Euler Hermes Economic Research

Weekly Export Risk Outlook

16 March 2017

FIGURE OF THE WEEK

+7.2%

Iceland's 2016 GDP growth

In the Headlines

U.S.: Fed raises rates, projects two more hikes this year

As expected the Federal Reserve raised its policy rate by +0.25pp to a range of 0.75% to 1.0%. The Fed also projected two more interest rate hikes this year, to a range of 1.25% to 1.5%, and three hikes in 2018. Financial markets reacted well, yet the hike, statement, and press conference presented mixed messages, and even a dissenting vote. Chair Yellen said "The simple message is the economy is doing well", yet their GDP forecasts were virtually unchanged at a tepid +2.1% for both 2017 and 2018 - that's the same rate GDP has been growing on average since the great recession, the weakest recovery since WWII. Inflation forecasts were also tepid at 1.9% and 2% for the next two years, and yet the Fed acknowledged for the first time that higher inflation is now also a risk, using the word "symmetric" to describe its inflation goal. Major banks raised their prime rates by +0.25pp to 4.0%. We expect that the Fed will indeed raise rates two more times, probably in June and December as inflationary pressures develop. In February, consumer price inflation rose to 2.7% y/y (from 2.5%) while the core rate was unchanged at 2.2%. Retail sales gained only +0.1% m/m, dropping the y/y core rate from +4.4% to +4%.

Netherlands: Pro-European vote win

Preliminary results show that PM Rutte's Liberal Party won 33 seats out of a total of 150 (8 less than in 2012). The turnout reached a high 77.6% vs. 74.6% in 2012. The Freedom Party won 20 seats, 5 seats more than in 2012, but less than suggested by the polls. The Labor Party won only 9 seats, losing 75% of its 2012 seats. The Christian Democrats and the Centrist D66 each won 19 seats, 4 more than in 2012. The Green Party won between 14 and 16 seats (against only 4 in 2012). Liberal Party, Christian Democrats and Centrist D66 are expected to form a coalition but they are 5 seats short of a majority. Scenarios for a fourth party in the coalition point to either the Labor Party, despite their big loss, or the Greens. Uncertainty could last for more than one month as in 2012 when it took 49 days to form a coalition. Based on the past, we estimate that the cost of uncertainty could be -0.2pp of GDP growth, mainly through lower corporate investment. Overall, the economy is strong with GDP growth expected at +1.9% in 2017 and firms' turnover on the rise (+1.1%) thanks to reflation and stronger demand.

China: Positive start

The economy started the year on a positive note, in contrast to last year. In January-February, industrial production rose by an average +6.3% y/y (from +6% y/y in December 2016), retail sales growth proved resilient at +9.5% y/y and urban fixed asset investment picked up speed. Trade figures reveal a more mixed performance. USD-denominated imports rose by +27.4% y/y on average over the first two months of the year, supported by robust domestic demand. However, USD-denominated exports grew by just +3.3% y/y on average. Overall, the growth composition is becoming more balanced with (i) a gradual improvement of private investment, (ii) improving producer prices, and (iii) positive growth of imports. However, the contribution of net trade to growth will be lower as the expansion of imports will outpace exports. Moreover, monetary authorities and financial regulators are expected to adopt a more hawkish stance to reduce credit risks. As a result, Euler Hermes expects real GDP growth to slow gradually over the course of this year, reaching +6.3% in full-year 2017 (down from +6.7% in 2016).

Iceland: Capital controls lifted...risk of new overheating?

On 14 March Iceland has lifted the last remaining capital controls affecting firms, pension funds and households, almost nine years after wide ranging restrictions were implemented in the wake of the global and domestic financial crisis. The country has successfully followed a path of gradual removal of controls without significant negative impact on the foreign exchange market while the economy has rebalanced. However, new challenges are on the agenda, notably the risk of economic overheating, reflected in surging wages (around +9% in 2016), limited labor supply (unemployment at 3%) and rising house prices. Real GDP soared by +11.7% y/y in Q4, taking full-year 2016 growth to +7.2%, driven by private consumption (+6.9% in 2016, benefiting from wage rises) and a tourism-related construction boom which pushed up fixed investment by +22.7%. Concerned about overheating, the central bank yesterday kept its key policy interest rate at 5% (well above levels in peer countries) though this will not relieve upward pressures on the ISK which appreciated by +16% against the EUR in 2016.

