Euler Hermes Economic Research

Weekly Export Risk Outlook

2 May 2018

FIGURE OF THE WEEK

+0.4%

Q1 2018 GDP growth in the Eurozone (q/q, flash estimate)

In the Headlines

U.S.: Solid growth in both output and inflation

Q1 GDP rose +2.3% q/q annualized vs. expectations of +2.0%. Investment contributed the most, growing +7.3%, but consumption grew only +1.1% on the quarter. However, the last month of the quarter was more encouraging, as consumption rose +0.4% m/m after losses in the first two months. Those losses had been caused by auto sales being pulled forward from hurricane replacements in Q4 2017. PCE inflation at the headline and at the core both gained +0.3% m/m to +2.0% and +1.9% y/y, respectively; the Fed's target is +2.0%. Inflation also appeared in wages and salaries in the Employment Cost Index which rose +3.7% q/q annualized to +2.7% y/y – both the fastest in about 10 years. Manufacturing remains strong. The Fed's Chicago and Richmond manufacturing reports were both robust as was the ISM survey which was still solid even after slipping -2.0 points to 57.3. New and backlog orders are both strong at 61+. Rising input prices appeared in all three surveys from vigorous demand and from recent metals tariffs. Housing continues to struggle with tight supply as pending home sales fell to a -3% y/y rate and residential construction dropped to the slowest pace in six years.

Eurozone: Just an economic soft-patch

According to Eurostat's preliminary flash estimate, Eurozone GDP grew by +0.4% q/q in Q1 2018 – the slowest rate of expansion since mid-2016 and in line with our forecast – following an upwardly revised +0.7% q/q in the previous quarter. Even though the economic momentum in the Eurozone has clearly cooled in recent months – as indicated by weaker "hard" and "soft" indicators, the end of the upswing is far from in sight. In our view the Eurozone economy is only undergoing a temporary soft-patch: Following an optimism overshoot in early 2018, due to positive growth surprises, the outlook has been relativized and then further clouded by intensifying trade tensions. Special factors – such as unusually cold weather, the flu epidemic and short-term capacity bottlenecks – likely also played a role. However, with sentiment indicators broadly stabilizing in April we see little evidence for a marked growth setback and expect economic momentum to pick up again in Q2 2018. Despite rising downside risks that must be closely monitored, we hence stick to our GDP growth forecast of +2.3% for 2018.

France: Relax, take it easy

Real GDP growth eased to +0.3% q/q in Q1, the lowest figure since Q3 2016. Private consumption grew by just +0.2% q/q in Q1 (unchanged from Q4) since household purchasing power increased by only +0.2% in Q4 and was still burdened in Q1 by accelerating inflation (+1.6% y/y in April, the highest since October 2012). Inventories added +0.4pp to growth in 2017, since corporates expected more demand. But, as a result of the mistaken demand growth expectations, de-stocking was pervasive in Q1. Exports of goods and services were the other disappointing factor, decreasing by -0.1% q/q in Q1, after a strong Q4 (+2.5%). Good exports still grew in Q1 (+5% y/y in value terms) but services exports were on the downside (-9% y/y in value terms). R&D and fees related to intellectual property made the bulk of the decrease. At the same time, the turnover of the business services sector grew by +6.1%, suggesting that French corporates now prefer to invest at home instead of abroad. It supports our corporate investment scenario (+4.5% expansion in 2018).

UK: Q1 growth disappoints, but perhaps mostly snow-related

Q1 GDP growth was unexpectedly low at +0.1% q/q, down from +0.4% in Q4 2017. Although business confidence softened somewhat, the average Manufacturing PMI remained high at 55.2 points in Q1, suggesting growth of +0.3% q/q. The slowdown seems to reflect unusually cold weather in Q1, that triggered significant falls in the construction and retail trade sectors, and could be even larger than what the Office for National Statistics has estimated. The preliminary Q1 growth estimate is based on only 40% of the data, so we expect revisions in the upcoming releases. However, the Q1 export performance is likely to have remained robust as suggested by export orders. And consumer spending should have been resilient as consumer confidence was less depressed and real purchasing power was supported by stronger wage growth (+2.8% y/y) and lower inflation (+2.3% y/y). The Bank of England is now in a difficult position to raise interest rates on 10 May. A move later on this year seems more realistic when a clearer picture of the nature of the strong Q1 slowdown is available.

