Euler Hermes Economic Research

Weekly Export Risk Outlook

19 March 2014

FIGURE OF THE WEEK

-2.3%

Ireland's q/q Q4 2013 GDP

In the Headlines

Ukraine & Russia: Crimea crisis update

Events relating to the Crimea crisis continue to unfold rapidly. In a controversial referendum held on 16 March, Crimean voters chose to secede from Ukraine, reportedly with a backing of 97% on a turnout of 83%. On 17 March, the Crimean parliament formally declared independence and applied to join Russia. President Putin of Russia recognised Crimea as an independent state and, on 18 March, signed a treaty with Crimean leaders to absorb the region into the Russian Federation, which is likely to be confirmed by the Russian parliament by the end of this week. The interim Ukrainian government and western powers condemned these developments as an illegal annexation of Crimea by Russia. The US and the EU imposed further relatively cosmetic sanctions, including visa bans and asset freezes on a number of Russian and Crimean politicians and officials who, however, have reacted with dismissive responses, suggesting that such measures will have little effect. Despite the stepped-up rhetoric by all parties involved over the past few days, there is still a chance that the conflict will not escalate much further and a return to dialogue will ensue. Western powers and Russia, as well as Ukraine, have fundamental interests in de-escalation and a peaceful compromise solution, not least because of large mutual economic dependencies. These include: (i) strong trade, foreign investment and banking relationships between the EU and Russia; (ii) Ukraine's dependence on Russian gas and Russia as an export market; (iii) Russian-owned assets in Ukraine and (iv) Crimea's dependence on utility supplies from Ukraine. However, the tail risk that the conflict spirals out of control is not insignificant, particularly as pro-Russian eastern regions of Ukraine are experiencing high levels of anti-government protests. The tail risk includes the possibilities of a Russian incursion into east Ukraine, a partition of Ukraine, serious economic sanctions by western powers and retaliatory action by Russia. In such a scenario, the economic cost would be markedly higher, not only for Ukraine and Russia but also for the EU and, to a lesser extent, for the wider global economy. A largely-ignored potential trigger for Ukraine partition, to date, is the prospect of better living standards for east Ukrainians in the event of becoming Russian; GNI per capita in Ukraine is just USD3,500 (USD7,180 in PPP terms) but three times higher in Russia (USD12,700 and USD22,720).

US: Weather report

Record snow and cold weighed heavily on the economy from December 2013, but some payback is starting to emerge. Retail sales increased 0.3% m/m in February after falling in January and December. Auto sales also recovered 0.3% m/m after severe losses of -2.3% in both January and December. Even so, retail sales growth on a y/y basis and adjusted for inflation was a meagre 0.7%. Overall, industrial production increased by 0.6% m/m in February after declining -0.2% in January. Manufacturing output increased by 0.8% m/m after contracting -0.9% in January, with auto output up 4.8%, almost recovering January's sharp decline of -5.2%. Meanwhile, housing data continue to be erratic. The National Association of Homebuilder's Housing Market Index was up 1 point in March after losing 10 points in February. Housing Starts declined for the third consecutive month in February (-6.4% y/y) while permits increased for the first time in four months, gaining 7.7% m/m. Overall, data indicate a bounce back towards normal conditions, with spring perhaps likely to bring more even growth in overall economic activity.

Ireland: The trend remains positive

The economy slipped back into recession in 2013 (-0.3% after two consecutive years of positive growth) reflecting revisions to earlier quarterly 2013 GDP data and a sharp fall in Q4 (-2.3% q/q). This was the first contraction in three quarters and the largest in the past five years. Much of the deterioration resulted from a strong rebound in imports (+5.8% q/q) and contraction in private consumption (-0.6% q/q), although this came after two quarters of strong growth. However, the underlying trend remains positive as suggested by the GNP, which excludes the profits of foreign companies based in Ireland, as this increased by +0.2% q/q in Q4 2013 and +3.4% in 2013 as a whole. Investment posted its first annual increase since 2007 (+4.9% in 2013) and exports were held back (+0.1%) by the expiry of several pharmaceutical patents in 2013; pharmaceutical products account for around 30% of total exports. The economy is generally healthier and the successful exit from the EU/IMF three-year assistance programme in December 2013 is certainly supportive and a boost to business confidence. GDP numbers in Ireland are relatively volatile and possible upward revisions are not excluded. EH expects a further improvement in the economic outlook, with GDP growth of +1.6% in 2014 and +1.8% in 2015.

