Euler Hermes Economic Research

Weekly Export Risk Outlook

30 July 2015

FIGURE OF THE WEEK

+3.1%

Spain's y/y GDP growth in Q2

In the Headlines

U.S.: Housing and confidence disappoint, Fed on hold

The housing market showed compelling strength last week, only to follow with disappointing news this week. New home sales fell a sharp -6.8% in June to an annualised rate of 482,000 units, the lowest since last November, and the previous two months were revised down a total of -40,000 units. It was the third decline in four months, dragging the y/y growth down from +27.6% in April to +18.1%. The median price edged up +0.5% but it was only the second gain in seven months, leaving the y/y rate at -1.8%. Existing home prices fell by -0.2%, the first decline in 11 months. Losses were widespread as prices fell in 12 of the 20 cities in the survey. Consumer confidence fell a sharp -8.9 points in July, to 90.9, just above the 90 level indicating a stable economy. Pessimism about future employment drove the expectations component down -12.8 points to 79.9. Durable goods orders did provide some lift, gaining +3.4% in June, but they are still down -2.8% y/y. As expected, the Fed left interest rates unchanged and gave no hint about the timing of future rate increase; EH expects it to be most likely in December, although September remains a possibility.

Spain: Better and better

The economic recovery gained traction in Q2. According to initial INE estimates, GDP growth in Q2 accelerated to +1% q/q (+0.9% in Q1) and +3.1% y/y (+2.7% in Q1), the highest since 2007. Domestic demand is likely to have been the main driver as public spending increased after the November 2014 general elections, while private consumption benefitted from improved confidence. Indeed, retail sales continued their upward trend (+3.5 y/y in May), sustained by a fall in unemployment (22.7% in Q2, registering a -1.4pps fall from Q1), recovery in wages (+4% y/y in Q1 in nominal terms), personal income tax changes implemented at the beginning of July (initially planned for 2016) and falling prices (-0.1% y/y in June). Although the recovery will continue in coming quarters, we expect it to moderate slightly as consumer and business confidence diminished marginally in recent months. All in all, we expect GDP growth in Spain of around +3% in 2015, outperforming Germany, France and Italy.

UK: Faster GDP growth in Q2, still no rate hike

GDP increased by +0.7% q/q in Q2, in line with expectations and driven primarily by a +0.7% q/q increase in services. Meanwhile, total industrial production increased by +1% q/q but this was driven predominantly by a +7.8% increase in mining and quarrying resulting from a sharp rebound in oil and gas production. This may be the result of tax changes announced in the latest budget. In contrast, manufacturing output contracted by -0.4% q/q and agricultural output fell by -0.7%. Although initial GDP estimates are often subject to significant revision, with less than half the total data collected, the latest release was strong enough to renew the debate about when the BoE will increase interest rates. Indeed, one of Governor Carney's three prerequisites for considering a rate rise is above-trend growth of +0.6%, the others being a pick-up in unit labour costs and a rise in core inflation. Even though wage growth picked up in May (+3.2%), core inflation measures have fallen below 1%. On balance, we continue to expect the BoE will not increase interest rates in 2015 and may even wait until Q2 2016.

United Arab Emirates: Boost from subsidy cut

A new transport fuel pricing policy linked to average global prices will come into operation on 1 August. This will increase fuel prices but decrease the amount the state expends in subsidies. As a result, inflation will increase (but be manageable) and the fiscal balance will improve. The new policy could save around USD7 bn in 2016, providing a resource boost for productive investments in, for example, job creation, education, health care and infrastructure. Higher fuel prices will encourage the use of public transport and conservation of petroleum and also assist in the protection of the environment through emission reductions. Energy subsidies are currently equivalent to around 5.6% of GDP and we revised upwards our estimate of the 2016 fiscal surplus to +2.5% of GDP (previously +2%).

NOTE: WERO is taking a break. The next issue will be 19 August 2015.

