Euler Hermes Economic Research

Weekly Export Risk Outlook

14 March 2018

In the Headlines

FIGURE OF THE WEEK

+4.7%

Romania's y/y inflation in February

U.S.: Risky tariffs announced, economy remains solid

President Trump announced import tariffs of 25% on steel and 10% on aluminum effective 23 March. Imports from Canada and Mexico will be temporarily exempted, and the administration left the door open for other countries to negotiate exemptions as well. The tariffs will help metal producers but hurt metal consumers, will likely destroy more jobs than they create, and will create the risk of a dangerous trade war as other countries have already made retaliatory threats. The domestic economy remains solid, as the February employment report was very strong, showing widespread gains of +313k jobs, with upward revisions of +54k on the prior two months. The labor force gained +806k, the most in 15 years, pushing the participation rate up from 62.7% to 63%, the biggest increase in eight years. The massive increase in the labor supply over the past two months may have helped keep wages in check, driving them down from +2.8% y/y to +2.6% in February. Inflation in consumer prices was subdued as well as the Consumer Price Index rose +0.2% m/m to +2.2% y/y from +2.1% in January. Core prices also rose +0.2% m/m to +1.8% y/y; they have ranged between +1.7% and +1.8% for 10 months.

China: A strong start of the year but…

Latest official data were encouraging. USD-denominated exports rose by +44.5% y/y in February. Looking at January-February figures in order to reduce the seasonal effect of the Chinese New Year, the momentum is still strong at +24.4% y/y. Industrial production accelerated to +7.2% y/y in Jan-Feb (from +6.2% y/y in December). On the expenditures side, nominal retail sales remained solid (+9.7% y/y in Jan-Feb), investment edged up (+7.9% y/y in Jan-Feb, compared to +7.2% in 2017). On prices, producer prices continued to rise but at a slower pace (+3.7% y/y in February, after +4.3 in January), yet consumer price inflation increased to +2.9% from +1.5%. Going forward, we expect this momentum to be temporary. First, rising protectionist measures from the U.S. will likely hamper export growth this year. Second, tighter credit conditions are set to act as a drag on further improvement of investment. Third, rising inflation may limit private consumption growth. Against this background we expect economic growth to slow to +6.5% in 2018 (from +6.9% in 2017).

Turkey: Overheating concerns and rising country risk

Moody's downgraded Turkey's long-term sovereign rating last week further into junk territory, to Ba2 from Ba1, citing the continued weakening of economic and political institutions as well as increased risks from widening current account deficits and rising external debt. Moody's also downgraded 14 banks and six large corporates. Data released this week showed that the current account deficit came in at –USD7.1bn (+163% y/y) in January, taking the 12-month rolling shortfall to –USD52bn (up from –USD47bn in December and –USD34bn in January 2017). Only 15% of that were covered by net FDI inflows. The remainder was financed through short-term foreign capital inflows. As a result, short-term external debt on a remaining maturity basis rose to USD177bn at end-2017, up from USD160bn a year earlier. Financial markets have reacted markedly: since end-February, the TRY has weakened -2% against the USD and the 10-year TRY bond yield has risen +60bp to 12.2%. Concerns about economic overheating – real GDP rose by an estimated +7% in 2017 and core inflation hovers around 12% y/y – and rising country risk will remain on the agenda.

Russia: Economic outlook mixed, political outlook stable

Early indicators for 2018 were mixed. The Composite Output index rose to 55.2 points in February, after it had fallen to 54.8 in January, driven by a rebound in the Services PMI to 56.5 (from 55.1). The latter was propelled by rising demand, reflected in a strong increase in new orders and the quickest rate of job creation since end-2012. This bodes well for consumer spending in early 2018, even though real retail sales growth eased to +2.8% y/y in January from an average +3% y/y in Q4 2017. Meanwhile, the Manufacturing PMI fell to a 19-month low of 50.2 points in February (52.1 in January), with across-the-board weaker expansion in output, new orders and prices and a fall in employment. This suggests that the rebound in industrial production growth to +2.9% y/y in January from an average -1.7% y/y in Q4 2017 may be short-lived. On Sunday, Russia will hold presidential elections. Vladimir Putin, the incumbent, is widely expected to be re-elected for a fourth term. Hence do not expect major changes to economic and foreign policy in the medium term.

