Euler Hermes Economic Research

Weekly Export Risk Outlook

20 May 2015

In the Headlines

FIGURE OF THE WEEK

-1.9%

Russia's y/y GDP contraction in Q1

Russia & Ukraine: Both in recession now

Russia's economy slipped into recession in Q1, as expected, but the contraction in real GDP by -1.9% y/y (preliminary estimate by RosStat) was less severe than widely forecast. A full breakdown by GDP sub-components is not yet available but sharp declines in Q1 of retail sales, by -6.7% y/y, and fixed investment, by -6% y/y, indicate that domestic demand registered a marked downturn. Meanwhile, industrial production has shown surprising resilience, declining by only -0.4% y/y in Q1. Possible explanations for this are an import substitution effect on the back of the depreciated RUB (nominal imports fell by -32% in Q1) and an increase in inventories. The latter is likely to be reversed in coming quarters. Euler Hermes continues to expect a deep recession in 2015 but the forecast for full-year GDP contraction was revised to -4% in 2015 (-5.5% previously). In **Ukraine**, the recession deepened further as a flash estimate showed that Q1 real GDP contracted by -17.6% y/y and -6.5% q/q (-14.8% y/y and -3.8% q/q in Q4 2014). In January-April, real industrial production fell by -21.5% y/y and retail trade by -25.3% y/y. Euler Hermes forecasts full-year 2015 GDP will decline by at least -8%.

UK: Softly, softly, catchee monetary monkey

After the disappointing Q1 GDP growth figures (+0.3% q/q), April inflation turned negative for the first time since 1960 (at -0.1% y/y) and core inflation (excluding food and energy) continued to slow, to +0.8% from +1% in March, the lowest level since March 2001. Goods prices continued to decrease (-2% y/y) while service prices slowed (+2% compared with +2.4% in March). With little evidence of a catalyst for aggressively higher oil prices, inflation will only increase gradually in the coming months and will remain unusually low this year (+0.2%) – markedly below the BoE 2% target in 2015 (+1.5%) also hindered by the strong GBP and contained wage increases despite the rapidly falling rate of unemployment (at 5.5% in Q1). Given the contraction in corporate investment and the slower than expected GDP growth this year, we see little reason for the BoE to rush into beginning its monetary policy tightening cycle. Therefore we remain inclined to believe that the first rise in interest rates will come late in Q2 2016, with the potential for a delay if growth disappoints.

Portugal: Slow but steady?

According to preliminary estimates, GDP expanded by +0.4% q/q in Q1 (+1.4% y/y), completing four consecutive quarters of positive growth. Improvements in domestic demand and net exports, in particular, were large contributors to overall growth. Exports accelerated, partly reflecting weakness in the EUR, while low oil prices helped to hold down imports. Consequently, the trade deficit narrowed further (export receipts covered 88.9% of import costs in February, the highest level in 40 years) and this enabled the current account to register a broad balance in February. In the wake of the sovereign debt crisis, although much of the country's flow imbalances have been largely corrected, concerns remain evident, including a persistent lack of productivity gains. Moreover, after declining steadily from 18% at the beginning of 2013, the rate of unemployment appears to have stagnated over the past six months, at around a still elevated 13.5%. Against this backdrop, EH expects continuation of modest GDP growth through 2015, with +1.5% overall, picking up to +1.8% in 2016.

Israel: Growth to continue, despite precarious coalition

The fractured domestic political environment, which resulted in a Likud-led coalition with the slenderest of majorities in the Knesset (one seat), is expected to limit the effectiveness of policy implementation. Against this background - and with ongoing troubled relations with the Palestinian authorities, associated risk of potential European sanctions and regional concerns - there are uncertainties relating to the short-term economic outlook. However, Q1 GDP increased by an annualised +2.5% q/q and +2.9% y/y, although that followed +6.6% q/q in Q4 2014. Growth in Q1 was led by robust private consumption (+5.5% q/q) but net exports had a negative impact as import growth (+7.1%) outpaced that of exports (+3.1%). Meanwhile, recent deflationary pressures suggest that there is scope for further monetary stimulus, which may come through unconventional measures as interest rates are already near zero (key policy rate 0.1% in May). We expect: (i) accommodative monetary policy throughout 2015 and (ii) GDP growth of over +3% in 2015 and around +3.5% in 2016.

