Euler Hermes Economic Research

Weekly Export Risk Outlook

22 February 2018

In the Headlines

FIGURE OF THE WEEK

+1.7%

The UK's GDP growth in 2017 (second estimate)

UK: Saved by the global economy

GDP growth was revised down to +1.7% in 2017 (from a flash estimate of +1.8%). While the headline figure indicates a second year of resilient economic expansion after the Brexit decision, the detailed breakdown shows a marked slowdown in domestic demand, by two thirds compared to 2016. The acceleration of external demand and the weaker GBP boosted UK exports and saved GDP growth as net exports made a positive contribution to it for the first time since 2011. Going forward, 2018 should confirm the UK's economic resilience as households are confident about their future financial situation. The inflation rate should stabilize at an elevated level (2.6%) and wage growth should accelerate due to rising labor market shortages. As external demand stays strong (we expect almost +4% real export growth in 2018), corporate investment should expand, helping companies improve their margins by reducing the UK's supply chain dependency on foreign input. Overall, we expect +1.5% GDP growth in 2018 which should in turn pave the way for two interest rate hikes by the Bank of England (+50bp to 1%). As 85% of bank lending to companies and 40% of households' mortgages are at floating rates, this should induce higher interest expenditures for both companies and households.

Eurozone: Upswing not at risk despite sentiment setback

The composite purchasing managers' index (PMI) for industry and services in the Eurozone fell to a 3-month low in February. Despite the setback, however, at 57.5 points the sentiment indicator remains at a very high level consistent with strong economic activity. After all, the PMI had reached a near 12-year high of 58.8 in January. Further reassuring evidence in support of sustained strong economic momentum and a favorable growth outlook are indicated by robust employment growth and a renewed improvement in companies' optimism about the year ahead – this sub-index once again reached a record high. Going forward it is likely that sentiment indicators in the Eurozone will continue to retreat from record highs. However, we do not see this as the end of the current economic upswing. Rather, the sentiment setback is in line with a gradually unfolding normalization of the extraordinarily strong Eurozone growth rates witnessed since late 2016. All in all, following last year's +2.5% GDP growth, we expect Eurozone growth to come in at +2.2% in 2018.

Thailand: Above the +3% mark, again

Real GDP rose by +4% in Q4 2017 (after +4.3% in Q3). On the production side, growth was driven by a rise in non-agricultural production (+4.6% y/y) while agriculture contracted (-1.3% y/y) due to unfavorable weather and floods. On the expenditure side, exports expanded at a fast pace (+7.4% y/y, up from +6.9% in Q3) supported by dynamic services exports (+9.7% y/y) thanks to a rise in foreign tourist arrivals. Private consumption remained healthy (+3.5% y/y) thanks to a combination of robust (non-farm) income growth, low inflation and solid consumer confidence. Investment underperformed with marginal growth of +0.3% y/y due to weaker growth in private and public construction. Overall, economic growth accelerated to +3.9% in 2017 (from +3.3% in 2016). Looking ahead, we expect growth to remain firm but the pace may slow slightly to +3.6% in 2018. On the upside, we expect domestic expenditures to pick up speed as the development of the Eastern Economic Corridor should help boost investment. On the downside, slower growth in China (forecast at +6.4% in 2018) should dent Thai export growth.

Germany: Ifo index drops but remains at high level

The Ifo business climate index in Germany's industry and trade sector fell sharply to 115.4 points in February (from 117.6 in January), however, this is still a very high level. Noteworthy, companies' business expectations have weakened for the third consecutive month. In economic terms, the trees do not grow into the sky. We interpret this development rather as a normalization that was already overdue in view of increasing euphoria than as the beginning of an economic downturn. Several factors may have contributed to the more restrained expectations. Inflation and interest rate fears, which have caused unrest on the financial markets in recent weeks, probably also weigh on the mood in the real economy. The financing conditions for companies are likely to become less favorable, given the withdrawal of central banks from their ultra-loose monetary policy. Concerns about protectionism and fears that the increased external value of the EUR will dampen the export performance may have also contributed to the decline in business expectations.

