Euler Hermes Economic Research

Weekly Export Risk Outlook

26 March 2014

FIGURE OF THE WEEK

USD70bn

Estimate of Russia's Q1 capital outflows

In the Headlines

Ukraine & Russia: Crisis update

At the end of last week, the EU and Ukraine signed the political provisions of the Association Agreement between them, while the Russian parliament approved the treaty to absorb Crimea into Russia. The US and the EU have extended their relatively cosmetic sanctions – visa bans and asset freezes – to include further Russian politicians, officials and businessmen. The EU also suspended some arms exports to Russia while the US sanctioned one Russian bank, the Rossiya Bank. To date, Russia has responded by banning a select group of US and Canadian officials. The west is also engaging in diplomatic isolation of Russia, calling an emergency session of the G7 leaders (excluding Russia) and cancelling the G8 summit in Sochi. Meanwhile, both S&P and Fitch revised their outlook on Russia's long-term foreign currency sovereign rating (both at BBB) to negative from stable, citing the crisis' negative impact on the Russian economy so far and the potential damage of forthcoming sanctions. Fears of tighter sanctions appear to have increased capital outflows to around USD70 billion in Q1 2014, according to Russia's deputy economics minister, which compares with capital flight of USD63 billion in full year 2013. After the sharp fall in early March, the RUB has stabilised, for now, most likely supported by FX intervention of the central bank, which is concerned about the exchange rate pass-through to inflation.

US: Fed continues to taper, housing remains weak

The Fed continued tapering its QE programmes and again signalled that they are likely to be completed by the end of 2014. At Chairwoman Yellen's first meeting in that role, the Fed dropped completely the previous threshold for raising interest rates of a rate of unemployment down to 6.5% and, instead, gave a more definitive time frame of approximately the first half of 2015. Meanwhile, consumer confidence in March increased more than expected, driven by expectations of improved conditions six months from now, although the appraisal for current conditions fell slightly. The housing market continues to weaken as sales of both new and existing homes fell for the third time in four months, putting the y/y rate in February at -1.1% for new homes and -7.1% for existing homes. Sales of the latter have been damaged by rising prices (9.1% y/y), tight supply (5.1 months, compared with an established average of 7.2), higher mortgage rates and severe winter weather. Sales of new homes have been affected by most of the same factors.

Eurozone: Business confidence suggests a gradual recovery

The PMI Composite Index in March was 53.2, broadly stable from February. The Services PMI fell slightly to 52.4 (from 52.6) and the Manufacturing Output indicator increased moderately to 55.4 (from 55.3). In the manufacturing sector, growth in new orders (domestic and export) and employment increased moderately. In the services sector, despite a moderation in the index, activity has now risen for eight consecutive months, with new business at the highest level since June 2011. However, the output prices index fell to 48.6, an eight-month low, suggesting that underlying prices are very weak. In Germany, the Composite PMI remained strong (55.0) with Services at 54.0 and the Manufacturing Output Index at 57.0. In France, both services and the manufacturing sector increased above the no-growth threshold. For the latter, it was the first time since August 2011. The Composite PMI Index was 51.6, a two-and-a-half year high. The latest regional PMI data suggest that Eurozone GDP will increase by +0.4% q/q in Q1, after +0.3% in Q4 2013. German GDP is expected to grow by +0.6% q/q, while French growth is expected to remain moderate at +0.1% because of January's increase in VAT.

South Africa: Resource legislation

The lower legislative body endorsed the Minerals and Petroleum Resources Development Act (MPRDA) Amendment Bill that is intended to allay concerns of a wholesale nationalisation of the mining sector. However, it will facilitate potential nationalisation of some mining assets, will enforce local processing requirements and allow export bans. It is likely that the bill will be revised and its most controversial clauses watered down, but, in the interim, it raises concerns that the ANC could become more populist and this may further depress business and investor sentiment at a time when vulnerable emerging markets are already seeing capital outflows and currency weakness. The bill may hamper investment flows into the iron ore, coal, platinum and gold sectors but thereby benefit other regional mining centres, such as Botswana, Mozambique and Namibia.