Countries in Focus

Americas

Brazil: Still encouraging developments for consumers

After slightly disappointing Q4 GDP figures, recently released national data indicate a positive start of the year for the Brazilian consumer. First, inflation remains below target, with the CPI increasing slightly by +0.32% m/m in February after +0.29% in January, in line with market expectations. On a y/y basis, inflation edged down to +2.84% from +2.86% in January. On the other hand, real retail sales advanced at their fastest monthly pace in January (+0.9% m/m) since June 2017. The retail sales index is now at its highest level since November 2015. Consumption developments should continue to be supported by employment gains (unemployment rate at 12.2%, down from a high of 13.6% in April 2017) and by a more accommodating monetary policy stance (policy rate at 6.75%, down from 14.25% in late 2016). Moreover, business confidence is back to its late 2013 level. Thus we expect the recovery of investment to continue in 2018, supporting the overall growth performance as well.

Europe

Romania: The overheating goes on

Headline consumer price inflation rose to 4.7% y/y in February, up from 4.3% in January and the highest since June 2013. While food price inflation edged down to 3.7% y/y (from 3.8% in January), prices rose stronger for non-food products (6.3% y/y, after 6.2% in January) and for services (2.9%, up from 0.9%). The continued surge in prices will further stoke overheating concerns. Real GDP soared by +7% in 2017, largely driven by a +10.2% rise in consumer spending. And the latter was boosted by strong pro-cyclical fiscal stimulus and a +13% increase in nominal wages, which was well above productivity gains. Since headline inflation has now clearly exceeded the 2.5% ± 1pp target range of the National Bank of Romania (NBR; the central bank) for two months in a row, despite two policy interest rate increases by 25bp each in January and February, we expect further, perhaps more aggressive rate hikes in the next months. The next regular monetary policy meeting is scheduled for 4 April.

Africa & Middle East

Kenya: Counting stars

Kenya experienced a difficult year in 2017, with political uncertainty and lower agricultural output due to drought. Inflation surged to +11.7% y/y in May 2017 just before the presidential election, exacerbating tensions. However, despite these problems the impact on growth was quite limited (+4.8% in 2017, after +5.8% in 2016), smoothed by fiscal stimulus which took the fiscal deficit to -9% of GDP in 2017. The precautionary IMF program that was supposed to end in March 2018 was just prolonged by six months. It should help the country to benefit from the recent improvement of many conditions that were subpar in 2017. First, the manufacturing PMI went to 54.7 in February 2018 (back to the April 2016 level), with both high new orders and output. Second, the interest rate cap that inhibited credit during the election period will be reviewed, on IMF request. Third, the dispute between the two presidential candidates ended smoothly last week. Final argument, the agricultural output is likely to normalize. As a result, growth should reach +6.5% in 2018, the highest rate since 2011.

Asia Pacific

Australia: Saved by consumption

Economic growth slowed down to +0.4% q/q in Q4 2017 (from +0.7% in Q3). Final consumption accelerated to +1.1% q/q (from +0.4%) on the back of higher households spending (+1% q/q) and government consumption (+1.7% q/q). Investment contracted in Q4 2017 (-1.2% q/q) reflecting a decline in business investment (-2.2% q/q). Exports contracted by -1.8% q/q. Inflation edged up slightly to +1.9% y/y in Q4 2017 (from +1.8% in Q3). Looking ahead, business surveys, namely the Manufacturing and Services PMIs, still suggest solid growth. Private consumption is underpinned by a continued rise in compensation and positive job creation. Yet, pockets of risk do remain with high household debt. We expect the authorities to adopt a balanced policy mix with a gradual rise in the policy interest rate (+0.25pp in 2018) to tame financial and inflationary risks as well as supportive fiscal policy to keep growth stable (+2.4% in 2018, similar to 2017).

What to watch

- March 15 – Poland February inflation
- March 16 – Portugal sovereign debt to be rated by S&P
- March 16 – Singapore February exports
- March 16 – Turkey January industrial production
- March 16 – U.S. February housing starts
- March 16 – U.S. February industrial production
- March 19 – Poland February industrial production
- March 20 – South Africa Q4 current account balance
- March 20 – Turkey March consumer confidence
- March 21 – Argentina Q4 GDP growth
- March 21 – Brazil Central Bank meeting
- March 21 – Spain January trade balance
- March 21 – Ukraine Q4 GDP growth
- March 21 – U.S. February existing home sales
- March 21 – U.S. FOMC announcement

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