Euler Hermes Economic Research

Weekly Export Risk Outlook

7 May 2014

In the Headlines

FIGURE OF THE WEEK

USD17bn

Ukraine's two-year facility agreed with the IMF

Ukraine: IMF loan forthcoming but political tensions intensify

Last week, the IMF Executive Board approved a USD17 billion two-year Stand-By Arrangement (SBA), with a first disbursement of USD3.2 billion available immediately. The IMF facility will also unlock further funds of around USD15 billion from the donor community, including the World Bank, the EU, Japan and Canada. The SBA will reduce the risk of immediate economic collapse, but it will require painful economic reforms and a recession in 2014 is unavoidable. According to a flash estimate, real GDP in Q1 declined by -1.1% y/y and -2% q/q, less severe than expected. EH expects a full year contraction of at least -3% in 2014 as austerity measures and trade disruptions with Russia will take their toll. The balance of risks to this forecast is firmly on the downside, mainly reflecting the ongoing political tensions in the east. These escalated further over the past week as Ukrainian security forces began an "anti-terrorism operation". In Odessa, so far a relatively peaceful city in the south, fighting last weekend between pro-western and pro-Russian activists caused over 40 casualties, mostly pro-Russian. Further escalation is possible as Donetsk and Luhansk provinces are both preparing to hold an independence referendum on 11 May.

U.S.: Springboard?

Economic data were markedly positive in the past week. The economy created a strong 288,000 jobs in April, much more than expected, with significant upward revisions to the previous two months. Unemployment fell to 6.3%, but that improvement reflected the one negative in the jobs report; the labour force contracted by 806,000, driving the participation rate down 0.4pps to match the post-recession low of 62.8%. Meanwhile, personal consumption expenditures increased by 0.9% m/m in March, the most since August 2009, while personal income improved by 0.5%. The April ISM manufacturing index showed all round strength, especially in employment, and increased 1.2 points to 54.9, notably above the 50 level indicating expansion. The ISM non-manufacturing index showed similar strength in new orders and inventories, increasing by 2.1 points to 55.2. As expected, the Federal Reserve lowered its monthly asset purchases by another USD10 billion, maintained the overnight Fed Funds rate between 0% and 0.25% and also hinted at optimism, saying "economic activity has picked up recently."

Portugal: Clean bailout exit, downside risks remain

The government decided to end its three-year bailout programme without requesting any additional line of credit from the EU/IMF, as rapidly falling sovereign interest rates allow the country to support its financing needs through issuance on bond markets. Ten-year bond yields are now below 4% (compared with a peak of 17% at end-2012) and very close to their pre-crisis level. However, as the international financial environment remains highly volatile, these favourable financing conditions cannot be taken for granted, particularly as fragilities remain evident, including weak domestic demand, high unemployment, persistence of deflationary risks, a fragile banking system and ongoing fiscal consolidation. Portugal still needs to issue around EUR11 billion in medium- and long-term debt and EUR24 billion in short-term debt in 2014 in order to finance the fiscal deficit (EH expects EUR7 billion or 4.1% of GDP) and maturing debt (EUR21 billion, 12% of GDP). The debt-to-GDP ratio peaked at a very high level of 129% in 2013 and is expected to stabilise at this level in 2014. EH also expects GDP growth to pick up to +1% in 2014 and +1.3% in 2015.

Eurozone: Banks need to prove their financial strength

Before taking over as the Single Supervisory Body in November 2014, the ECB is conducting an Asset Quality Review (AQR) and, in collaboration with the EBA, a series of stress tests on 130 institutions accounting for approximately 85% of the region's bank assets. The AQR analyses banks' credit and market exposure, on- and off-balance sheet positions and domestic and non-domestic exposures to all asset classes. The EBA recently unveiled the methodology for the upcoming stress tests in May. The worst-case scenario is stricter than in 2011and takes into account a fall of -2.1% in eurozone GDP between 2014 and 2016, a sell-off in bond and equity markets and sharp house price declines. The purpose is to test banks' financial strength. Results could prove tight for some banks in southern Europe (bail-in measures and use of money from the national resolution fund are expected) as market recapitalisation is not allowed. However, most banks have cleaned up their balance sheets recently, which has acted as a drag on credit activity. Results will be announced in October/November. At that time, the ECB is likely to take further action to support the economic recovery by announcing a series of non-conventional measures (including private asset purchases and targeted liquidity for SMEs).