Countries in Focus

Americas

Chile: Activity will slow in 2014

GDP decreased by a seasonally-adjusted -0.5% q/q in Q4 2013, resulting in annual growth of +4.1% for the whole year (+5.4% in 2012). Smaller inventory accumulation and weak investment were the main causes for the deceleration as reconstruction needs following the 2010 earthquake are nearing completion. Investment in equipment and machinery contracted by -4.2% in 2013 (+17.4% in 2012) while investment in construction decelerated to +3.3% (+9%). Private consumption (+5.6%) remained the main growth driver in the absence of inflationary pressures (3.2% y/y in February, following 20 months below 3%) and low unemployment (5.6% in 2013). Net exports contributed +0.7pps to growth as exports (+4.3%) outperformed imports (+2.2%). EH expects growth will moderate further in 2014, to +3.7%, because of weaker domestic demand and exports (global copper prices are expected to stagnate, at best, as Chinese demand will slow) but increase to +4% in 2015.

Europe

Serbia & Slovakia: Election results

In **Serbia**, the centre-right SNS led by PM-designate Aleksandar Vucic won a landslide victory in the early legislative elections held on 16 March, securing 48.3% of the vote and approximately 158 seats in the 250-seat single-chamber parliament, according to preliminary results. The socialist SPS, junior coalition partner of the SNS in the current administration, came second with 13.5% of the vote. Five smaller parties will complete the next parliament. The convincing result for the SNS provides the prospect of increasing political stability and a strong mandate to push through urgently-needed reforms of the public sector, pension system, labour market and bankruptcy legislation. The presidential election in **Slovakia** will go to a second round on 29 March when the current PM Robert Fico will contest the poll with independent challenger Andrej Kiska. The two came top in the first round held on 15 March, securing 28.2% and 24% of the vote, respectively.

Africa & Middle East

Libya: Centralised authorities struggle to counter regional militia

Last week, the General National Congress (transitional parliamentary body) passed a vote of no confidence in PM Ali Zeidan after his government seemingly failed to prevent the eastern movement seeking independence or autonomy from exporting a tanker shipment of crude oil. This week, ownership of the tanker's contents was restored to the government in the west but, by then, Zeidan had been replaced as premier. The episode further indicates the fragile nature of the political transition and the deep divisions along regional and tribal fractures within the country. Do not expect the new PM to be markedly better at controlling the myriad of armed groups. With militias holding such significant power, the central government is likely to remain largely ineffective in the short term, heightening risks that tribal and regional divisions will lead to an effective partition of the country. Meanwhile oil output and therefore FX generation remain considerably below potential.

Asia Pacific

India: Inflation eases but headwinds remain

In February, CPI inflation eased for a third consecutive month, reaching 8.1% (from 8.8% in January), driven by a continuing decline in primary food and fuel price pressures. The hawkish monetary policy stance of the central bank (Reserve Bank of India, RBI) since mid-2013 (the key repo interest rate was raised from 7.25% in August 2013 to 8% in January 2014) appears to be working and the RBI is likely to achieve its inflation rate target on schedule (below 8% by January 2015). This downward trend in price growth suggests a repo rate hike is unlikely in the mid-term, especially as it would be a drag on investment and could undermine still fragile GDP growth (+4.7% y/y in Q4 2013). EH classifies India as one of the Fragile 10 emerging economies, with twin deficits, exchange rate volatility and decelerating GDP growth, and financial pressures could be exacerbated by political uncertainties relating to the outcome of presidential elections scheduled for May.

What to watch

- March 20 – Germany February PPI
- March 20 – Russia February retail sales
- March 20 – EU European Council summit
- March 20 – US February existing home sales
- March 20 – US February leading indicator
- March 21 – Canada February CPI
- March 22 – Maldives parliamentary elections
- March 24 – Ghana Q4 2013 GDP
- March 24 – Germany March PMIs (preliminary)
- March 24 – Eurozone March business confidence (PMI)
- March 25 – US February new home sales
- March 25 – US January Case-Shiller Home Price Index
- March 25 – US March consumer confidence
- March 25 – Germany March Ifo business climate survey
- March 25 – Hungary monetary policy meeting

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