Euler Hermes Economic Research

Weekly Export Risk Outlook

11 July 2018

FIGURE OF THE WEEK

+5.4%

Egypt's GDP growth in fiscal year 2017/18

In the Headlines

UK: Towards a softer Brexit than expected

The first monthly GDP reading showed a pick-up in growth in the three months ending May (+0.2% 3m/3m) vs flat growth in the three months to April. The services sector experienced growth of +0.4% in the three months to May. Growth in consumer-related industries (e.g. retail, hotels, restaurants) picked up, particularly thanks to the warm weather and the royal wedding. However, manufacturing declined by -1.2% 3m/3m, mainly driven by weak exports. Overall, this release is in line with our expectation for a modest pick-up in GDP growth to +0.3% / +0.4% q/q in Q2 from +0.2% q/q in Q1.

The UK government will publish a detailed White Paper by the end of this week on the future targeted FTA with the EU. First hints suggest a softer Brexit than initially announced: zero tariffs for manufacturing and agricultural goods, but not services – which is rather similar to the FTA EU-Switzerland. However, downside risks to such a softer Brexit have emerged promptly as key ministers have resigned this week owing to disagreement with PM May's course. A confidence vote against PM May doesn't seem feasible at this stage but a contest for leadership at the Conservative autumn party conference (30 Sept. to 3 Oct. 2018) cannot be ruled out which could increase the likelihood of early elections in 2019.

U.S.: Strong labor market unfazed by trade concerns

Fears that a trade war would put a damper on hiring have proved unfounded so far. The June labor report was quite strong as the economy created +213k jobs, exceeding expectations of only +190k. Job gains were widespread across most industries including a strong +36k in manufacturing. The unemployment rate backed up from 3.8% to 4.0%, but it was a sign of strength as it was caused by +601k people entering the labor force, which also drove the participation rate up by +0.2pp to 62.9%. However, once again wages refused to budge, resulting in a +2.7% y/y rate, near where it has been for seven straight months. One reason wage growth has been so weak is the lack of skilled labor, which has required businesses to hire people at unskilled wages and then train them. It was the number one business problem again in this month's NFIB survey. Demand for labor is very strong as shown by a separate labor survey reporting an elevated quits rate and a record high job openings/unemployed ratio. A trade war may hurt jobs in the future, but not yet.

Egypt: Growth surprises positively

Real GDP growth was estimated at +5.4% in the fiscal year 2017/18 (which ended on 30 June), the fastest rate since 2007/08. The gradual approach to reform is paying off and the international context is supportive (tourism and Suez Canal activity were key growth contributors). Egypt kept repaying its debt to foreign oil corporates (two thirds are now repaid) and leveraged its regained market access to issue USD6bn in Eurobonds in 2018. However, the recent new cut implemented on subsidies ended the disinflation period. An expected rise in inflation to 16.8% at the end of Q3 from the low observed in May (11.4%) is a downside risk to growth. The implementation of a new set of reforms aimed at improving the business climate is now expected by many observers, but the current administration has not yet given any particular sign on the subject. This should not affect short-term growth prospects (+5.8% are forecast in 2018/19) but no further reform would weigh on the current account deficit (we expect -3.5% of GDP in 2018/19) and on the overall public debt scenario (forecast at 95% of GDP in 2018).

Emerging Markets: Selectivity needed

Growth in the manufacturing sector kept on landing in Emerging Markets (EM) in June. Our aggregate Manufacturing PMI eased to an 11-month low of 51.0 points. Obviously, there were two shocks at the same time. First, higher oil prices hit EM oil importers and capital flow reversals hit the most vulnerable EM. Our EM oil importers aggregate PMI fell to 50.7 in May and was unchanged at this low level in June (down from 54.2 at end-2017). At the same time, our Fragile 4 (Brazil, Mexico, South Africa, Turkey) index fell below the 50.0-neutrality threshold (to 49.7) in June for the first time since February 2017. This followed weak Q1 GDP growth performances in some of them (Brazil, South Africa) and negative news since then, intertwining political risk with protests. These PMIs may well reflect some overreaction, but also signal a risk of some months of negative growth, particularly in Turkey where the exchange rate crisis had a sizeable impact on inflation and in Brazil where political uncertainty is still considerable.

