Euler Hermes Economic Research

Weekly Export Risk Outlook

31 January 2018

FIGURE OF THE WEEK

+2.5%

Eurozone GDP growth in 2017

In the Headlines

U.S.: Consumers drive the economy

Q4 GDP growth was markedly stronger than the headline +2.6% q/q annualized rate indicated. Business investment gained a solid +6.8%, and residential investment made a sharp +11.6% increase after two consecutive negative quarters. The only real downside to the report was that a surge in imports caused the trade deficit to swell, knocking off a full -1.1pp of the headline growth rate. Most importantly, personal consumption (PCE) grew a very strong +3.8% in the quarter and is now running at +2.8% y/y. One worry though is that consumers are spending most of their income to fuel consumption, driving the savings rate down to 2.4%, the fifth lowest monthly reading since 1959. However, income is starting to trend up, growing +2.1% y/y vs. only +1% just five months ago. In addition, consumers have the willingness to spend as January consumer confidence rose +2.3 points to 125.4, still near November's 17-year high. Durable goods orders gained an outsized +2.9% m/m, driven by defense aircraft. After stripping out volatile components, orders shrank -0.3% but the y/y rate is still a hot +8.4%. Inflation remained tame in December as the (PCE) core rate rose a tick to a still slow +1.5% y/y.

Eurozone: Strong growth contrasts with ECB's easing bias

Eurostat's first flash estimate has put Q4 real GDP growth at +0.6% q/q. This means the Eurozone continued to expand almost as strongly as in the previous quarters. For 2017 as a whole, economic growth reached a respectable +2.5%. And there is also a good basis laid for 2018 – we continue to forecast GDP growth of at least +2.2%. Furthermore, the latest sentiment indicators and especially further rising capacity utilization in the Eurozone's industrial sector contribute to the positive picture. The current economic momentum shows in retrospective that the loose ECB monetary policy is having an effect (naturally with a time lag). Looking ahead, the current monetary policy stimulus – the ECB's balance sheet continues to grow – may be too strong. At last week's Governing Council meeting the forward guidance was left unchanged. However, the ECB's easing bias appears no longer appropriate and is likely to be dropped soon. Starting in October, the monthly bond purchases should be scaled back from EUR30bn to zero.

France: Ignition, supply side

GDP growth ended 2017 with a new steady figure of +0.6% q/q in Q4, the fifth quarter with about +0.5% growth. This growth was supply-side driven. Corporates increased their inventories which added +0.4pp to full-year 2017 growth, a usual pattern of growth acceleration when firms bank on future demand increases. Moreover, corporates continued to increase their capacity utilization rate which reached 85.8% in Q1 2018, a level rarely seen in the past. This triggered strong corporate fixed investment growth of +4.3% in 2017. And low vacancy rates in housing boosted household investment growth to +5.1% in 2017. Yet, overall domestic demand did not accelerate in 2017 (+1.9%, after +2% in 2016) as private consumption grew by just +1.3% (after +2.1% in 2016). We forecast full-year growth to accelerate from +1.9% in 2017 to +2.1% in 2018, driven by domestic demand (+2.3%) which should be fueled by consumption (+2%) and a new strong increase of corporate investment (+5%). External demand will also be supportive, since export expansion is expected to accelerate to +4.7% (from +3.5% in 2017) as a result of higher demand from the Eurozone.

UK: Economy set to enter a downtrend in 2018

Q4 2017 GDP growth came in at +0.5% q/q, slightly above the +0.4% q/q observed in the previous quarter. This took growth for 2017 as a whole to +1.8%. While only a slight dip compared to the +1.9% expansion seen in 2016, this is the lowest growth rate for the British economy since 2012. Whereas the preliminary Q4 growth estimate seems to underline the British economy's resilience 18 months after the Brexit vote, in our view it's downhill from here with the slow-burning growth deceleration that is already underway set to become more pronounced in 2018. Brexit uncertainty will have a dampening impact on investment while the consumer squeeze will continue in 2018 in the context of inflation outpacing wage growth and weakening house prices. Meanwhile the modest growth contribution from the external sector – thanks to the favorable global growth outlook – will not prove strong enough to offset the expected slowdown in domestic demand. We forecast UK GDP growth to reach just +1.4% this year – one of the lowest growth rates across the EU.

