Euler Hermes Economic Research

Weekly Export Risk Outlook

20 December 2017

In the Headlines

FIGURE OF THE WEEK

USD64

Barrel price of benchmark Brent crude oil (+16% y/y)

Russia: Busy week for the Central Bank

The Central Bank of Russia (CBR) cut its key policy interest rate by 50bp to 7.75% last week, bringing the cumulative decline this year to 225bp (six cuts since March). The move reflects that inflation fell to a new record low of 2.5% y/y in November – thanks to (i) a good harvest that brought down food price inflation to 1.1% y/y, and (ii) a stabilization of the RUB in 2017 – and will undershoot the CBR's end-2017 target of 4%. As the impact of temporary factors will wane, we expect inflation to move to around 4% y/y by end-2018. Meanwhile, advanced indicators of economic activity in Q4 are mixed. Industrial production was flat in October and dropped by -3.6% y/y in November while retail sales rose by an average +2.9% y/y in the first two months of Q4.

In another matter, the CBR nationalized Promsvyazbank (PSB) last week. Russia's 9th largest bank in terms of assets had faced severe liquidity strains after two other large private banks were bailed out before (Otkritie in August; Binbank in September). We do not expect a full-blown banking crisis in 2018 as state-owned banks remain strong while the CBR would bail out other large private banks, if needed.

U.S.: Broad strength across the economy

The economy is demonstrating broad strength across consumption, manufacturing and housing. Retail sales rose a sharp +0.8% m/m in November and +0.5% in October, pushing the y/y rate to +5.8%, the fastest in almost six years. Gains were widespread, and core sales, which feed into the GDP calculation, rose a steep +0.8% m/m to 4.8% y/y. The industrial side of the economy also continued to make gains as industrial production rose +0.2% m/m, with the manufacturing component also gaining +0.2%. It was the third straight increase for both measures, putting the y/y rates to +3.4% and +2.4% y/y, respectively, both the highest in over three years. The housing sector also made gains as the Housing Market index, a gauge of homebuilder sentiment, rose a sharp 5 points to 74, the highest level in over 18 years, driven by steep increases in sales and prospects. Housing starts rose +3.3% m/m or +12.9% y/y to the highest level in 14 months. Permits slipped -1.4% m/m but are still growing +3.4% y/y.

Turkey: Unassertive monetary tightening

At its regularly scheduled monthly meeting last week, the Monetary Policy Committee (MPC) of Turkey raised the lending rate for the late liquidity window from 12.25% to 12.75%. However, it kept its official benchmark policy one-week repo rate unchanged at 8% as well as the overnight lending and borrowing rates which remained at 9.25% and 7.25%, respectively. In its press release alongside the move, the MPC indicated concerns about rising inflationary pressures, rapid credit growth and increasing cost factors. Private sector credit growth surged to 23.5% y/y in Q3 and headline inflation rose to a 14-year high of 13.0% y/y in November. Hence real interest rates remain negative, even though the Central Bank is currently funding the market mostly through the late liquidity window lending rate. In 2018, inflation is set to ease slightly and the MPC is likely to begin modest monetary loosening.

Commodity prices: It's such a perfect day

Global growth accelerated markedly from +2.6% in 2016 to an estimated +3.2% in 2017 (which we forecast to be repeated in 2018). Yet commodity prices increased only marginally since the output of oil, industrial metals and a wide range of agricultural commodities (e.g. cocoa, coffee, grains) remained high. Euler Hermes expects the oil price (benchmark Brent) to average 62 USD/bbl in 2018, just about the current level. As a first consequence, inflation should not accelerate in the Eurozone in 2018 – we expect +1.6% (after +1.5% in 2017). Secondly, there is uncertainty about key drivers, notably a slow-down of growth in China to +6.4% in 2018 (from +6.8% in 2017) will weigh on industrial metal prices, despite growing private investment in advanced economies. Thirdly, agricultural commodity exporters have improved productivity, driving the output higher with a structural impact on prices. Overall, global inflation is unlikely to accelerate (markedly) next year, a dovish environment for Central Bankers.

Note: WERO is taking a break. The next issue will be 10 January 2018.

