Euler Hermes Economic Research

Weekly Export Risk Outlook

29 March 2017

FIGURE OF THE WEEK

125.6

US Consumer Confidence, highest figure in 16 years

In the Headlines

UK: The departure from Europe formally begins

A withdrawal notification sent by the UK government to the European Council on March 29th triggered the two-year countdown as specified by Art. 50.

In a report titled "The Taming of the Brexit" published on March 29th we note that an EU exit deal could be reached and ratified by spring 2019.

The report suggests there is an 80% probability that the parties will agree on a transitional deal covering EU-UK future relations. Such interim arrangements could bridge the gap between the EU exit deal and a final Free Trade Agreement (FTA). During the transition period, the UK economy should stay resilient amid a modest sterling depreciation (below 3%).

A final deal could be reached in 2021 and take the shape of a limited FTA (55%) where selective sectors would be duty-free while others could be subject to tariffs. In 2021, UK GDP growth would reach 0.3%

A cliff-edge scenario is still possible yet very unlikely (20% probability). It could be the result of either a lack of transitional deal in 2019 or a final World Trade Organization-like status in 2021. In both cases, disruption in trade flows would have a significant negative impact on the UK and the EU. In such an extreme scenario GDP would fall by -1.2% in 2019, and the UK would remain in recession until 2021

France: Do not bank too much on expectations

Nominal GDP growth should rise in 2017 by 2.3%, up from +1.9% in 2016. Moreover, corporate turnover growth is set to accelerate from +0.3% in 2016 to +1.4% in 2017.

This should help push down business insolvencies for the second year in a row by a healthy -7%.

The return of nominal growth is a boon for corporates, as selling prices have rebounded moderately in the second half of 2016. As a result, business confidence was up.

Yet the March figure serves as a reality check. Manufacturing confidence fell to 104 from 107 in February. This level is more consistent with hard data, particularly industrial production which has been stable over the last 3-months (y/y average).

Thus, growth recovery should not be overestimated. Granted, improvement is here. But there is also some wait-and-see behavior, driven by the uncertainty surrounding the elections.

Germany: Ifo business climate signals upswing

Sentiment among German firms hit a record high this month, after improving for the seventh consecutive month. The Ifo Business Climate index reached an all-time peak of 112.3 points in March, the highest level since July 2011. Both the assessment of the current situation and business expectations rose, signaling that the economy is set to strengthen further.

In particular, the manufacturing sector index soared from 16.8 to 21, indicating a substantial expansion of Germany's core sector. These optimistic prospects were driven by a renewed surge in domestic demand as well as the upswing in the global economy, with the Eurozone leading the pack. Yet risks may still affect growth. These include the pickup in inflation and political uncertainty in Germany and on the economic policy outlook in the US. All told, we are still penciling in an increase in real GDP to 1.7% in 2017. In the first quarter of the year, the German economy is likely to have grown by 0.5 - 0.6%.

Portugal: Fixing the leak

Portugal's fiscal deficit exceeded expectations in 2016, falling to a 40-year low at -2.1% of GDP. This represents a clear improvement from the 2015 figure (-4.4%), caused by the use of public funds to support the banking sector. It also benchmarks well against the -2.5% target set by the European Commission. Thus, the country could request to leave the excessive deficit procedure it has been subjected to since 2009. Such a move would boost confidence. So far, the government, backed by the left-controlled parliament has reversed some austerity measures. Yet at the same time, it has managed to reduce the fiscal deficit by curbing public investment.

Still, concerns remain about high public debt, which rose in 2016 to 130% of GDP. Sluggish growth (+1.4% in 2016) casts doubts on the trajectory of the Portuguese fiscal consolidation. Rating agencies have warned they would only raise sovereign bonds' grade when the reversal in debt to GDP ratio is confirmed and growth picks up.