Countries in Focus

Americas

Mexico: Rebound confirms resilience

A first estimate has put real GDP growth in Q4 2017 at +1% q/q seasonally adjusted (+1.8% y/y unadjusted), reflecting a rebound following the temporary contraction by -0.3% q/q in Q3 due to natural disasters. This takes full-year 2017 growth to +2.1%, in line with our forecast. Services growth surprised on the upside (+1.2% q/q after -0.1% in Q3), driving the GDP growth acceleration. This suggests that consumer spending remained strong despite inflation reaching a 16-year high in December. Agriculture posted the highest q/q growth (+3.1%) since Q4 2013, while industry continued to struggle (+0.1% q/q, after -0.6% in Q3). We expect Mexico's economy to remain resilient in 2018, though a moderate slowdown is possible as high interest rates may impede private consumption and investment while elections and NAFTA renegotiations are still uncertain. However, the projected fall in inflation in early 2018 and further progress on NAFTA negotiations could become game-changers.

Europe

Ukraine & Hungary: Different monetary policy needs

In **Ukraine**, the Central Bank (NBU) raised its key policy interest rate by a larger than expected 150bp to 16.0% last week, following two 100bp hikes in October and December 2017, citing still high inflation and underlying inflation expectations. Consumer prices rose by 13.7% y/y in December (up from 13.6% in November), clearly exceeding the NBU's inflation target range of 8% ± 2pp. Moreover, core inflation continued to rise to a 20-month high of 9.5% y/y in December. The NBU now expects headline inflation to return to the target in the middle of 2019, broadly in line with our forecast (average 11% in 2018 and 8% in 2019). In **Hungary**, the Monetary Council (MC) kept its key policy interest rate at 0.9% this week, unchanged since May 2016. Both headline (2.1% y/y) and core inflation (2.6% y/y sa) eased to 5-month lows in December – being in line with the MC's expectations – despite output being close to potential, a tight labor market and a dynamic rise in wages.

Africa & Middle East

UAE: Inflation on an uptrend

Consumer price inflation increased to a nine-month high of 2.7% y/y in December 2017 (from 1.7% in November), taking the full-year average inflation rate to 2%, up from 1.6% in 2016. Rebounding oil prices boosted transportation costs, especially at the end of 2017 (9.3% y/y in December), thus contributing markedly to headline inflation. Similarly, prices for miscellaneous goods and services rose by 9.3% y/y in December due to recovering commodity prices. Food prices increased more modestly by 3.2% y/y in December and 1.2% in 2017 as a whole, while housing prices fell by -0.3% y/y (+0.9% for all of 2017). In 2018, we expect inflation to speed up to an average 4% as the UAE introduced a 5% VAT at the start of the year. The introduction of a 5% VAT in early 2018 had actually been announced across the GCC region but was implemented only in the UAE and Saudi Arabia. Facing administrative hurdles, the other six member countries are likely to delay the VAT implementation until mid-2018, at least.

Asia Pacific

Malaysia: Rate hike, what's next?

The Central Bank of Malaysia (BNM) raised its key policy rate by 25bp to 3.25% last week, the first hike since July 2014. The decision was based on three reasons. First, external conditions have improved with stronger global demand, broadly stable financial markets and a more balanced economic outlook. Second, economic activity continues to show signs of strength. Exports are expanding at a robust pace; domestic demand is strong, supported by a solid labor market and firm investment growth. Third, average annual inflation of 3.7% in 2017 was close to the upper end of the BNM's 3%-4% target range. Looking ahead, we expect the tightening cycle to be halted until the end of Q3, because (i) inflationary pressures should stabilize on the back of a strong ringgit, and (ii) uncertainties related to the forthcoming general elections in August call for a gradual approach. Assuming growth remains robust (+4.9% in 2018) and uncertainties fade, the BNM may increase its policy rate by another 25bp in Q4 2018.

What to watch

- February 1 – Eurozone January manufacturing PMI
- February 1 – Brazil, Poland, Russia, Turkey January manufacturing PMI
- February 1 – South Africa January vehicles sales
- February 1 – U.S. Q4 productivity
- February 1 – U.S. January ISM manufacturing index
- February 2 – U.S. January employment report
- February 5 – Indonesia Q4 and 2017 GDP growth
- February 5 – Turkey January inflation
- February 5 – U.S. January ISM non-manufact. index
- February 6 – Germany December factory orders
- February 6 – U.S. December international trade
- February 7 – Brazil Central Bank meeting
- February 7 – France December trade balance
- February 7 – Germany December industrial production

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