Countries in Focus

Americas

Chile: Another pro-business victory in the region

As expected, former president and center-right candidate Sebastián Piñera won the runoff in the presidential election last Sunday. He got 54.6% of the vote against 45.4% for Alejandro Guillier, the center-left candidate. Divisions in the left camp, controversial reforms under the center-left administration of outgoing President Bachelet, and a less favorable environment of low commodity prices fueled the desire of a change in the policy direction. In the first round, the total vote share of the left was much higher than predicted by polls but it was not entirely captured by Guillier in the runoff. Piñera will take office after a protracted period of sluggish GDP growth (average annual +1.8% in 2014-2017 against +4.7% in 2003-2013). The cyclical recovery should play in his favor, as Latin America has exited recession and copper prices are rising. Yet, congress is fragmented after the November election, which should make it more difficult to push a pro-business agenda, in particular corporate tax cuts.

Europe

Ukraine: Inflationary pressures remain high

The National Bank of Ukraine (NBU) raised its key policy interest rate by 100bp to 14.5% last week, following a same size hike in October, citing still high inflation and a further deterioration of inflation expectations in recent months. The headline inflation rate actually declined from an 18-month high of 16.4% y/y in September to 13.6% y/y in November, though at a slower pace than the NBU had forecast, remaining well above its inflation target range of 8% ± 2pp. Factors that have contributed to the deteriorated inflation expectations include (i) recently raised government budget spending plans; (ii) increased risk of a postponement of the next IMF funding tranche; (iii) significantly rising food prices; and (iv) strengthening global growth potentially leading to labor migration and rising wages in Ukraine. Nonetheless, Euler Hermes expects inflation to continue to ease gradually in 2018, reaching an average 10% or so.

Africa & Middle East

Tanzania: Growth is not enough

2017 was the fifth year in a row with about +7% growth in Tanzania. The good performance was led by increasing investment, a rise in the technological content of growth (from a low base), and key reforms to ease exports (the country improved to rank 61 in the World Bank's latest *Logistics Performance Index*, up from rank 138 previously). Appetite from foreign investors, in particular from China, is also fueling the boom. Meanwhile, about 65% of the current account deficit (which Euler Hermes forecasts at -7.5% of GDP in 2018) is financed by FDI inflows. Moreover, some policy reforms got underway with the help of IMF monitoring under a Policy Support Instrument. However, *de jure* efforts have not always translated into *de facto* implementation. In the World Bank's *2018 Doing Business* survey, Tanzania is only ranked 137th . Moreover, some capital controls that were widened last week in order to tame depreciation pressures have put the country under scrutiny. Continued reform momentum will be a cornerstone to post high growth rates for longer.

Asia Pacific

India: Patching wounds

The economy is recovering gradually from the demonetization shock. Yet, the recent batch of figures shows that the upswing observed in Q3 2017 (GDP up +6.3% y/y) is still fragile. Firstly, industrial production growth slowed to +2.2% y/y in October 2017 (from +4.1% in September) with subdued performance in consumer durables, manufacturing and mining. Secondly, inflation rose to 4.9% y/y in November (from 3.6% in October) as a result of higher commodity prices. On a positive note, the trade performance improved in November as exports soared by +30.6% y/y. Looking ahead, short-term indicators continue to indicate a positive momentum, helped by higher new export orders. Notably, the Nikkei manufacturing PMI rose to 52.6 points. Against this background, EH expects real GDP growth of +6.5% in fiscal year (FY) 2017-18 before accelerating to +7.3% in FY2018-19.

What to watch

- December 21 – Czech Republic Central Bank meeting
- December 21 – Turkey Dec. consumer confidence
- December 22 – Poland November retail sales
- December 22 – Poland Dec. business confidence
- December 22 – U.S. November personal income and spending
- December 22 – U.S. November durable goods orders
- December 22 – U.S. November new home sales
- December 22 – Canada October GDP
- December 26 – Turkey Dec. business confidence
- December 27 – China November industrial profits
- December 29 – Germany December CPI
- January 5 – Germany November retail sales
- January 8 – Germany November factory orders
- January 9 – Germany November industrial production