Euler Hermes Economic Research

Weekly Export Risk Outlook

8 January 2014

In the headlines

FIGURE OF THE WEEK

18

Number of eurozone countries, with Latvia's accession

US: Outlook for 2014 is relatively positive

Prospects for the economy in 2014 appear somewhat brighter than 2013. The government now has a budget for the first time in four years, averting another shutdown and perhaps signalling an easing in partisan non-productivity. However, the budget failed to address long-term entitlement reform and leaves the debt ceiling and jobless benefit issues unresolved. Both the manufacturing and non-manufacturing ISM surveys remain solidly above the 50-mark suggesting expansion, with critical new orders showing particular strength in manufacturing. Consumer confidence rebounded 6.1 points in December 2013, although still weak at 78.1. Consumer spending increased by a solid 0.4% and 0.5% m/m in October and November 2013, respectively, concentrated in durables, and the autos sector is expected to be relatively strong again in 2014. The merchandise trade deficit improved by an unexpected USD6.3 billion in November 2013, to USD34.3 billion, the lowest since October 2009, largely on lower oil imports. Meanwhile, rising mortgage rates and low supply are causing erratic housing data, with prices rising by some measures and falling by others, and housing starts soaring but sales and permits falling.

Eurozone: Low inflation, is it the ECB's conundrum?

Inflationary pressures moderated in December 2013, to 0.8% y/y (from 0.9% in November). Core inflation edged down to 0.7% y/y, a record low since 2000. A breakdown by country will be released on 16 January. However, preliminary national data show that inflation increased slightly in Germany, to 1.4% y/y (from 1.3%) while it remained unchanged in Italy (0.7%) and Spain (0.2%). With low inflation and the trend on the downside, concerns remain evident, although fears of deflation remain contained, to date. EH sees the need for the ECB to act as soon as H1 2014 through a new refi (refinancing) rate cut, negative deposit rate or new ECB VLTRO similar to the BoE's Funding for Lending Scheme, particularly if inflation persists at current levels for another few months. Indeed, this would endanger the recovery and debt sustainability, notably in countries with large primary deficits, such as Spain (as higher real interest rates will make deleveraging more painful). Further, downside pressures on prices could endanger corporate profitability, which is already weak in France and Italy. The ECB forecasts that inflation will remain low in the next two years, at 1.1% in 2014 and 1.3% in 2015.

Turkey: Political turmoil weighs on financial markets

The TRY reached a historic low at the start of this week, trading at 2.19 per USD and 2.98 per EUR, down around 6.5% since 18 December 2013. Government bond yields have also risen sharply, by more than 100bps. Both result from a combination of the announcement of the start of the US Fed's tapering and increased domestic political uncertainty. The latter reflects a large-scale corruption investigation involving high profile politicians and businessmen that appears to have caused unprecedented disarray within the ruling AK Party. Three cabinet members resigned and six other ministers were replaced by PM Erdogan in late December. The political turmoil appears to be a more dominant factor than the Fed's tapering as the latter has had a much less impact on financial markets of other emerging markets categorised as fragile, such as Brazil, South Africa, India and Indonesia. The Central Bank of Turkey (CBT) has so far tried to stem depreciation pressures mainly through foreign exchange market intervention. However, if the political uncertainty persists and exerts continued downward pressure on the TRY, the CBT may no longer be able to refrain from interest rate hikes. Economic output could also be affected and this could lead EH to reduce its current GDP growth forecast of +4% for 2014.

Singapore: GDP growth eased in Q4 2013, but remains solid

Advance estimates (based on data for two months) indicate that Q4 2013 real GDP increased by +4.4% y/y (down from a strong +5.9% in Q3) and contracted by -2.7% on a q/q seasonally-adjusted annualised basis (+2.2% in Q3). This took full year 2013 growth to +3.7%, up from +1.3% in 2012. Services continued to expand, by a robust +5.5% y/y but declined by -1.7% on a q/q saa basis in Q4, reflecting moderation in domestic trade and financial services. Construction increased by +4.7% y/y but contracted by -6.9% q/q saa, largely a result of a slowdown in private sector construction. Growth in manufacturing weakened to +3.5% y/y and shifted to a decline of -4% q/q saa in Q4, as output of the biomedical sub-sector contracted markedly. The manufacturing PMI fell by 1.1 points to 49.7 in December 2013, the first score below the 50-point benchmark in 10 months, indicating further slowdown in early 2014. For 2014 as a whole, EH expects GDP growth of around +4%.

