Euler Hermes Economic Research

Weekly Export Risk Outlook

10 May 2017

FIGURE OF THE WEEK

66.1%

Macron's share of votes in French presidential election

In the Headlines

Puerto Rico: U.S. territory declares bankruptcy to re-structure government debt

Puerto Rico has declared a form of bankruptcy saying it was "unable to provide its citizens effective services" because of its debt burden. The island is seeking protection from creditors in hopes of being able to restructure USD74bn worth of government debt. By comparison, Detroit's bankruptcy in 2013 was for USD18bn. The creditors, including U.S. money management firms, have in effect rejected the government's plan to pay only USD787mn in debt service per year on the USD3.5bn which the creditors are actually owed. A recent budget proposal included cutting USD300mn of funding to the public universities, and cutting -10% from the public retirement system, resulting in protests from students and government workers. Government funded projects and basic services are at risk. The Puerto Rican economy has been in recession since 2006, unemployment is high, and 11% of the population has left the island. To cover years of budget shortfalls the government has borrowed to the point that the debt level can no longer be serviced. The next step in the process is that U.S. Supreme Court Chief Justice John Roberts must now appoint a bankruptcy judge to adjudicate the case.

South Korea: Elections – one problem solved

The year started with a lot of challenges. On the economic front, South Korea has to deal with weak global trade growth, high household's debt and an ageing population. On the geopolitical front, tensions with North Korea have escalated rapidly. And relations with China – its main trade partner – have deteriorated since South Korea sided with the U.S. to improve its defense capability. On the domestic political front, scandals prompted the impeachment and removal of Park Geun-Hye as president. Against this difficult background, presidential elections were held on 9 May. Moon Jae-in, a former human rights lawyer and leader of the liberal Democratic Party, won a landslide victory. His promises include chaebol reforms, fiscal stimulus of up to KRW10tn to boost growth in the near term, public sector job creation, and a rise in the minimum wage. Euler Hermes expects GDP growth to remain resilient at +2.5% or so in 2017. While the export outlook is mixed due to the rising tensions with China, additional fiscal spending and a low monetary policy rate should boost domestic demand.

Brazil: The pension reform is seeking for a vast majority

As the economy begins to emerge from recession, the government continues to push for ambitious reforms. At present on the agenda is the reform of the pension system which aims to set the minimum retirement age at 65 for men and 62 for women and to reduce pension benefits. Currently Brazilians retire on average at 54 with almost full benefits. As more than 70% of Brazilians are opposed to the reform, the government delayed the vote in the full house, planned initially for this week, to ensure a comfortable majority to pass the law. Reforming the pension system, which is one of the most generous in the world, seems essential to improve public finances. Official estimates suggest that social security spending would surge from currently 8.1% of GDP to 17.2% by 2060 without the overhaul.

Emerging Markets: Till April's dead, change not a thread

In key Emerging Markets (EM) the cyclical upturn exhibited by Manufacturing PMI data was by and large confirmed in April. Only two key economies still have PMI figures below the 50 points mark, indicating contracting activity in the sector (South Korea 49.4 and South Africa 44.7). This suggests that growth is now back almost everywhere, with Hong Kong (51.1 in April) and Brazil (50.1) being the latest countries to recover above the threshold. Despite this broadening, the overall growth momentum appears to weaken somewhat in pace, as indicated by our proprietary EM aggregate Manufacturing PMI which eased from 51.8 in March to 51.2 in April. This may reflect some recently published disappointing data for global growth drivers such as the U.S. (Q1 GDP growth of +0.2% q/q) and China (weakening of the official Manufacturing PMI from 51.8 in March to 51.2 in April). More generally, a "recombination" of cyclical surveys and hard data appears to evolve; the former were overly optimistic during the last months and are now normalizing as the latter turn out to be less buoyant than expected. Overall, this is in line with our forecast of a gradual global growth recovery from +2.5% in 2016 to +2.9% in 2017.