Countries in Focus

Americas

Latin America: China strengthens its presence

China pledged investments of around USD50 bn in **Brazil**, particularly in infrastructure. Additionally, deals were concluded with state-owned oil company Petrobras (USD7 bn) and for the purchase of 22 Embraer aircraft (USD1.3 bn), while the Chinese market for Brazilian beef will be re-opened. Further co-operation is expected in the automobile and energy sectors and in ports, hydro-power and railways. These are the first steps in China's plan to strengthen its presence in LatAm by boosting trade and investment projects that could total USD250 bn. Notably, China is willing to finance a USD10 bn railway between **Brazil** and **Peru.** It is already one of the largest foreign investors in the region (mainly commodities and infrastructure projects) and its share of LatAm exports is almost 10% (compared with only 1% in 2000). China's share of the export trade of some countries is particularly marked, including **Brazil** (18%), **Chile** (25%), **Colombia** (10%), **Peru** (25%) and **Venezuela** (12%).

Europe

Central & Eastern Europe: Regional growth rebounds in Q1

Advance estimates indicate that real GDP growth in the group of 11 EU members in the CEE region rebounded to around +3.1% y/y in Q1, following a gradual decline during 2014 to +2.4% y/y in the final quarter. The central European countries, in particular, surprised on the upside, with **Romania** (+4.3% y/y) now at the forefront, followed by **Czech Republic** (+3.9% y/y), **Poland** (+3.5%), **Hungary** (+3.4%), **Slovak Republic** (+3.1%) and **Bulgaria** (+2%). Domestic demand was the key growth driver but external demand also improved because of the ongoing Eurozone recovery and resilience to the geo-political tensions in the east. In contrast, the Baltic states are more exposed to the Russian crisis because of closer trade relations. As a result, Q1 GDP growth slowed in **Latvia** (+2% y/y), **Lithuania** (+1.2% y/y) and **Estonia** (+1.2% y/y). Euler Hermes expects regional growth of the 11 EU members in the CEE will pick up from +2.6% in full-year 2014 to just below +3% in 2015.

Africa & Middle East

Nigeria: Slowing but growing

In Q1, GDP growth slowed for the third consecutive quarter, to +4% y/y, following +5.9% in Q4 2014. The expected slowdown largely reflects relatively low oil output and prices – the oil sector contracted by -8.2% but non-oil sectors expanded by +5.6%. On a quarterly basis, overall GDP contracted by -11.6% in Q1. Meanwhile, following this week's meeting of the Monetary Policy Committee (MPC), the Central Bank announced a harmonisation at 31% of the two cash reserve ratios; the public sector CRR was previously 75% and the private sector CRR 20%. The MPC retained the key policy interest rate at 13%. The overall economic outlook is somewhat complicated by the fact that President-in-waiting Muhammadu Buhari takes office on 29 May, although we do not expect a significant change in policy direction. The economy will remain supported by robust non-oil developments and we retain our GDP growth forecasts of +4.5% in 2015 and a rebound to +6% in 2016.

Asia Pacific

Malaysia: Q1 GDP shows resilience to weak commodity prices

Real GDP expanded by +5.6% y/y in Q1 (after +5.7% in Q4 2014), beating most regional peers in Southeast Asia. Domestic demand strengthened as a result of accelerating growth in private consumption (+8.8% y/y) – perhaps in anticipation of the 6% Goods and Services Tax that was implemented in April – and fixed investment (+7.9%) as well as robust public consumption (+4.1%). The modest growth slowdown in Q1 resulted from declining exports (-0.6% y/y), driven by weak global energy and commodity prices, while imports increased moderately (+1% y/y). Nonetheless, the current account surplus widened by +75% q/q to MYR10 bn in Q1, mainly reflecting a narrowing in the deficits in the primary income and services accounts. Moreover, the world's second largest gas exporter showed resilience as both mining (+9.6% y/y) and manufacturing (+5.6%) activities grew slightly stronger in Q1 than in Q4 2014. We expect full-year growth of around +5% in 2015, with oil price volatility remaining a concern.

What to watch

- May 21 – Eurozone May composite PMI
- May 21 – UK April retail sales
- May 21 – U.S. May flash manufacturing PMI
- May 21 – Brazil March economic activity
- May 21 – Mexico Q1 GDP
- May 21 – European Council meeting
- May 22 – Canada April CPI
- May 22 – Germany Q1 GDP (details)
- May 22 – Germany May Ifo business climate
- May 22 – U.S. April CPI
- May 22 – France May business climate
- May 22 – Italy March retail sales
- May 25 – Mexico Q1 current account
- May 26 – Hungary monetary policy meeting
- May 27 – Germany May GfK consumer confidence
- May 27 – Germany April retail sales
- May 27 – Argentina March economic activity

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