Euler Hermes Economic Research

Weekly Export Risk Outlook

17 December 2015

In the Headlines

FIGURE OF THE WEEK

+0.25%

US Fed interest rate hike

U.S.: Fed begins new era

As expected the Fed raised short term interest rates by +0.25% to a range of +0.25% to +0.5%. It was the first increase in over nine years and the first time rates have been greater than 0% in seven years. The Federal Open Market Committee's decision was unanimous. All 17 participants foresee more rate increases in 2016 to an average rate of 1.4%, implying four hikes of 0.25% each, although we expect a slightly slower pace. The statement was mostly dovish, twice mentioning "gradual" increases, softness in exports, and a "shortfall of inflation." In addition inflation forecasts for 2016 were marked down -0.1% to +1.6%, well short of the +2% target. As changes in monetary policy can take a year or more to fully affect the economy, and since rates will remain historically low through 2016, and the Fed has no immediate plans to shrink its balance sheet, monetary policy is still extraordinarily loose.

In other news, November housing starts and permits were strong gaining +10.5% and +11.0% (m/m, respectively). Manufacturing industrial production was flat resulting in an anaemic +0.9% y/y rate. And congressional leaders are on the verge of a budget deal which would include eliminating the 40-year-old ban on exporting oil.

Turkey: Q3 GDP surprises but risks for 2016 are rising

Q3 GDP increased by +4% y/y, after +3.8% in Q2 and +2.5% in Q1, driven by surging (pre-election) public spending (+7.8% y/y), inventory re-stocking (+0.4pps) and improving net exports. The latter added +0.1pps to Q3 growth (-1pps in Q2) as the fall in imports (-1% y/y) outpaced that for exports (-0.6%). Turkey is a large energy importer benefitting from low global oil prices. Consumer spending growth slowed to +3.4% y/y in Q3, reflecting the TRY depreciation and rising unemployment (10.1% in Q3). Investment contracted by -0.5% y/y after a strong Q2 (+9.7%). Early Q4 data suggest growing momentum of economic activity. EH lifted its full-year GDP growth forecast to +3.6% for 2015 (previously +3.2%). However, the forecast for 2016 was lowered to +3.3% (from +3.6%) as downside risks for next year have increased. The recent sharp deterioration in relations with Russia is likely to have adverse effects on Turkish exports and Russian investment in Turkey, thereby leading to renewed currency instability. Also, a weaker TRY could trigger inflationary pressures and rising interest rates.

Eurozone: Solid but slowing year-end business confidence

Eurozone Composite PMI contracted marginally to 54 in December, dragged down by Services. On the contrary, the Manufacturing sector output rose at the fastest pace in 20 months. The other bright spot is the positive employment outlook supported by consistent growth in private sector new business and high backlogs of work. Germany experienced solid - though weaker - output growth in December, shown by the Composite PMI decline from 55.2 to 54.9. Slowing output growth in services and overall weaker growth in new business were offset by manufacturing good performance on the back of improved external demand - new orders were on the rise for the 5th consecutive month. France is showing more mixed results as service PMI decreased from 51 to 50. However, new business in private sector rose for the 4th consecutive month. Overall, the Q4 PMI confirms growth is likely to rise by a meager +0.3% q/q as the quarterly average edged down compared to Q3.

South Africa: Three finance ministers in one week

Market turmoil – the ZAR fell to record lows against most leading currencies, including the USD, and there was a sell-off of government bonds – when President Jacob Zuma replaced FM Nhlanhla Nene was to be expected, as was the bounce back when Zuma rescinded his initial appointment and re-introduced Pravin Gordhan as head of the treasury. However, investors and markets in general will be concerned by the apparent failure to gauge the impact of the first change on financial markets. Governance as a whole is under increasing scrutiny. It is too early to suggest that Zuma's hold on power is irretrievably jeopardised but the ANC will be concerned that the party's image (and therefore electoral standing) is slipping. The main concern when Nene was replaced was a perception that it signalled the end of orthodox economic policies. Paradoxically, the latest episode and its fall-out may now ensure policy continuity in the short term. Unfortunately, this suggests upward pressure on interest rates to curb inflation and continuing weak GDP growth (capped at around +2% in 2016-17).

