Euler Hermes Economic Research

Weekly Export Risk Outlook

6 June 2018

FIGURE OF THE WEEK

+0.8%

Q1 2018 q/q GDP growth in Greece

In the Headlines

Italy: Political uncertainty to weigh on growth prospects

The second estimate for Italian GDP growth in Q1 2018 confirmed an expansion of +0.3% q/q. A negative growth contribution from the external sector with exports (-2.1%) falling at a faster pace than imports (-0.9%), was more than made up for by positive impulses from domestic demand. Worryingly though, inventories (+0.7pp) proved to be the main driver while private consumption growth (+0.3%) was moderate and fixed investment activity registered a sizeable set-back (-1.4%). Going forward we expect no pick-up in domestic demand given elevated political uncertainty around the course of Italy's newly installed populist government. On the contrary, in our baseline scenario we expect concerns about the negative impact of expansive fiscal policy measures on public debt fundamentals as well as a moderately confrontational EU stance to weigh on firms' investment and hiring plans and on consumption decisions. The external sector is unlikely to save the day with export demand – in particular from the Eurozone – showing signs of slowing down while the threat of intensifying trade tensions persists. We forecast GDP growth to slow to +1.2% in 2018 from +1.5% last year.

Greece: Strong start in 2018

The economy kicked off the year 2018 with a strong GDP growth performance of +0.8% q/q in Q1, up from +0.2% in Q4 2017. Compared to Q1 2017, GDP rose by +2.3% – the strongest annual reading in a decade. Net exports were the key driver of growth with exports increasing +9.5% y/y while imports declined by -2.7%. Meanwhile domestic demand proved to be a mixed bag: Private consumption came in at a better-than-expected +1.3% y/y whereas investment disappointed with a decline of -8.3%. The overall Q1 GDP reading is boosting the odds that Greece's exit from its third bailout and return to international capital markets this summer will be a success and it confirms our 2018 growth forecast of +2.3%. Maintaining the reform momentum, however, remains key to attract long-term investment going forward and in turn to ensure a sustainable economic recovery. Worryingly, the Greek government's 100-page post-bailout growth plan proves rather short on details, and high hopes that debt relief provided by its European partners will boost growth prospects by itself may be misplaced.

France: Growth price tags

Increasing evidence shows that Q2 GDP growth should remain quite subdued. Inflation came out at +2% y/y in May, the first time since August 2012 it reached the 2%-threshold. The picture for wage growth is quite different: it grew by just +1.4% y/y in Q1 2018, compared to +2.2% in Q3 2012. As a result, household purchasing power is likely to show weak growth in H1 2018, after an already mere increase of +0.2% q/q in Q4 2017. Obviously, the inflation rise in May was driven by a genuine oil price increase (benchmark Bent reached on average 77 USD/bbl in May). This is bad news for corporate margins since selling prices have not increased as well, in particular in the manufacturing sector where prices grew in February for the first time in the last five 5 years but returned to deflationary territory in March (-0.2% y/y in May). These divergent price tags between the consumer and the corporates are bad signals for Q2 growth. We expect +0.3% q/q (after +0.2% in Q1), and +1.8% for 2018 as a whole.

Turkey: Prices up, sentiment down

On the back of last month's sell-off in the TRY as well as rising oil prices, inflation climbed markedly in May, with the headline figure up to 12.2% y/y (10.9% in April) and core inflation up to 12.6% y/y (12.2% in April). The rise in inflation was relatively broad-based, with the large price components food inflation (up from 8.8% in April to 11% in May) and transportation inflation (up from 16.5% to 20%) each adding +0.5pp to the headline figure in May. Meanwhile, the Manufacturing PMI dropped further to 46.4 points in May (48.9 in April), driven by an ongoing slowdown in new orders, indicating a marked decline in the health of the manufacturing sector. These two bad news at the start of this week reversed the tempo-rary recovery of the TRY following the two decisive monetary policy measures at the end of May (see also WERO 30 May 2018). The TRY has hovered around 4.60 vs. the USD so far this week, down from 4.48 at the end of last week. We believe that another rate hike in the region of 300bp is needed in order to calm down investors and stabilize the currency more permanently. However, it is unlikely to come at the next meeting tomorrow, given the weak production outlook and the relative improvement of the TRY from its all-time low of 4.92 vs. the USD on 23 May.