Countries in Focus

Americas

Uruguay: Infrastructure projects designed to boost growth

The government of President Tabaré Vásquez, in place since March, announced earlier this week a record infrastructure investment programme of USD12.4 bn (over 20% of GDP) in the period 2015-19. The overall plan will be 66% financed by public resources and will rely strongly on public-private partnerships (PPP). The projects will cover critical sectors for the country, including energy (USD4.2 bn), roads (USD2.4 bn), social infrastructure (USD1.9 bn) and housing (USD1.3 bn). The programme is an attempt to reinvigorate economic growth, which has been negatively affected by the adverse external environment; recession in the country's main trade partners, such as Brazil, Argentina, Venezuela and Russia, has coincided with downward pressures on key raw material prices (particularly low cereal and dairy prices). After slowing to +3.5% in 2014 (compared with +5.1% in 2013), we expect real GDP growth will remain relatively weak this year, below +3%.

Europe

Eurozone: Sentiment fading in the summer? Probably not

The flash composite PMI in July fell -0.5 points to 53.7, weaker than expectations (54). The PMIs for both manufacturing and services fell, by -0.3pts (to 52.2) and -0.6pts (to 53.8), respectively. The downturn was driven by the index for **France**, which fell by -1.8pts to 51.5, unwinding part of last month's improvement, with a -2.1pts deterioration in the services PMI, to 52.0, and -1.1pts fall in manufacturing, to 49.6. **Germany's** composite PMI fell by -0.3pts, with a contraction in both manufacturing (-0.4pts to 51.5) and services (-0.1pts to 53.7). However, the German Ifo rebounded in July, from 107.5 to 108.0, with the assessment of current conditions and business expectations increasing to 113.9 (+0.8) and 102.4 (+0.3), respectively. Furthermore, the industrial business climate in France improved by 2pts to 102. All in all, the latest PMI data probably understate the ongoing recovery, although a slight short-term negative confidence shock from the 'Greek story' cannot be excluded.

Africa & Middle East

South Africa: Central Bank independence

In re-affirmation of its independence and focus on inflation, the Central Bank (SARB) increased by 25bps its key policy interest rate. The decision came against a background of inflationary pressures (breaching the upper end of the inflation target range of 3-6% by Q1 2016) but also official expectations of lacklustre GDP growth (Q2 likely to be "broadly similar" to the +1.3% q/q annualised growth in Q1 and +2% in 2015 overall). SARB is concerned about the inflationary impact of electricity tariff increases (including +13% in 2016), potential for further ZAR weakening as the U.S. Fed moves to tighten monetary policy and expected increases in food prices. This suggests that interest rates in South Africa will increase further this year. Restrictive monetary and fiscal policies and power disruptions will all limit economic growth. We keep our GDP forecast of +2% for 2015 but our +3% projection for 2016 is looking too optimistic, with downward revision likely in the absence of a positive short-term boost.

Asia Pacific

South Korea: Respiratory problems

Q2 GDP growth was +0.3% q/q compared with +0.8% in Q1 and was the lowest in six years. The slowdown resulted from the worst MERS outbreak (outside Saudi Arabia) that led to sweeping quarantines and loss of confidence (private consumption -0.3% q/q). Tourist numbers fell -40% m/m in June and -60% in July, with weakness likely to persist, shaving off -0.1% from annual GDP. In addition, a drought reduced agricultural output by -11.1% q/q in Q2 and construction growth deteriorated to +1.7% q/q from +7.4% in Q1. Against this background, the BOK cut its annual growth forecast to +2.8% from +3.1% and cut its key policy interest rate to 1.5% and the government proposed a KRW11.8 tr supplementary budget to prop up demand. There is optimism that the worst of the MERS outbreak is now over but its lingering impact, the unwillingness of the BOK to cut rates further (to prevent over-indebtedness) and the economy's flat export trend all suggest weak growth will continue.

What to watch

- July 31 – U.S. Q2 employment cost index
- July 31 – Eurozone June unemployment
- July 31 – France June consumer spending
- July 31 – Germany June retail sales
- July 31 – Japan June CPI
- July 31 – Japan June unemployment
- August 1 – Puerto Rico bond repayment due
- August 3 – U.S. June personal income and exp.
- August 3 – U.S. July manufacturing ISM index
- August 3 – U.S. June construction spending
- August 4 – U.S. June factory orders

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