Countries in Focus

Americas

U.S.: Strong jobs growth but weak productivity

The April employment report was strong, with very good details. The economy created a robust 211,000 jobs vs. expectations of about 185,000, and the unemployment rate dropped to 4.4%, the lowest of the recovery and the lowest since May 2007. The report erased any doubts about the labor market that the anemic March report had created. However, average hourly earnings slipped -0.1pp to a +2.5% y/y rate. One reason for such slow wage growth might be weak productivity, which fell -0.6% q/q annualized in Q1, to a +1.1% y/y rate, less than half the historical average of +2.3% y/y. Weak productivity could also have fed into the ISM manufacturing index which fell from 57.2 to 54.8 points, led by a tumble in new orders from 64.5 to 57.5. By contrast the ISM services index rose from 55.2 to 57.5, with new orders gaining 4.3 points to 63.2, the highest in over 11 years. Finally the Fed signaled that it will hike interest rates in June, and we expect another hike later in 2017.

Europe

Eurozone: Cost of borrowing for corporates is bottoming out

The composite cost-of-borrowing indicator for NFCs seems to have bottomed out as it increased by +7bp to 1.83% in March 2017. This is the first increase since September 2016 and the highest level since mid-2013. When looking at the cost of borrowing for new loans by SMEs (loans up to EUR1mn) the floating rate up to 1 year continued to fall, to 2.25%, its lowest level since 2003. Both fixed rates for loans between 1 and 5 years and above 5 years increased by +5bp compared to its lowest level reached in December 2016 (to 2.35% and 1.81%, respectively) but remain at very low levels. Interest rates for big companies (loans above EUR1mn) are clearly below those for SMEs: 1.38% for floating up to 1 year (+18bp since last month's through), 1.4% for 1 to 5 years (lowest since 2000) and 1.66% for above 5 years (+13bp above the lowest of August 2016). In real terms, interest rates for SMEs are close to 0% and negative since January 2017 for big companies. We expect the ECB to increase its refi rate for the first time in H1 2019 (see also our Report for details on the impact).

Africa & Middle East

Qatar: 22-year growth low in 2016 - modest recovery in 2017?

Recently published data by the Ministry of Development Planning and Statistics put Q4 2016 real GDP growth at +1.7% y/y, down from +3.9% in Q3, taking full-year 2016 growth to just +2.2%, the lowest annual increase since 1994. The weak outcome in Q4 2016 reflects a -2.5% y/y decline in mining and quarrying, after +2.6% in Q3, resulting from a drop in crude oil production and refinery activity. Meanwhile, the non-hydrocarbon sectors grew by +5.7% y/y in Q4, with construction (+17.3%) and the financial industry (+7.4%) being the biggest contributors. Manufacturing expanded by just +0.2% y/y in Q4 (after declining in the previous two quarters) while wholesale and retail trade were up by +3.2% y/y (+3% in Q3). We expect full-year growth to recover only moderately to +2.8% in 2017 as oil production cuts agreed under the OPEC deal from November 2016 will curb output in the hydrocarbon sector while large infrastructure projects will continue to boost construction.

Asia Pacific

China: Slowing the tempo

After strong GDP growth of +6.9% y/y in Q1, the economy has begun to show signs of moderation. USD-denominated export growth slowed down to +8% y/y in April (from +16.4% in March) while import expansion decelerated to +11.9% y/y (+20.3%). Both the official and the private measure of economic activity weakened in April, with the official Manufacturing PMI decreasing to 51.2 points (from 51.8 in March) and the Caixin-Markit Manufacturing PMI falling to 50.3 (from 51.2). On the price front, producer prices continued to increase but at a slower pace of +6.4% in April, down from +7.6% in March, reflecting cooling commodity prices and less favorable base effects. Consumer price inflation edged up slightly to +1.2% y/y in April, driven by a rise in non-food inflation. Going forward, Euler Hermes expects GDP growth to remain resilient but the pace will likely moderate throughout the year, bringing full-year growth to +6.7% in 2017.

What to watch

- May 11 – European Commission economic forecasts
- May 11 – Hungary Q1 GDP (preliminary)
- May 11 – BoE Bank Rate and Inflation Report
- May 11 – Turkey March BOP
- May 11 – UK March industrial production
- May 11 – UK March trade balance
- May 12 – Germany Q1 GDP (preliminary)
- May 12 – Hong Kong Q1 GDP
- May 15 – Portugal Q1 GDP (preliminary)
- May 15 – Thailand Q1 GDP
- May 16 – EU & Eurozone Q1 GDP (preliminary)
- May 16 – Eurozone March trade balance
- May 16 – UK April CPI and PPI
- May 17 – Italy March trade balance
- May 17 – Poland interest rate decision
- May 17 – Russia Q1 GDP (preliminary)

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