Countries in Focus

Americas

Mexico: Defying political uncertainty…for now

A first estimate has put real GDP growth in Q1 2018 above expectations at +1.1% q/q (+2.4% y/y) after +0.8% q/q in Q4 2017. This was the highest growth performance since Q3 2016. Services, which represent 63% of Mexico's output, was the main driver of growth, accelerating to +1.2% q/q (after +1% in Q4). Non-seasonally adjusted y/y figures show a contracting manufacturing sector for the fourth quarter in a row. Yet, a rebound from Q4 2017 should be a sign of a recovery in the export-led industry, driven by a U.S. acceleration. On the consumer side, inflation (finally) started easing in 2018, after remaining above 6% for eight consecutive months; it stood at +5% y/y in March. Yet, NAFTA re-negotiations remain on an uncertain path and could trigger additional peso volatility, driving inflation back up. In addition, investment could be in a wait-and-see mode in Q2 as the frontrunner candidate for the July presidential election is running on a left of center and nationalist platform.

Europe

Austria: Robust start to the year 2018

The Austrian GDP expanded by a solid +0.7% q/q (seasonally and calendar adjusted) in the first three months of this year, following a slightly upward-revised +0.9% q/q in the fourth quarter of 2017. The economic upswing remains broad based, with both domestic demand and net exports delivering positive growth contributions. While private consumption registered a fairly modest increase of +0.3% q/q, gross fixed investment (including investment in machinery and equipment as well as construction) expanded strongly by +0.8% q/q. With capacity utilization clearly above the long-term average, companies continue to expand their production capacities. The external sector carried on growing, albeit at a somewhat slower pace than previously seen. Exports expanded by +0.8% q/q and imports increased by +0.5% q/q. Given the better than expected start to the year, our current 2018 GDP growth forecast of +2.4% may prove to be somewhat too cautious.

Africa & Middle East

South Africa: One size does not fit all

Consumer confidence skyrocketed in Q1 to 26 points from -8 in Q4, out of the negative territory for the first time since Q3 2014. The political transition, the ZAR appreciation (+20% from November to February) and low inflation (+3.8% y/y in March) were the main triggers. We expect inflation to reach +4% on average in 2018, well below consensus and the Central Bank forecasts (+4.9%). That inflation surprise should give more leeway to monetary easing: we expect more rate cuts by -75bp, adding to the -25bp done in March. But, reactions to recent policy moves show that the honeymoon could end soon. The plan to implement a nationwide minimum wage (ZAR20 or USD1.6 per hour) was badly received. The first union in the country, COSATU, has strong ties with Ramaphosa's party (ANC). But, the second union (SAFTU) has called for strikes. Unemployment (26.7% in Q4) and inequalities remain high and explain why the growth recovery is likely to be gradual (+2% in 2018, after +1.3% in 2017).

Asia Pacific

South Korea: From tailwinds to headwinds

Real GDP rose by +1.1% q/q in Q1 2018 (after -0.2% q/q in Q4 2017) supported by a recovery of exports (+4.4% q/q, after -5.3% in Q4) and a rise in investment (+3% q/q, up from -1.2% in Q4). In contrast, private consumption growth decelerated to +0.6% q/q in Q1 (from +1% in Q4). Going forward, advanced indicators and monthly economic data point to cautious optimism. Rising investment and an increase in minimum wages this year suggest continued improvement in domestic demand in the short run. Yet, increased risks for exports pose a threat to the current momentum. USD-denominated exports decreased by -1.5% y/y for the first time in 18 months in April, due to weaker ship exports. Business sentiment as measured by the manufacturing PMI weakened to 48.4 points in April (from 49.1 in March) due to reduced new orders. Against this background, Euler Hermes expects economic growth of +3% in 2018 (after +3.1% in 2017).

What to watch

- May 3 – Czech Republic Central Bank meeting
- May 3 – Russia April Manufacturing PMI
- May 3 – Turkey April CPI and PPI
- May 3 – U.S. March international trade
- May 3 – U.S. Q1 productivity
- May 3 – U.S. April ISM non-manufacturing index
- May 4 – U.S. April employment report
- May 7 – Czech Republic March industrial production
- May 7 – Germany March factory orders
- May 7 – Indonesia Q1 GDP
- May 7 – Russia April Services PMI
- May 8 – Germany March industrial production
- May 8 – Hungary March industrial production
- May 9 – Mexico April inflation rate
- May 9 – Portugal Q1 unemployment rate

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