Countries in Focus

Americas

U.S.: A firmer outlook

The outlook for Q1 GDP has improved somewhat, as the trade deficit shrank, shipments of durable goods increased, and consumer confidence rose sharply. The trade deficit narrowed in February from USD68.8bn to USD64.8bn as exports shrank only -0.1% m/m while imports shrank -2.1% m/m.
Separately, shipments of core durable goods, a direct input to GDP, rose +1.0% m/m to a +2.1% y/y rate in February, the fastest in over two years. New orders for core goods did slip -0.1% m/m, but the y/y rate is still a respectable +2.7%. Finally, consumer confidence continued to soar in March, gaining 9.5 points to 125.6, the highest since December of 2000, over 16 years ago.
The subcomponents also showed remarkable strength with the present conditions index rising to the highest in over 15 years, and the future expectations index rising to the highest in over 16 years. The firmer data offers a contrast to recent softness, improving the outlook.

Europe

Slovak Republic: Robust growth thanks to consumers and exports

Second estimates by the Statistical Office show that Q4 real GDP grew by +3% y/y, unchanged from Q3 but below the average +3.6% y/y posted in H1. Q4 growth took the expansion of real GDP in 2016 as a whole to +3.3%, down from +3.8% in 2015.
The decline of full-year growth is a result of a sharp fall in EU co-financed investment activity at the beginning of the new programming period which caused fixed investment to contract by -9.7% in 2016, after a strong +16.9% increase in 2015, as well as a slowdown of public spending expansion to +1.6% (+5.4% in 2015). Instead, consumer spending was a main growth driver in 2016, up by +2.9% (+2.2% in 2015), along with net exports which contributed +1.9pp to 2016 growth (-0.8pp in 2015) since export expansion (+4.8%) outpaced imports (+2.9%).
Euler Hermes expects investment activity and, correspondingly, imports to recover in 2017, resulting in full-year growth of around +3% in 2017.

Africa & Middle East

Côte d'Ivoire: financing needs are growing

As Cocoa prices are currently -33% lower than at the end of 2015, the regulator will probably have to lower guaranteed farm gate prices. This will have an impact on exports, (cocoa represents 50% of the total), as well as on public finance and external deficits. The fiscal deficit could worsen to -5% of GDP in 2017, a deterioration from a baseline expectation of -3.5%.
The IMF granted Côte d'Ivoire a USD660 million in December 2016. But the chosen instruments chosen - Extended Credit Facility and Extended Fund Facility - are designed to support mid-term needs.
Thus in the short-run disbursements will be quite low. At the current level, foreign exchange reserves provide import cover for roughly 5 months. Yet deepening current account deficit with -4% of GDP expected in 2017 (after -2% of GDP in 2016) will weigh on the reserves. The country has already requested more assistance. IMF conditionality poses a risk to our otherwise robust growth forecast for 2017: +8%.

Asia Pacific

Hong Kong Election : And the winner is…

On March 26th, Hong Kong's Election Committee elected Carrie Lam (67% of votes) as the new Chief Executive. Ms. Lam will take up her five-year term of office on July 1st, 2017. Despite the resounding victory, some observers consider Lam's opponent, John Tsang, to be more popular with the general public. The freshly-elected Chief Executive's mission will not be easy. Internally, the new leader will have to deal with weak economic growth, increased inequality, and political tensions with the Mainland. Externally, the financial hub is reliant on export activity but global demand growth is still fragile. GDP growth is expected to tick up in 2017 to +2.2% (up from +1.9% in 2016) due to a gradual increase in exports and an expansionary fiscal policy.

What to watch

- March 30 – US Q1 GDP
- March 30 – Eurozone March confidence indicators
- March 30 – South Africa Monetary policy meeting
- March 31 – UK March GfK Consumer Confidence
- March 31 – UK Q4 Current Account Balance
- March 31 – US Feb personal income and spending
- March 31 – Canada January GDP
- March 30 – Argentina February industrial production
- March 31 – France Feb Consumer Spending
- March 31 – China NBS PMI for March
- April 3 – Brazil March manufacturing PMI
- April 3 – US March construction index
- April 4 – EU Parliament declaration on Brexit

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