Countries in Focus

Americas

Dominican Republic: A coral reef in the Caribbean

The Dominican Republic is the tenth largest economy in Latin America and one of the best performers in recent years in terms of growth as the country scored an average +3.2pp more than the regional average during the last ten years. Euler Hermes estimates that real GDP increased by +5.9% in 2016, down from +7% in 2015, but in line with the +5.6% average recorded in the previous decade. However, production is predicted to decelerate to +4.5% in 2017. Meanwhile, consumer prices are expected to rise by an annual average 3.8% in 2017, up from 1.6% in 2016 and 0.8% in 2015, bringing inflation back into the 4% +/-1pp target range of the Central Bank. The latter has kept its key policy interest rate at 5.50% after a 50bp hike in November 2016. Regarding the business environment, the World Bank ranks the Dominican Republic similar to its neighbors. Weaknesses remain with regard to insolvency resolution, issues related to getting electricity, tax red tape and contract enforcement.

Europe

Romania: Strongest growth in CEE in 2016

Second estimates by the National Institute of Statistics confirmed that Q4 real GDP growth picked up to +1.3% q/q (+0.5% in Q3) and +4.7% y/y (+4.3% in Q3), taking growth in 2016 as a whole to +4.8% (up from +3.8% in 2015), making Romania the fastest growing economy in Central and Eastern Europe last year. The acceleration of full-year growth was driven by fiscal stimulus, wage increases and falling unemployment which boosted consumer spending to surge by +7.4% in 2016 (+6.1 in 2015) while public spending picked up to +2.6% (+1.6% in 2015). In contrast, fixed investment weakened sharply and was flat in 2016 (+8.8% in 2015). However, inventories added +0.7pp to 2016 growth (a turnaround from -0.8pp in 2015). Net exports subtracted -0.8pp from 2016 growth (-1.5pp in 2015) as export expansion (+7.6%) was outpaced by imports (+9.3%). Euler Hermes forecasts annual growth to moderate to a still robust +3.6% in 2017 as one-off fiscal effects fade and consumer prices pick up.

Africa & Middle East

Tunisia: Missed expectations weigh on liquidity

The cyclical recovery was more subdued than previously thought. After Tunisia narrowly avoided a double-dip recession in 2015 (full-year growth was +0.8%), growth picked up to just +1.3% in 2016, missing expectations of a stronger rebound (we had forecast +2% previously), even though the government fueled the economy with more fiscal stimulus than previously intended. As a result, the fiscal deficit deteriorated to -6% of GDP in 2016 (from -4.5% in 2015) and public debt increased to 60.5% of GDP. Fitch downgraded the long-term foreign currency sovereign rating by one notch to B+ and the IMF signaled that some policy slippage has to be addressed before the institution is freeing the next installment of its lending program to the economy. A delayed disbursement should be manageable but may create some exchange rate volatility as the import cover level of foreign exchange reserves is relatively weak, between 3 and 4 months.

Asia Pacific

Thailand: Around +3% annual growth is the new normal

Q4 real GDP growth eased slightly to +3% y/y but stabilized at +0.4% q/q, taking growth in 2015 as a whole to +3.2%. The latter is slightly up from +2.9% in 2014 but still markedly below the average +5.2% recorded in 1999-2006. Full-year 2016 growth was driven by solid domestic demand while external demand remained subdued. Private consumption accelerated to +3.1% (+2.2% in 2015) while government consumption moderated to +1.6% (+3% in 2015) and fixed investment to +2.8% (4.4% in 2015). Reduced investment growth caused imports to decline by -1.4% in 2016 (flat in 2015) while export expansion picked up but remained sluggish at +2.1% (after +0.7% in 2015), impacted by modest demand growth from key regional trade partners, notably China. As a result, the contribution of net exports to overall growth increased last year. Euler Hermes expects the economy to grow by around +3% in 2017.

What to watch

- March 17 – Eurozone January trade balance
- March 17 – Poland February industrial production
- March 17 – Russia February industrial production
- March 17 – U.S. February industrial production
- March 17 – U.S. March consumer sentiment
- March 20 – Eurogroup meeting
- March 20 – Chile Q4 2016 GDP
- March 20 – South Africa Q1 consumer confidence
- March 21 – UK February CPI & retail price index
- March 21 – UK January house price index
- March 21 – Argentina & Ukraine Q4 2016 GDP
- March 22 – Eurozone January balance of payments
- March 23 – Germany March GfK consumer climate
- March 23 – Poland February retail sales
- March 23 – Poland March business confidence
- March 23 – Turkey March consumer confidence

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