Euler Hermes Economic Research

Weekly Export Risk Outlook

4 July 2018

FIGURE OF THE WEEK

15.4%

Year-on-year inflation in June in Turkey

In the Headlines

U.S.: Tepid consumption, strong manufacturing

Real disposable personal income rose a disappointing +0.2% m/m in May, putting the y/y rate at a weak +1.7%. Real personal consumption expenditures (PCE) were flat on the month, bringing the y/y rate down to a tepid +2.3% from +2.9% six months ago. PCE inflation rose from 2.0% y/y to 2.3%, while the core rate, the Fed's favorite inflation gauge, rose from 1.8% y/y to 2.0%. Notably, it was the first time in six years that core PCE reached the Fed's 2% target, bolstering expectations of two more Fed hikes this year. The manufacturing sector, unlike the consumer, is thriving. The June ISM manufacturing index rose from 58.5 to a very strong 60.2. Supplier deliveries rose a steep +6.2 points to 68.2; normally that would be a sign of economic strength, but it is instead being driven by a lack of truckers. Survey respondents were "overwhelmingly concerned" about tariffs. In a separate report, core orders for durable goods rose +0.3% m/m to a solid +6.5% y/y rate. Shipments of core orders, which feed into the GDP calculation, gained +0.2% m/m to a strong +6.3% y/y.

Turkey: Inflation surges to near 15-year high

Consumer price inflation rose to a stronger than expected 15.4% y/y in June, up from 12.2% in May. The large price components food inflation (up from 11% in May to 18.9% in June) and transportation inflation (up from 20% to 24.3%) added +1.8pp and +0.8pp to the headline figure in June, respectively. The substantial rise in inflation in June reflects the TRY sell-off in May as well as much higher oil prices than a year ago. Although the TRY had stabilized in June, it was down -30% y/y against the USD (-34% y/y vs the EUR). And the average oil price in June was up by +60% y/y. The size of the increase in inflation in June is likely to trigger another sizeable interest rate hike at the next meeting of the Monetary Policy Committee (MPC) on 24 July, following the cumulative 500bp rise between end-April and early June. Failure to raise interest rates would prompt renewed concerns about the MPC's independence. Meanwhile, the Manufacturing PMI inched up to 46.8 points in June (from 46.4 in May) but remained well below the 50.0 threshold that separates growth from contraction, thus indicating a marked overall deterioration of the sector in the coming months.

Saudi Arabia: Out of recession, growth to strengthen in H2

Data released this week show that real GDP grew by +1.2% y/y in Q1, rebounding from four consecutive quarters of contraction and -0.7% in full-year 2017 that came on the back of the end-2016 OPEC agreement to cut oil output, the impact of which has now faded. Supply-side data show that the oil sector increased by +0.6% y/y in Q1 while the non-oil sector grew by +1.6%, the second fastest performance in nine quarters. Looking ahead, we expect the recovery to gain further momentum in the course of 2018, for several reasons. First, fiscal stimulus measures implemented in Q2 to offset the blow to incomes from austerity measures at the beginning of the year will support activity. Second, the non-oil private sector PMI rose to a six-month high of 55.0 in June, driven by accelerating output and new orders components, which bodes well for the non-oil sector in H2. Third, the largest boost to growth is likely to come from the revised OPEC agreement from end-June which is expected to result in an increase of Saudi oil output by up to +0.5 million barrels per day. Overall, we are likely to revise upwards our current GDP growth forecast of +1.7% in full-year 2018 soon.

Algeria: Protectionist stance

The die is cast. Protectionism is the A-Word of 2018 and not only in the U.S. A new (old) kind of protectionism is (again) on the rise: administrative limits to imports in countries running significant external deficits and stuck in protracted low growth periods. Algeria easily qualifies for this criterion (we expect a current account deficit of -10% of GDP and growth of +2.7% in 2018) and just implemented the (bad) medicine. In fact, Algeria lost the plot in terms of attractiveness even before the recent move. A survey made in Q1 2018 (our French exporters' barometer) shows that Algeria lost its position in the top 10 ranking of the most promising export destinations – quite a paradox in a year where higher oil prices would have been positive for the country. The new measures enacted will not revert the fall: a 60% to 200% levy will be applied on a wide range of finished goods. The goal is import substitution, but scarcities may well arise and become a downside risk to our +2.7% growth forecast for 2018.

