Euler Hermes Economic Research

Weekly Export Risk Outlook

9 November 2016

In the Headlines

FIGURE OF THE WEEK

+5%

Q3 2016 y/y GDP growth in Indonesia

U.S.: Surprise win for Trump, but Congress will provide balances

In an upset victory which has widely been called "stunning", Republican Donald Trump has been elected the 45th President of the United States and will be sworn into office on 20 January 2017. Having been viewed as a divisive candidate, reaction to his election worldwide has been intemperate. However, for virtually the first time since the start of the campaign, Trump struck a conciliatory tone in his victory speech, praising Clinton for her service to America and asking those who had opposed him for guidance and help. While Republicans maintained majorities in both the House and the Senate, Trump will still face significant hurdles implementing some of his proposals. Virtually all Democrats in Congress are likely to oppose him on many proposals, and a significant number of Republicans still disapprove of him and his ideas, potentially forming a voting block against him. The economic effects of his election will likely include an increased deficit due to stimulus measures of lower taxes and more spending, and a significant risk to growth from anti-trade policies. However the removal of uncertainty could spur consumer confidence and spending, and may give businesses the confidence to resume investment. The Fed is still most likely to hike in December.

Egypt: The force awakens

Last week, the authorities delivered two long-awaited reforms (see also WERO 12 October 2016) and Egypt should now qualify for a three-year, USD12bn loan from the IMF. These reforms are: (i) The free floating of the exchange rate, ending a self-defeating defense of a peg to the USD (foreign exchange reserves fell to four months of import cover). The EGP depreciated by about -50% after the decision, and the premium over the black market exchange rate vanished immediately. (ii) Large cuts in price subsidies that sent the subsidized prices – which had heavily weighed on public finances in the past – substantially up (by +30% to +47%) to more normal levels. The Central Bank decided to hike its policy rate by +300bps to 15.25% in order to reduce the pass-through from depreciation to inflation. Nonetheless, Euler Hermes expects inflation to accelerate further from an average 13% in 2016 to 20% in 2017. This transitory shock will weigh on GDP growth, forecast at +2% in 2017, after +3.5% in 2016, with downside risks related to the social impact of the unpopular decisions (the unemployment rate is 12%).

Germany: Robust growth outlook, despite summer volatility

Economic activity indicators weakened in September. In m/m terms, industrial production was down -1.8%, new orders in manufacturing -0.6%, retail sales -1.4% and exports -0.7%. However, this came after mostly strong increases in August and earlier weaknesses in July, with the high summer volatility linked to the earlier average timing of school holidays and plant shutdowns this year. Hence a look at quarterly data provides a better view. In working-day adjusted y/y terms, industrial production increased by +0.8% in Q3 (+0.4% in Q2), new orders in manufacturing by +1.5% (-1% in Q2), retail sales by +0.8% (+1.4% in Q2) and exports by +0.3% (-0.8% in Q2). Overall, the indicators point to moderate but stable growth in Q3, while the new orders component combined with the recent strength in economic sentiment (see also WERO 26 October 2016) suggests that growth may pick up in Q4. Euler Hermes expects full-year GDP growth of +1.8% in 2016 and +1.7% in 2017.

Emerging Markets: Big is beautiful

Growth accelerated a little more in the Emerging Markets (EM). The Euler Hermes proprietary aggregate EM manufacturing PMI increased to 50.6 in October (after 50.1 in September and 49.5 in July). It becomes increasingly evident that this positive surprise is driven by key EM, mainly China (51.2, best performance since July 2014), India (54.4, best since December 2014) and Russia (52.4, best since October 2012). The positive impulse in these economies came from domestic demand as domestic new orders improved while foreign orders did not as world trade is sluggish (see also our Economic Outlook Trade Wars: The Force Weakens). As a result, real GDP growth is likely to accelerate, but more importantly nominal GDP growth is also recovering since producer prices are no longer falling. In China a 5-year old deflationary cycle is ending. Nominal growth is key in order to achieve stronger turnover and profits growth. Low turnover growth went hand-in-hand with low corporate investment since corporates preferred to hoard cash (USD11trn globally) weighing on world GDP growth.

