Euler Hermes Economic Research

Weekly Export Risk Outlook

6 July 2016

In the Headlines

FIGURE OF THE WEEK

+1.3%

Revision of China's 2015 nominal GDP level

UK: BoE tries to alleviate the Brexit impact

In its bi-annual stability report, the BoE gave a first assessment of the expected impact of the Brexit vote. The main channels of impact are: (i) the financing of the large current account deficit, (ii) the real estate market, which relies highly on capital inflows from abroad, (iii) the high level of household indebtedness and the risk linked to tightening of financial conditions and (iv) the fragility in financial markets given the high volatility and uncertainty lying ahead. In reaction to the Brexit impact, the BoE announced the reduction of the countercyclical capital buffer rate from 0.5% to 0% for UK banks until at least June 2017 (capital buffers reduced by GBP5.7bn) which is expected to free-up GBP150bn of additional lending from banks to the private sector. This measure comes in addition to the GBP250bn liquidity provided to banks on the day after the Brexit vote. The next BoE monetary meeting is planned for 14 July, but it may be too early to see further monetary easing given that the economic data related to the Brexit impact is available only starting on 31 July. The next moves are likely to focus on credit easing measures (extension of the Funding for Lending Scheme) or a rate cut (from 0.5% currently).

Eurozone: Resilient business confidence in Q2

The June PMI Composite came in at 53.1, above the flash estimate of 52.8 but unchanged from May, suggesting steady growth in the Eurozone. An improvement in the manufacturing PMI to 52.8 (from 51.5 in May) was countervailed by a slowdown in the services PMI to 52.8 (53.3). The average PMI Composite for Q2 stands at 53.1, slightly down from 53.2 in Q1. The June PMI Composite indicates strong growth in **Ireland** (59.2) and **Spain** (55.7) and an improvement for **Italy** (52.6) in response to acceleration of new businesses. The index for **Germany** remained unchanged from May (54.4) signalling both a positive economic environment and a strong increase in manufacturing export orders while services marked a softer pace in June (53.2) compared to May (55.2). Meanwhile, the June index fell to 49.6 in **France** (50.9 in May) indicating that companies are still lagging behind mainly due to a lasting downturn in the manufacturing sector. Euler Hermes expects a slowdown in Eurozone growth to +0.3% q/q in Q2 from +0.6% in Q1 and forecasts +1.6% for 2016 as a whole, unchanged from 2015. Going forward, uncertainty related to the Brexit decision is expected to soften economic momentum.

U.S.: Yields fall to record lows on Brexit uncertainty

Euler Hermes expects Brexit to have virtually no effect on U.S. GDP through 2019, but the resulting uncertainty has driven investors to the safety of the 10-year U.S. Treasury note, pushing the yield below 1.4%, the lowest since records began in 1962. The yield also reflects in part weakness in the U.S. economy. Real personal consumption expenditures rose +0.3% m/m in May, but the y/y rate crept down from +3.0% to +2.7%, while disposable income gained only +0.1% m/m to reach +3.2% y/y. PCE core inflation was +1.6% y/y in May; it has ranged from +1.6% to +1.7% for five straight months. Construction spending fell for the second straight month in May, losing -0.8% m/m to a +2.8% y/y rate; last May it was +10.7%. Non-residential construction is the weak component at only +1.2% y/y, and that weakness is also reflected in orders for core durable goods which have fallen for two consecutive months, and five of the past seven, to a -3.8% y/y rate. The ISM manufacturing index rose +1.9 to a still tepid 53.2 in June, despite strength in new orders.

Emerging Markets: Summertime with clouds

Cyclical surveys show better prospects for Emerging Markets overall. Our proprietary EM aggregate manufacturing PMI index improved from 49.4 in May to 49.7 in June but remained under the 50 neutral-threshold. So, the growth momentum is still eroding but that erosion is moderating in pace and is not everywhere. Many economies in Asia experienced improvements. The regional manufacturing PMI (excluding China) is above 50 (50.4) for the first time since September 2014, indicating that growth may now accelerate in this area. In recessionary economies, the pace of contraction is set to slow as indicated by improvements in **Brazil** and **Russia**, for example. **China**'s cyclical surveys are more ambiguous. The official PMI was marginally down to 50.0, signalling that growth may decelerate. Negative news came from export-oriented markets, particularly in Eastern Europe, with poorer PMIs in **Poland**, the **Czech Republic**, **Hungary** and **Turkey**. This may be related to Brexit news which may have an impact on trade in the longer term.