Countries in Focus

Americas

U.S.: Mixed data, but inflation fears are overdone

January retail sales fell -0.3% m/m to +3.6% y/y, driven by falling auto sales which had been pulled forward by hurricane-induced replacements. Core sales were flat, pushing the y/y rate down to a still respectable +3.9%. Recent inflation concerns seem overdone. Consumer prices rose +0.5% m/m, but the y/y rate was unchanged at +2.1%, and a year ago it was +2.5%. The core rate was +1.8% y/y, a rate which has ranged between +1.7% and +1.8% for 9 months. Similarly producer prices rose to +2.7% y/y, but two months ago it was +3.1%, while core prices have been in a range of +2.2% and +2.4% for 6 months. Regional Fed reports continue to show manufacturing strength, but manufacturing industrial production was flat m/m and at +1.8% y/y. Volatile housing starts rose to the second highest level of the recovery, and the Housing Market Index continued to show strong optimism among home builders, but existing home sales fell -3.2% m/m to -4.8% y/y.

Europe

Latvia: Turmoil in the financial system

Latvia's banking system was hit by new scandals over the past week. First, central bank governor Rimsevics was arrested over the weekend by the Latvian anti-corruption agency on allegations of seeking a bribe. Rimsevics was released on bail on Monday but was suspended as the investigation is pending (he has refused to resign, denying any wrongdoing). Second, on Monday the Latvian banking supervisory authority imposed a moratorium on ABLV Bank, Latvia's third largest lender, following a request by the ECB. ABLV has faced liquidity shortages since the U.S. took action against it earlier this month over alleged money laundering and activities linked to North Korea's weapons program. So far, the two events appear to be unrelated. But their occurrence within a very short period is another blow to the reputation of the Latvian banking system. Yet, overall financial soundness indicators of the banking sector remain solid; and those (mainly Nordic-owned) banks that predominantly serve domestic clients are healthy. Hence we do not expect any significant impact of the scandals on the overall economy, for now.

Africa & Middle East

Iran: Currency risk on the rise again

The Central Bank of Iran (CBI) raised bank deposit rates and froze the accounts of hundreds of foreign exchange dealers on 15 February in an attempt to stem the recent slide in the black market exchange rate of the Iranian rial (IRR). During 2017, the official exchange rate of the IRR against the USD fell by -11% while the black market rate declined by just -2% so that the gap between the two rates narrowed from 25% at end-2016 to 15% at end-2017. However, the exchange rate regime has come under considerable pressures since the start of this year and the black market value of the IRR fell by -18% from end-2017 to mid-February, reaching an all-time low of IRR49,000 per USD1 on 14 February. And since the CBI devalued the official rate by only -3% over the same period, the gap between the two rates widened again to 32%. Although the black market rate has regained some +8% over the past week, we expect further exchange rate volatility over the course of this year.

Asia Pacific

Indonesia: Slowly but surely?

Latest trade figures point to a still solid export outlook and strong growth in domestic demand. USD-denominated exports rose by +7.9% y/y in January (after +7.5% in the previous month). Import growth surged to +26.4% y/y (after +18.1% y/y) driven by a strong rise in non-oil and gas purchases (+28.1% y/y). Car sales figures were also buoyant with growth of +11.1% y/y in January (from -2% y/y the previous month). The key policy interest rate was kept unchanged at 4.25% at the last monetary policy meeting. Policymakers are comforted by improving GDP growth prospects and a limited rise in inflation, yet elevated financial risks (for example currency and financial market volatility) call for caution. Going forward, we expect economic growth to improve gradually to +5.3% in 2018 (after +5.1% in 2017). Investment is set to pick up progressively thanks to higher infrastructure spending and easier regulation for foreign investors.

What to watch

- February 23 – Austria January consumer prices
- February 23 – Austria December industrial production
- February 23 – Croatia January consumer prices
- February 23 – France February consumer confidence
- February 23 – Germany Q4 2017 GDP (with details)
- February 23 – Lithuania January industrial production
- February 23 – Serbia January consumer prices
- February 26 – U.S. January new home sales
- February 27 – Germany February CPI (flash estimate)
- February 27 – Hungary Central Bank meeting
- February 27 – U.S. January durable goods orders
- February 27 – U.S. January international trade
- February 28 – China February NBS PMIs
- February 28 – Poland Q4 2017 GDP (with details)
- February 28 – U.S. Q4 2017 GDP (2^{nd} estimate)

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