Countries in Focus

Americas

Brazil: A few inflation clouds

In line with market expectations, inflation rose to +4.4% y/y (+1.3% m/m) in June, a 15-month high and up from +2.9% y/y in May (+0.4% m/m). While the BRL depreciation (-3% in June after -7.4% in May) continued weighing on the Brazilian economy, the price rise of perishable goods (food inflation accelerated from 0.3% m/m in May to 2% in June) can be interpreted as a consequence of the truckers' movement. Indeed, significant shortages in food and beverages spread throughout the country. Headline inflation was also boosted by higher gasoline prices which chime with the global rise in oil prices. As inflation was driven by one-off shocks, and since oil prices should stabilize going forward, we expect the rise in inflation to be more gradual from now on. Yet, activity data releases show market tensions and the truckers' strike hit the recovery: industrial production decreased by -10.9% m/m in May (after growing +0.8% in April) and consumer confidence dropped to its lowest level in almost a year.

Europe

Italy: Political uncertainty to weigh on the economy

The economic soft-patch in Italy appears to have extended into the second quarter of 2018. Despite a rebound by +0.7% m/m in May, industrial production for the period March to May was still down -0.4% compared to the previous three months. Meanwhile, due to higher energy prices, gradually tightening monetary policy and elevated uncertainty at the global (persistent trade tensions) and in particular the domestic level (Italy's budget presentation in autumn) economic conditions are unlikely to brighten notably going forward. A Bank of Italy survey on inflation and growth expectations among 1,000 Italian firms supports this view. While the assessment of current conditions stabilized in Q2, expectations across firms from all sectors have become less favorable, driven to a large extent by deteriorating financial market conditions and political uncertainty. According to the survey firms have cut their 2018 investment and hiring plans. Overall we expect Italian GDP growth to slow to +1.2% this year from +1.5% last year.

Africa & Middle East

Morocco: Less growth, more inflation

Q1 GDP grew by +3.2%, in line with our expectations, including observed non-agriculture output acceleration (+3.3% y/y) while one-off effects that drove 2017 growth to +4.2% (agriculture output recovery from very low crops in 2016) are no longer present in 2018. But downside risks have now emerged. Morocco is particularly exposed to oil price spikes. Inflation has rebounded and should reach +2.5% on average in 2018 (a 10-year peak) and may well impact household purchasing power. The risk could be quite sizable since the labor market remains sticky (job creation is low) with the ability to cut overall Moroccan growth by -0.5pp. The current account deficit is likely to be impacted by a higher import bill as well, by -1pp (from current expectations of -4% of GDP this year). Such a scenario would also mean a slight deterioration of the import cover by forex reserves to 5.5 months – though still in the comfort zone. Overall, we do no longer see upside risks to our 2018 GDP growth forecast of +3%.

Asia Pacific

China: Surfing against the wind

Last month has been tough for China with a drop in the stock market, a depreciation of the currency and a rise in trade related risks. Despite these bad news, the economy managed to show resilience. A rise in foreign exchange reserves (+USD1.5bn to USD3,112bn in June) suggests that capital outflows were contained. A continued producer price reflation (+4.7% y/y in June) points to still solid growth in industrial profits. In that context, we estimate that economic growth rose by a robust +6.7% in H1. We have penciled in growth of +6.5% in H2, reflecting tight financial regulation and a somewhat slower export performance. Yet, risks are tilted to the downside with a 10% tariff on USD200bn of Chinese exports looming.

What to watch

- July 12 – Hungary, Romania May industrial production
- July 12 – Hungary, Poland June consumer prices
- July 12 – Serbia Central Bank meeting & June inflation
- July 12 – Ukraine Central Bank meeting
- July 12 – U.S. June consumer prices
- July 13 – China June trade figures
- July 13 – Slovakia June consumer prices
- July 15 – Kazakhstan June industrial production
- July 16 – Bulgaria June consumer prices
- July 16 – China Q2 GDP
- July 16 – U.S. June retail sales
- July 17 – Croatia June consumer prices
- July 17 – Turkey May industrial production
- July 17 – U.S. June industrial production
- July 18 – Poland June industrial production

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