Countries in Focus

Americas

Mexico: Resilience, but risks remain

As expected, left-wing candidate Andrés Manuel Lopez Obrador (AMLO) won the presidential election by a wide 30-point margin (53% of the vote count). His coalition now holds a majority in both chambers of Congress. In December, he will inherit a resilient, but underperforming economy. Unemployment has reached historical lows (3.4%) and the accelerating U.S. cycle drives industrial production. Yet red tape, corruption and soaring crime rates are weighing down on growth which is capped at +2.5%. Monetary policy is proactive and the fiscal responsibility framework is robust. Going forward, fiscal slippage should be rather constrained by institutions and by AMLO's campaign promises. Yet exchange rate volatility and financial pressures should continue, as two risks remain: the NAFTA deal is unlikely to be renegotiated before 2019, and the liberalization of the energy sector is likely to be partially overturned by the new administration. Both risks prolong the "wait-and-see" mode of investors.

Europe

Czech Republic and Romania: Good and not so good

The National Bank of the **Czech Republic** (CNB) raised its key policy interest rate by 25bp to 1.0% last week, continuing its gradual tightening cycle that began in August 2017 (four hikes by a cumulative 95bp). The labor market is still hot – unemployment has fallen to a record low 2.3% and nominal wage growth was +8.6% y/y in Q1 – but otherwise overheating concerns are in check. Inflation edged up to 2.2% y/y in May, slightly above the CNB's 2% target but below the average 2.4% recorded in 2017. We expect further gradual monetary tightening and average inflation of 2.2% in 2018.

In contrast, the National Bank of **Romania** (NBR) decided today to keep its key monetary policy interest rate unchanged at 2.5%, despite still mounting overheating concerns. Inflation rose to 5.4% y/y in May, well above the NBR's 2.5% ± 1pp target range, and nominal wages surged by +14.7% y/y in April (see also WERO 14 June 2018). Moreover, in January-April 2018, the current account deficit widened to –EUR2.1bn from –EUR1.8bn in the same period a year earlier. We believe that decisive monetary tightening is needed and should come by the end of 2018; otherwise the risk of a hard landing of the economy in 2019 will increase.

Africa & Middle East

Kenya: Growth-on

Growth accelerated during the first quarter to +5.7% y/y from +5.3% y/y in Q4 2017. The recovery was well expected following positive signs in the manufacturing sector activity since November 2017. After stagnating from Q2 to Q4 2017, manufacturing output grew by +2.3% y/y in Q1 2018. This bodes well for an overall growth acceleration in 2018, a positive momentum favored by the end of the political dispute that arose after the presidential election. More floods also drove the cyclicality of Kenya's growth, as agricultural output grew by +5.2% y/y in Q1, the strongest since Q2 2016. Moreover, the Central Bank cut its policy rate by -75bps to 9.25% since the beginning of the calendar year, banking on low inflation (4.6% y/y in June 2018). The overall improvement of the growth components should drive full-year growth to +6.5% in 2018 from +4.9% in 2017.

Asia Pacific

China: Economic growth to prove resilient

China's currency and stock markets have been under significant pressure over the past few days as new U.S. tariffs are expected to take effect on 6 July. This led the Chinese Central Bank to adopt a more defensive strategy as it cut the reserve requirement ratio by -50bp to provide liquidity to the banking system. Meanwhile, latest economic indicators suggest that there is still room to grow in the short run. Corporates' financial health remains solid as reflected in the continued rise in profits (industrial profits up +16.5% y/y in January-May). And confidence remains resilient despite rising trade tensions. The official Manufacturing PMI decreased to 51.5 points in June (from 51.9 in May) but still suggests expansion. The Non-manufacturing PMI edged up to 55.0 (from 54.9 in May). Against that background, we expect economic growth to rise by +6.6% in 2018 (after +6.9% in 2017).

What to watch

- July 5 – Germany May factory orders
- July 5 – Russia Q2 consumer confidence index
- July 5 – U.S. June ISM non-manufacturing index
- July 6 – Canada June employment report
- July 6 – France May trade balance
- July 6 – Germany May industrial production
- July 6 – Russia June inflation
- July 6 – U.S. May international trade
- July 6 – U.S. June employment report
- July 10 – Argentina interest rate decision
- July 10 – China June consumer and producer prices
- July 11 – Canada monetary policy announcement
- July 11 – Czech Republic and Romania June inflation
- July 11 – Poland monetary policy meeting
- July 11 – Turkey May balance of payments