Countries in Focus

Americas

Panama: Surprise result in presidential elections

Last Sunday, Vice-President Juan Carlos Varela (Panamenista party) won the presidential election, with approximately 39% of the vote. He outdistanced José Domingo Arias (Democratic Change party, 32%), former President Martinelli's preferred choice and the favourite to win in most pre-election surveys. Even so, Arias' party won the most seats (30) in the 71-member National Assembly, compared with 12 for Varela's party. The new president is committed to maintain high economic growth, lower public debt and reduce inequalities and poverty. He also made completion of the Panama Canal's expansion one of his top priorities, although the project is behind schedule as a result of a workers' strike from April 2013. Although this limited overall economic activity in the latter part of 2013 (and may do so in 2014), Panama still registered one of the strongest rates of regional GDP growth in 2013 (+8.4%). EH expects a slowdown in 2014 (+6.8%) and in 2015 (+6.3%).

Europe

Belgium: Towards more balanced GDP growth

In 2013, economic activity expanded by +0.2%, supported by resilient private consumption and favourable terms of international trade, while investment remained in negative territory. In Q1 2014, GDP growth accelerated to +0.4% q/q (after +0.3% in Q4 2013) according to preliminary estimates of the National Bank of Belgium. A GDP breakdown will be available on 4 June but advanced indicators suggest positive trends in most sectors, as industrial production increased by +9.4% y/y in February and business confidence improved in the industry, construction, services and retail sectors. In 2014, EH expects GDP growth will pick up to +1.3%, reflecting rising private consumption, a rebound in total investment and strong exports as a result of the eurozone recovery and Belgium's role as a regional trade hub. Economic momentum is forecast to remain positive and EH expects GDP growth will increase to +1.4% in 2015.

Africa & Middle East

South Africa: And the result is…

Today's parliamentary elections will provide the ANC with a renewed mandate to govern and, as a consequence, President Jacob Zuma will secure a second term as head of state. While the actual result is not in doubt, voting patterns will be analysed closely for signs of potential political change, including: if the turnout is low it will indicate mounting dissatisfaction with the electoral process and style of governance; if the main opposition DA gains votes it may show that it is widening its support base away from a white minority; and if the Economic Freedom Fighters win >5% of the vote it may suggest pressure on the ANC to adopt more populist policies (including nationalisation and land sequestration). There are also questions over whether Zuma will complete a full second term and, if not, will his deputy, Cyril Ramaphosa, have a strong enough ANC base to succeed him. EH expects that, whatever the poll outcome, structural economic rigidities will hamper growth potential.

Asia Pacific

Indonesia: Q1 GDP growth at a five-year low

GDP growth in Q1 (+5.2% y/y) registered its lowest rate since Q3 2009, reflecting deteriorating conditions resulting from the increase in interest rates (+50bps in late 2013 to 7.5%), high inflation (7.25% y/y in April 2014) and exchange rate depreciation (-4.4% since August 2013 after a slight improvement in confidence over the past few months). GDP was mainly driven by domestic demand: household consumption increased by +5.6% y/y and investment by +5.1%. External trade contributed negatively to GDP growth, with imports decreasing for a second consecutive quarter (-0.6% y/y) and exports falling by -0.8%, mainly affected by the ban on shipments of unprocessed minerals. Production in the mining sector fell by -0.4% y/y as a consequence of this government regulation, compared with +3.9% in Q4 2013. Manufacturing output increased by +5.2% y/y. EH expects GDP growth will slow to +5.3% in 2014 from +5.8% in 2013.

What to watch

- May 8 – ECB policy interest rates
- May 8 – Germany March industrial production
- May 8 – Spain March industrial production
- May 8 – Chile April CPI
- May 8 – Mexico April CPI
- May 9 – China April CPI
- May 9 – Latvia Q1 GDP (flash estimate)
- May 9 – UK & Italy March industrial production
- May 9 – Portugal March merchandise trade
- May 9 – Portugal March unemployment
- May 12 – Estonia Q1 GDP (flash estimate)
- May 12 – Spain Q1 GDP
- May 13 – US April retail sales
- May 14 – Japan Q1 GDP
- May 14 – Eurozone March industrial production
- May 15 – Eurozone Q1 GDP

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