Countries in Focus

Americas

Argentina: A new CPI index still leaves doubts over data reliability

According to the new consumer price index released by the government last month, prices increased by 3.4% m/m (13.7% y/y) in February, following 3.6% (17%) in January. Local authorities were asked by the IMF to revise their methodology for evaluating the cost-of-living measure in the country as there were concerns of potential manipulation of the data, perhaps as a means of lowering debt servicing costs, as approximately 25% of total debt payments are linked to inflation. The new methodology is intended to be more comprehensive, with national coverage (extended from concentration on the Buenos Aires region) and an updated basket of goods and services. However, many private institutes still claim that the new CPI index underestimates actual inflationary pressures and they suggest that prices increased by 4.6% m/m in January and 4.3% in February, with forecasts of a y/y rate in excess of 30% in 2014.

Europe

Greece: 5th Programme Review finally ends on a positive note

After three failed attempts to complete the 5th Programme Review, Greece and the EU/IMF reached an agreement that allows disbursement of EUR13.6 billion scheduled for Q4 2013-Q1 2014. However, debt about to mature remains high at EUR30 billion (17% of GDP), with around EUR15 billion due to the ECB by August and EUR7 billion to the IMF by December. Under the current scheme, a financing gap of at least EUR3.6 billion will remain uncovered in 2014, and this could be higher as the banking sector review could reveal higher-than-expected recapitalisation needs, given the rapid increase in NPLs (31% of total loans). The government intends to sell bonds in H2 but this seems challenging, given current interest rates. The end of the EU/IMF bailout is scheduled for the end of this year. However, it is unlikely that Greece will manage to cover its funding gap without some new financial assistance, such as an enhanced credit line from the ESM and/or debt relief on past loans.

Africa & Middle East

Zambia: Policy reversal to stem ZMW fall

Frontier markets can be subject to the same sell-off pressures as emerging markets. Zambia announced on 21 March that it was scrapping two recent regulations that restricted foreign exchange availability. This follows severe pressure on the ZMW (which fell to record lows against the USD in Q1), triggered by weak international copper prices, a widening fiscal deficit and perceptions that some government policies are overly populist. With Chinese demand for copper losing strength and around 70% of Zambia's export earnings from shipments related to that metal, Lusaka recognised the dangers of losing the inward investment of international mining groups and reversed policies perceived as business-unfriendly. Other measures to tighten monetary policy are also likely to restore some confidence ahead of a planned approach this year to global capital markets. Overall, EH sees the policy response as positive and annual GDP growth is expected to remain over +7% in 2014 and 2015.

Asia Pacific

China: Cyclical slowdown

The flash HSBC Markit PMI reached an eight-month low in March at 48.1 (from 48.5) confirming that the economy is likely to slow in Q1 2014. The fall was mainly driven by a decrease in output and new orders. It reflects the country's headwinds, particularly a slowdown in credit supply (as a consequence of tightening in the conditions associated with loan approval) and in investment growth. EH expects volatile growth in H1 2014 before stabilisation in H2, bringing full year growth to +7.5%. In particular, macro-economic policies are expected to be supportive following the Q1 slowdown, with broadly favourable general government budget (deficit target of -2.1%) and employment targets (10 million jobs to be created in 2014). These objectives are likely to be reinforced by an acceleration of infrastructure projects to boost investment growth, as suggested by official statements in favour of a "speed up of investment and construction plans" to support domestic demand.

What to watch

- March 27 – Japan February CPI
- March 27 – Japan February retail sales
- March 27 – UK February retail sales
- March 27 – US Q4 2013 GDP (third estimate)
- March 27 – US February pending home sales
- March 28 – Germany, Spain & Belgium March CPI
- March 28 – US February personal income and spending
- March 29 – West Africa ECOWAS summit meeting
- March 30 – Turkey local elections
- March 30 – Japan February industrial production
- March 31 – Turkey Q4 2013 GDP
- March 31 – France & Netherlands Q4 2013 GDP (2nd est.)
- April 1 – US March ISM manufacturing index
- April 1 – Eurozone March PMI manufacturing
- April 1 – Czech Republic Q4 2013 GDP

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