. The TRY initially rallied by around +3% against the USD after Erdogan's victory, but the gains have been wiped out in the meantime. Investors may have recalled concerns about Erdogan's unorthodox economic views which had already intensified the TRY's slide in May. A slowdown of the Turkish economy is already on the cards (see WERO 14 June 2018). How sharp it will be will depend on the economic policy course that President Erdogan will adopt now.

Germany: Ifo test with light and shade

After the temporary stabilization last month, the sentiment in the German economy deteriorated further in June. The Ifo Business Climate Index fell by 0.5 points. At 101.8 points, it is now at its lowest level in just over a year. A positive aspect of the latest survey results is that companies' assessment of their business expectations has not deteriorated further. Overall, it is still slightly positive. The decline in the overall index is solely attributable to the less favorable assessment of the current situation. There is no doubt that the downside risks for this year's real GDP growth forecast of +2.2% (working-day adjusted) have increased due to the weak start to the second quarter – industrial production and new orders disappointed in April. However, we remain confident that economic momentum will pick up somewhat in the course of this year, as the domestic economic conditions for a continuation of the upswing remain very good: The earnings situation in the corporate sector is positive, high capacity utilization promotes investment demand and job creation generates additional income – just to name a few.

France: Early signs of a recovery

France experienced a growth slowdown in H1 2018. Growth in Q1 (+0.2% q/q) was the weakest since Q2 2016; and Q2 2018 is set to be weak again: we expect +0.3%. The main reason is the impact of the unexpected rise in inflation (2% y/y in May) driven by higher oil prices. Household purchasing power was on the downside in Q1 (-0.6% q/q) and should decrease in Q2 as well. Corporates had to lower their output as a result of subdued demand and saw their margins stalling at 31.9%, since they felt renewed downward pressures on their selling prices. However, June business confidence data show some genuine improvements. First, the expected production in the automotive sector recovered quite fast, suggesting that past high inventories were reduced. Also, the construction sector saw a recovery in terms of overall confidence. Moreover, we expect inflation to reach its peak in July. Then, household purchasing power (and consumption) should recover somewhat and drive GDP growth higher. Overall, we stick to our growth forecast of +1.8% in 2018.

Countries in Focus

Americas

U.S.: Trade fears cause uncertainty and disruptions

Consumer confidence slipped in June from 128.8 to 126.4 points, but still remains close to the 17-year record set in February of 130.0. The decline was driven by a -4.0 point drop in the expectations components, the biggest in seven months, perhaps reflecting concerns over how a trade war could affect the economy in the future. Indeed, retaliatory tariffs on U.S. goods are already causing disruptions and uncertainty for domestic manufacturers, and on Friday the Trump administration proposed yet another round of tariffs on an additional USD200bn of Chinese goods. Other reports on housing show a market struggling with low supply and decreasing affordability. In May, existing home sales fell for the second consecutive month to a -3.0% y/y rate while prices rose +4.9% y/y. However, new homebuilders are starting to catch up with demand as sales and starts rose +14.1% y/y and +20.3% y/y, respectively, while prices fell -3.0% y/y.

Europe

UK: On course for a rate hike in H2 2018

As expected, the Bank of England (BoE) voted to maintain its policy rate at 0.5% but there was an additional vote in favor of a rate hike (6 to 3) than previously. The forward guidance regarding the balance sheet adjustment has also been revised (until the rates reach 1.5% compared to 2%). But we expect this level to be reached at the end of 2020 at the earliest. The hawkish stance of the BoE should limit the downward pressures on the GBP – we expect it to depreciate by -4% and -1% against the USD and EUR (to 1.34 and 1.12), respectively, by end-2018. The BoE considers the strong Q1 slowdown to be only temporary with economic momentum recovering in Q2, thanks to solid employment growth (the unemployment rate was 4.2%, the lowest since 1975), a strong pick-up in retail sales (+3.9% y/y in May), improving consumer confidence in their own future financial situation (+8 points in May, up +4.5 compared to the post-EU referendum average) and higher consumer credit flows. As the next BoE meeting is on 2 August and the Q2 GDP data release on 10 August, we see the BoE rather wait for the confirmation of the expected activity pick-up before raising rates. Hence the next rate hike (+25bp) is expected in November. Overall we expect GDP growth of +1.4% in 2018 and +1.3% in 2019.

Africa & Middle East

Ghana: Encouraging signs despite poor rains

Economic growth weakened to +6.8% y/y in Q1, after a very strong performance in full-year 2017 (+8.4%), triggered by much lower commodity output growth. Agricultural output grew by just +2.8% y/y in Q1 after +8.5% in Q4 2017. Poor rains were the main trigger and cocoa output should fall short of 2018's target (700 MT are expected this year, instead of 850 MT). However, Ghana's overall trends remained positive, since services (two thirds of the economy) grew by +5.2% y/y in Q1, accelerating from +3.4% in Q4. Moreover, the Manufacturing PMI exhibited a genuine increase to 55.8 points in May. This improving momentum in the non-agricultural sector should support overall growth in the next months. All told, poor rains will have an impact on the overall growth performance but it should be marginal, triggering a forecast revision from +9% to +8% for 2018 as a whole.

Asia Pacific

Asia: The hawks club

The last two months have seen a noteworthy change in the monetary policy stance across the region. India, Indonesia and the Philippines joined the club of monetary tightening central banks (the hawks), following South Korea, Malaysia, Singapore and China (the latter tightened mainly through regulation). Downward pressures on the currencies, the risk of capital outflows and signs of higher inflation in a context of rising interest rates in the U.S. were among the reasons. Who will be the next to move? In China, the latest PBoC move (RRR cut of 50bp) indicates a pause in the tightening cycle as trade tensions escalate. Australia could be the next to move (+25bp expected by end 2018) as inflation is close to target (1.9% y/y in Q1 2018) and growth is relatively robust. Gradual policy normalization could help reduce risks associated with high households debt.

What to watch

- June 29 – Croatia May industrial production
- June 29 – Germany May retail sales
- June 29 – Kenia Q1 GDP
- June 29 – Serbia May industrial production
- June 29 – U.S. May personal income and spending
- June 30 – China June official PMI
- July 1 – Kazakhstan June inflation
- July 2 – Czech Republic, Poland Manufacturing PMI
- July 2 – Estonia May industrial production
- July 2 – Russia, Turkey Manufacturing PMI
- July 2 – U.S. June ISM manufacturing index
- July 2 – U.S. May construction spending
- July 3 – Turkey June inflation
- July 3 – U.S. May factory orders
- July 4 – Romania monetary policy meeting

Contact Euler Hermes Economic Research Team
research@eulerhermes.com

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