Countries in Focus

Americas

U.S.: Vigorous economy

A host of recent reports depict a vigorous and accelerating economy. The May employment report exceeded expectations, creating a robust 223k jobs, driving the unemployment rate to 3.8%, tying for the lowest in 48 years. The number of job openings set yet another record and exceeded the number of job seekers by yet another record margin. Real disposable personal income rose in April from +1.7% y/y to +1.9% and real personal consumption expenditure (PCE) rose from +2.4% to +2.7%, boding well for Q2 GDP. Both the manufacturing and services ISM indexes rose in May, with 19 of 20 components collectively above 50 points. Backlogs hit 14- and 21-year records, respectively, and pricing pressures are evident in both reports with manufacturing running a very strong 79.5. Core factory orders rose +1% m/m to +5.7% y/y, while shipments, which feed into GDP, gained +0.9% m/m, again boding well for Q2. The Fed will likely raise interest rates next week.

Europe

Poland: Keep on growing

Q1 real GDP growth accelerated to +5.2% y/y from +4.9% in Q4 2017. The demand-side breakdown reveals that Q1 growth was entirely driven by domestic demand while external trade activity slowed down markedly. Private consumption rose by +4.8% y/y and government consumption by +3.6% while fixed investment surged by +8.1%. Inventories added a significant +1.9pp to Q1 GDP growth. Meanwhile, export expansion dropped to +1.1% y/y in Q1 (from +8.2% in Q4) while imports eased to +3.5% (+8.9% in Q4) so that net exports subtracted -1.5pp from Q1 growth. The Manufacturing PMI fell to a 9-month low of 53.3 points in May but remained well above the 50-threshold indicating growth. We expect investment activity to ease somewhat in the course of the year due to base effects and forecast full-year growth of +4.3% in 2018 (after +4.6% in 2017). Inflation came in at just 1.7% y/y in May and, as expected, the Monetary Policy Council today decided to keep its key policy interest rate at 1.5%.

Africa & Middle East

Tunisia: Foreign exchange reserves depletion

In April, the level of foreign exchange reserves decreased to a new low with regard to import cover (2.3 months). At the same time, inflation accelerated to +7.7% y/y, mainly triggered by earlier TND depreciation, though domestic credit conditions (+13.2% y/y in Q4 2017) have also contributed to the inflation environment. The monetary policy interest rate was last tightened in March, by +75bps to 5.75%. This muted response has generated a credibility issue for the Central Bank (CB), in particular since average annual inflation is expected to post its strongest rate since 1991 this year (+7.5%). But the main difficulty is related to rising debt and financing needs. The CB has made a statement in favor of a USD1bn issuance, despite currently difficult market conditions (market tensions in Italy, Turkey and Argentina). Overall, this CB statement shows the increasing difficulty to cope with the financing needs generated by increasing debt levels (external debt is projected to reach 84% of GDP in 2018). Financing issues are a sizeable downside risk to our 2018 GDP growth forecast of +2.5%.

Asia Pacific

India: Growth champion

Real GDP surged by +7.7% y/y in Q1 2018 (up from +7% in the previous quarter), driven by a strong rise in government consumption (+16.8% y/y), investment (+14.4% y/y) and a solid rise in private consumption (+6.7% y/y). Inflation rose to +4.6% in April (from +4.3%). Leading indicators suggest continued but slower momentum. The Manufacturing PMI points to firm expansion in May even though it edged down to 51.2 points (from 51.6 in April). The Services PMI dropped to 49.6 in May (from 51.4 in April) due to a stagnation of new orders and rising input costs in the context of rising oil prices and a weak INR. Against this background, the Central Bank decided to raise its policy rate to 6.25% (from 6%) today. On the fiscal side, a slowing of the consolidation process (central deficit expected at -3.3% GDP in FY2018-19, up from the initial plan of -3% GDP) should provide some boost to growth. Euler Hermes expects real GDP growth to rise to +7.3% in FY2018-19 (from +6.7% in FY2017-18).

What to watch

- June 7 – Germany April factory orders
- June 7 – Turkey monetary policy meeting
- June 8 – Canada May employment report
- June 8 – China May trade figures
- June 8 – Germany April industrial production
- June 8 – Hungary May inflation
- June 11 – Poland May inflation
- June 11 – Turkey Q1 GDP
- June 11 – Turkey April balance of payments
- June 11 – Ukraine May inflation
- June 12 – Romania May inflation
- June 12 – U.S. May consumer prices
- June 13 – Canada May Teranet home price index
- June 13 – Turkey April industrial production
- June 13 – U.S. Fed monetary policy decision

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