Countries in Focus

Americas

Colombia: Tax reform

The tax reform bill was finally received in Congress and referred to the respective committees. The reform aims to simplify the tax framework and raise revenues by unifying existing fees for businesses and closing the gap with the average fiscal burden in the Latin American region. It is expected to increase tax collection by +COP7bn in 2017 (0.8% GDP) and +COP26bn in 2022 (3.3% GDP). The rise in VAT (from 16% to 19%) and the expansion of its taxable base will come into force on 1 January 2017. The number of income tax payers is expected to increase by +440,000 up to 2.7 million by reducing the exemption level. Businesses will progressively converge to a 32% corporate tax rate in 2019 from the current 33% and 39% rates. Dividends will be charged with either a 5% or 10% tax and the purchase of new housing above COP800mm with 5%. The proposal also includes measures to fight informality and tax evasion. The Congress should approve the reform before 16 December.

Europe

Greece: Positive signal, but neither expect too much nor too soon

Greece was on the agenda at the Eurogroup meeting this Monday. The second Troika review is ongoing and is expected to unveil reviewed fiscal targets until the next Eurogroup meeting on 5 December when Greece will be discussed in greater detail, notably regarding the debt relief measures based on the ESM's proposed solutions. We believe the decision on debt relief measures will be conditional on (i) IMF participation in the current bailout (to be decided by year-end); (ii) future economic growth; and (iii) the pace of reforms. The implementation of debt relief measures will perhaps not come until the end of the current program, scheduled for mid-2018, and will probably not target a nominal debt haircut. As a reminder, the IMF requires a lower 2018 primary fiscal surplus target (+1.5% of GDP vs. the current +3.5%). Euler Hermes expects Greece to return to positive growth of +2% in 2017. As always, implementation risks on the agreed reforms remain.

Africa & Middle East

Mozambique: The importance of being earnest

S&P's downgraded its long-term foreign currency rating for Mozambique from CCC to CC (negative outlook). The rating agency views a debt default as imminent as public debt has surged to 130% of GDP. Following the discovery of the world's largest natural gas reserves in 2011 and the premature anticipation of large future revenues, the government went on a borrowing spree, but much of the receipts have been misspent. Undisclosed debt and secret loans of over USD2bn to SOEs led the IMF to pull out of a potential assistance package. The government wants to use an independent audit to re-engage the IMF and restore confidence but creditors remain skeptical about its proposed restructuring of USD11.2bn by January 2017. The MZN has depreciated by over -40% against the USD in 2016 YTD and inflation surged to +25% y/y in September. EH forecasts real GDP growth to slow down from an average +7% in 2010-2015 to +4% in 2016 and +1% in 2017, with sizeable downside risk.

Asia Pacific

Indonesia: Q3 GDP slows down slightly

Real GDP growth edged down to +5% y/y in Q3 from +5.2% y/y in Q2. The slowdown was the result of lower exports and a more cautious approach on government spending in the wake of low commodity prices and low fiscal revenues. Private consumption has remained broadly stable and short-term indicators point to some improvement. Consumer confidence is rising and lower inflation is supporting a rise in real income. Meanwhile, signals on corporate investment are somewhat mixed. Business sentiment has remained volatile as the Manufacturing PMI fell to 48.7 in October after two months in expansion territory, reflecting weak new orders. However, a more aggressive monetary easing stance of the Central Bank may eventually trigger a gradual recovery of investment. Against this backdrop, Euler Hermes expects full-year GDP growth of +5% in 2016 and +5.2% in 2017.

What to watch

- November 10 – France September industrial production
- November 10 – Greece & Ireland October inflation
- November 10 – Italy September industrial production
- November 10 – Philippines interest rate decision
- November 11 – Estonia Q3 GDP growth (flash estimate)
- November 11 – Mexico September industrial production
- November 11 – Peru interest rate decision
- November 14 – Italy October inflation
- November 14 – Japan Q3 GDP growth (flash estimate)
- November 14 – Russia Q3 GDP growth (flash estimate)
- November 15 – EU Q3 GDP growth (flash estimates)
- November 15 – France, Spain & UK October inflation
- November 15 – Germany November ZEW survey
- November 15 – Israel Q3 GDP growth (flash estimate)
- November 16 – U.S. October retail sales
- November 16 – Russia October industrial production
- November 16 – U.S. October industrial production

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