Countries in Focus

Americas

Argentina: Sharp slowdown in activity in Q1

After months of no data release, the Argentina Statistical Institute (INDEC) published new real GDP figures on 29 June. The methodology was entirely revamped after President Macri took power in December 2015. Past figures were strongly revised and revealed that the 2008-2009 global financial crisis caused a strong recession of -6% in 2009, and not only ‘a sharp slowdown’ of activity to +0.1% as previously published. Likewise, the economy contracted by -1.1% in 2012 (vs. +0.8%) and by -2.6% in 2014 (vs. +0.5%). Real growth in 2015 was +2.4%. As a result, the level of GDP is almost 10% lower than previously reported. In Q1 2016, real GDP grew by just +0.5% y/y, down from +2.2% in Q4 2015. Domestic demand moderated sharply in Q1, with private consumption expanding by +1.1% y/y (+8% in Q4) and public consumption by +2.7% y/y (+5.6% in Q4). Investment even dropped by -3.8% (after +12% in Q4). External demand contributed negatively to Q1 GDP growth, by -0.6pps.

Europe

Turkey: Rapprochement with Russia - benefits to be limited in 2016

Turkish-Russian relations – which deteriorated sharply after the downing of a Russian fighter jet in November 2015 – are set to improve following last week’s apology of President Erdoğan to Russian president Putin. The Russian travel ban to Turkey was already lifted and further removals of other sanctions are expected in the coming weeks, notably on trade and investment. However, the repeal of the Russian travel ban is unlikely to kick-start the tourism sector, accounting for 4% of GDP, which has been damaged even more by the recent series of terrorist attacks in the short term. Total tourism arrivals in January-May 2016 fell by -23% y/y, with May arrivals down a hefty -35% y/y. While the number of Russian visitors plunged by -83% y/y in the first five months, arrivals from Germany which accounted for 15.4% of the total in 2015 also dropped by -25% y/y. Euler Hermes expects weaker tourism to affect real GDP growth which is forecast to slow to +3.6% in 2016 (from +4% in 2015).

Africa & Middle East

United Arab Emirates: Rateability

Abu Dhabi announced a plan to merge two of its Sovereign Wealth Funds (IPIC and Mubadala), potentially creating a fund with total assets of around USD135bn. This follows an earlier proposal to merge the emirate’s two largest banks, the NBAD and FGB, with a combined market capitalisation of USD29bn and assets of USD175bn. Such consolidation is partly a result of the current relative weakness in oil prices and associated impact on export and government revenues. At the same time, it suggests: (i) there is an active reform strategy to counter the prevailing downturn, including rationalisation of SOEs and cost saving initiatives and (ii) the depth of financial resources of the country (total SWFs of over USD1,245bn). EH expects GDP growth of around +2% in 2016, compared with a ten-year average that is almost double that rate, but Dubai’s more diversified economy and trade hub status will ensure that, despite cuts in state (UAE) spending, commercial opportunities will remain evident.

Asia Pacific

China: GDP numbers boosted by R&D

China has released revised GDP numbers. The main change is the inclusion of research and development (R&D) spending in fixed investment while before it was part of intermediate consumption. This brings the country’s national accounts more in line with global standards set by the UN. As a result, the nominal value of 2015 GDP was revised up by +1.3% from RMB67.67tn to RMB68.55tn (for comparison: Germany’s 2013 GDP was changed by +2.6% after conducting a similar methodological change in 2014). In real terms, China’s GDP growth remained unchanged at +7.3% for 2014 and +6.9% for 2015. Already last year, China started to release balance of payment data more in line with IMF norms and nominal GDP numbers on a quarterly basis. Looking ahead, expect more such changes that should help improve data quality and economic monitoring, for example the regular release of GDP numbers on the expenditures side and GDP sub-component figures on a seasonally adjusted basis.

What to watch

- July 07 – South Africa June international reserves
- July 07 – South Africa May electricity prod. & cons.
- July 07 – Germany and UK May industrial production
- July 07 – Spain June PMI
- July 07 – Singapore Q2 GDP estimate
- July 07 – Brazil and Mexico June CPI
- July 08 – Hungary and Ukraine June CPI
- July 08 – Colombia and Venezuela June CPI
- July 08 – Venezuela Q1 GDP estimate
- July 08 – U.S. and Canada June employment report
- July 08 – Germany May current account balance
- July 11 – Russia Q2 current account balance
- July 11 – Russia Q2 consumer confidence index
- July 11 – Canada June housing starts
- July 11 – Poland and Romania June CPI
- July 12 – South Africa May manufacturing output
- July 12 – U.S. May JOLTS survey

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