Countries in Focus

Americas

Cuba: Step by Step

A further step towards normalizing of Cuba's international relations: after two years of discussions, Cuba reached an agreement on restructuring its debt to the Paris Club since 1986. The island will reimburse about EUR4.5bn over 18 years. Creditors, led by France, agreed to waive EUR10bn of accrued interest and penalties. Furthermore, a part of the refunds will be reinvested into development projects in the island. However, if Cuba does not meet the payment schedule by October 31 each year, it will be charged 9% interest until payment, plus other penalties. These agreements are part of the process of opening the island to the world. In addition to the ongoing reconciliation between the US and Cuba (which should culminate in the lifting of the embargo), the Cuban government presented last year an extensive projects' wish-list to foreign investors. Business opportunities are up for grabs (for more details, read our Economic Insight 'Viva la Economic Revolution' published in August 2015).

Europe

Russia: Trough of recession passed, recovery to be very modest

Second official estimates confirm that the economy contracted by -4.1% y/y in Q3 (-4.6% in Q2). Rosstat also published q/q data, which reveal a decrease in Q3 real GDP of -0.6% q/q, the fifth consecutive quarter of decline, following -1.3% in Q2. On the production side, value added in manufacturing (-4.3% y/y), hotels and restaurants (-4.5%), construction (-8%), real estate activity (-8.5%) and retail trade (-9.5%) registered the largest falls in Q3, with the latter indicating that consumer spending remains weak. Only agriculture (+2.1% y/y) and mining (+0.8%) increased modestly. The recession may have bottomed out but early Q4 data suggest that any recovery will be only gradual. EH forecasts full-year GDP will contract by -3.7% in 2015 and -0.3% in 2016. Last week, the Central Bank kept its key interest rate at 11% (unchanged since August), citing concerns about inflation (15% y/y in November) and persistently weak oil prices, which affect the RUB (down -27% against the USD since mid-2015).

Africa & Middle East

Egypt: Policy limitations of inflationary pressures

Consumer price inflation moved back into double digits in November, with 11.1% y/y (after 9.7% in October), the highest since June, and core inflation (excluding food and energy) increased by 7.4% y/y (6.3% in October). The uptick reflects EGP depreciation in October, with currency weakness exerting upward pressure on import costs, including foodstuffs (almost 40% of the CPI basket). The Central Bank will be wary of inflationary pressures and, to avoid social unrest, the authorities will only slowly implement reductions in fuel subsidies. Expect the measured subsidy reductions next year to keep inflation in double digits, on average, and monetary policy to remain relatively tight. Meanwhile, regional assistance continues to support the government's economic development programme; the AfDB approved a three-year USD1.5bn loan, with an initial USD500mn for almost immediate distribution. EH expects GDP growth of around +4% in 2015 (+2.1% in 2014) and +3.5% in 2016.

Asia Pacific

China: Gaining traction?

Activity indicators point to some improvement in November. Retail sales continued to pick up in November (+11.2% y/y). Industrial production accelerated (+6.2% y/y). Investment showed signs of stabilization (+10.2% YTD y/y). Downward prices pressures are still a concern. Consumer prices increased slightly (+1.5% y/y) but remain below the government target (about +3%). Producer prices continued to decline for the 45th consecutive month. Credit showed positive trend with aggregate credit flows improving and government expenditures still expanding at a fast pace (+25.9% y/y). Going forward, the authorities will probably maintain this easing stance, and enlarge their tools with further use of the currency. The recent introduction of trade weighted indexes to follow RMB development is probably a first step for a new type of currency management. RMB stability will be viewed through the lens of basket of currencies and not just in USD terms.

What to watch

- December 18 – Canada November CPI
- December 18 – Ukraine Nov. industrial production
- December 19 – Israel Nov. leading 'S' indicator
- December 21 – Eurozone Dec. consumer confidence
- December 22 – Turkey interest rate decision
- December 22 – U.S. Q3 GDP
- December 22 – U.S. November existing home sales
- December 23 – U.S. November durable goods orders
- December 23 – U.S. November personal income and outlays
- December 23 – U.S. November new home sales
- December 23 – Canada October GDP

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