Countries in Focus

Americas

Venezuela: Price pressures continue to undermine social cohesion

On 6 January, President Nicolás Maduro ordered a 10% increase in the minimum wage, with a further increase to come later in the year. The government appears to be seeking to increase popular support at a time when deteriorating economic conditions, including an inflation rate that reached 56% y/y at end-2013, are eroding living conditions. A devaluation in 2014 appears likely (in Q1 last year, the official exchange rate for the VEB was devalued by 32%, partly to fund a fiscal deficit – 10% of GDP in 2013) and this will put further upward pressure on prices. Other challenges include a shortage of some foodstuffs, restrictions on availability of foreign exchange and periodic power failures. Deteriorating living conditions have also resulted in increases in social, as well as organised, crimes. EH expects GDP growth of only around +2% in 2014 as further street protests and industrial action, reflecting discontent with living conditions and with political leadership, disrupt activity.

Europe

Latvia: Euro adoption underpins favourable outlook

On 1 January, Latvia became the 18th member country of the eurozone, reaping the fruits of an impressive economic policy track record after the severe and protracted recession and financial crisis in 2008-10. While the existing currency peg was maintained, ensuring low inflation, the fiscal deficit was reduced rapidly, from 10% of GDP in 2009 to less than 1.5% in both 2012 and 2013. Public debt increased from 9% of GDP in 2007 to 44% in 2010, but has fallen slightly since then and is now stabilised. Moreover, real GDP growth recovered to +5% in 2012 and +4.2% y/y in Q1-Q3 2013, making Latvia the fastest growing economy in the EU over the past two years. EUR adoption will reduce transfer and convertibility risk to negligible as long as the economy remains well-balanced. This should encourage cross-border trade and FDI inflows and underpin growth. EH expects annual GDP to increase by more than +4% in 2014.

Africa & Middle East

South Sudan: Internal conflict, regional impact

Following a seemingly intractable split between President Salva Kiir and his former vice-president, Riek Machar, the country has descended into armed conflict, with a risk of all-out civil war. Ostensibly a political fracture within the ruling SPLM, the division has widened into a tribal/ethnic conflict between the two leading communities, the Dinka (Kiir) and Nuer (Machar). Regional mediators (Kenya, Ethiopia and, to an extent, Uganda) brought the two sides together for peace talks but reconciliation will be challenging. Meanwhile, oil output is limited by the dispute, thereby significantly reducing revenues for both South Sudan and Sudan (through which pipelines transport crude oil for export) as well as exerting upward pressure on international oil prices. China is the largest buyer of oil from South Sudan. The wider region is already beset by conflict, including a border with the Central African Republic, and EH expects commercial prospects will remain limited.

Asia Pacific

Bangladesh: Election result unlikely to enhance stability

As expected, given a boycott by opposition parties, PM Sheikh Hasina's ruling Awami League (AL) and its allies won parliamentary elections held on 5 January. The pre-election period was marred by violence and disruption to business activity. The new government will face serious challenges: clashes between supporters of the AL and opposition BNP; reputational risk associated with safety concerns about the country's key clothing industry (accounting for approximately 80% of exports), following recent factory fires and collapses; and the possibility that the EU may suspend trade privileges under the GSP as a result of perceived lack of progress in terms of factory safety and overall protection of human rights. Meanwhile, the economy appears partly resilient to social and political clashes (average annual GDP growth of +6.2% in 2003-12). EH expects growth of +6% in 2014 but also further violent street protests and some commercial disruption.

What to watch

- January 9 – China December 2013 CPI
- January 9 – China December 2013 new Yuan loans
- January 9 – ECB January interest rate decision
- January 9 – Russia December 2013 CPI
- January 9 – UK January BoE base rate decision
- January 9 – Czech Republic December 2013 CPI
- January 10 – Canada December 2013 unemployment
- January 10 – France November 2013 industrial production
- January 10 – India December 2013 trade balance
- January 10 – US December 2013 employment report
- January 13 – Latvia and Romania December 2013 CPI
- January 14 – Egypt referendum on new constitution
- January 15 – Germany 2013 GDP and budget balance
- January 15 – Croatia and Hungary December 2013 CPI

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