Euler Hermes Economic Research

Weekly Export Risk Outlook

22 March 2018

In the Headlines

FIGURE OF THE WEEK

+2.9%

Argentina's GDP growth in 2017

U.S.: Fed hikes as expected, but turns more hawkish

As expected the Federal Reserve raised the Fed Funds rate from a range of 1.25% - 1.50% to 1.50% - 1.75% yesterday. The accompanying statement, the updated forecasts, and Powell's press conference all took a more hawkish stance. The statement said "The economic outlook has strengthened in recent months" and the forecasts were revised up significantly. 2018 GDP growth was revised up from +2.5% to +2.7%, and 2019 was revised up from +2.1% to +2.4%. The unemployment rate was revised down from 3.9% to 3.8% for 2018 and more sharply from 3.9% to 3.6% for 2019. The forecasts for inflation, however, remained virtually unchanged at 1.9% for 2018 and 2.1% for 2019. As a result of the more hawkish bias, the Fed could raise rates a fourth time this year. Eight voting members expect three hikes or less. But seven members now expect four hikes or more. In addition, the forecast for 2019 is now three hikes instead of two. At present, we don't expect the more hawkish bias to materially affect our 2018 growth forecast of +2.9%. But the Fed should now be watched even more carefully. If financial markets dislike the more hawkish bias, it could affect consumers and be a drag on the economy.

UK: Transition deal until end-2020 agreed

A draft agreement on the UK withdrawal from the EU has been reached between the two parties. It includes a 21-month transition deal that ends in December 2020. It is expected to be approved by the European Council on 22-23 March and it requires ratification by the national parliaments in the coming months. The transition deal comes in line with our expectations and should alleviate the negative economic shock going forward. We expect GDP growth to reach +1.5% in 2018 and +1.2% in 2019. However, the transition deal still depends on the successful conclusion of an Article 50 deal in the next 12 months and there is no sunset clause for a possible extension of the transition. Indeed, FTAs take five years on average to be negotiated; so 2023 would look more realistic for the EU exit. We continue to expect a limited FTA with an average tariff of 3% on goods and 10% additional costs on services. The UK will now be able to start negotiating trade deals with third party countries during the transition phase but any deal, if ratified during the transition, will only be effective after December 2020.

Germany: First impact of protectionism fears?

The Ifo business climate index for Germany´s industry and trade sector fell again in March. Nevertheless, at 114.7 points, the index is still at a very high level. It is noteworthy, however, that companies' business expectations have already weakened for the fourth consecutive month. Several factors have probably contributed to the more subdued business expectations. The rise in the external value of the EUR in recent months is likely to have dampened export expectations. Moreover, the financing conditions for companies might no longer be as favorable as they have been so far given the withdrawal of central banks from their ultra-loose monetary policy. Most recently, however, concerns about increased U.S. protectionist measures and a potential trade war may have been of greater importance. In our economic base case scenario, we still do not assume that there will be an outright trade war. We therefore stick to our growth forecast for the German economy of +2.5% in real terms this year. However, the longer the uncertainty about a possible increase in protectionist measures persists, the greater the likelihood that this concern will eventually leave its traces in Germany´s real economy.

Russia: Clear election result paves way for policy continuity

Vladimir Putin, the incumbent, was clearly re-elected for a fourth term in office in Sunday's presidential election, as expected. He received 76.7% of the vote, the highest result for all post-Soviet presidential elections. Independent election watchdogs and media reported that the election was cleaner than in the past. Yet, they also still reported numerous instances of manipulation and efforts at mobilization to vote by regional authorities. Despite the latter, the turnout was just 67.5%, the highest since the 2008 election but below the targeted 70%. A government reshuffle is likely after Putin's inauguration in May and should provide hints about the future policy direction. We expect broad continuity of foreign and economic policies in the medium term. In particular, since the economy has now entered a path of gradual recovery, we do not expect wide-ranging structural reforms that would be needed to bring the economy on a trajectory of higher long-term growth.

Countries in Focus

Americas

Argentina: Recovery confirmed in 2017

Q4 real GDP growth figures came in higher than expectations, at +3.9% y/y (non-seasonally adjusted). In seasonally adjusted terms, the economy grew by +1% q/q, accelerating from +0.8% in Q3 and +0.6% in Q2. Revisions of previous quarters' figures lead to full-year growth of +2.9% in 2017, in line with our forecast. Domestic demand was the main growth driver in Q4, with private consumption rising for the third straight quarter (+4.8% y/y) and investment soaring by +20.7% y/y. Yet, the positive 2017 picture is balanced by a poor export performance: overall in 2017 net exports subtracted -3.8pp from GDP growth as imports rose by +14.7% while exports lagged behind at just +0.4%. That should have widened the 2017 current account deficit, also because investment grew faster than national savings. This pushes for further fiscal consolidation to boost public savings and alleviate pressure on external accounts, amid continued ARS depreciation to improve competitiveness.

Europe

Turkey: Early indicators signal continued overheating

Advanced indicators point to continued strong economic momentum at the start of the year. In January, calendar-adjusted industrial production rose by +12% y/y, following +13.7% in December and an average +10.7% in Q4 2017. Combined with the Manufacturing PMI which came in at 55.6 points in February, well above the 50.0 threshold indicating growth, this bodes well for output growth in Q1 2018. Moreover, real retail sales growth picked up to +10.7% y/y in January from +8.9% in December and an average +5.6% in Q4. Combined with Turkstat's Consumer Confidence Index which averaged 72.0 points in Q1 2018, well above the average 65.9 in Q4 and 68.6 recorded for all of 2017, this indicates a strong increase in consumer spending in Q1. That said, keep in mind that the strong growth is to a large extent driven by pro-cyclical fiscal stimulus and has caused rising macroeconomic imbalances and mounting overheating concerns (see also WERO 14 March 2018).

Africa & Middle East

Egypt: A kind of magic

Ahead of the first round of the presidential election from 26-28 March, the economic situation has stabilized markedly. Major reforms are now more than one year old (key devaluation by -50%, partial unwinding of capital controls, and progressive unwinding of subsidies) but are still delivering positive outcomes. Foreign capital inflows have remained strong and helped import cover to reach a new high of 9 months. There were winners and losers in the short-run. Local manufacturers were among the winners, gaining market share since the lower EGP improved export competitiveness and was a powerful import diverter. But consumer-related sectors were hit by higher inflation. Now, that inflation is decreasing rapidly (from 30% in 2017 to an expected 12% in 2018), Egypt should reach higher growth in the current fiscal year: we expect +5.2%, after +4.2% in the previous one. And this growth should be more broadly based, on exports (forecast to rise by +10% in volume) as well as on domestic demand. Energy should also contribute positively to growth since new oil fields should generate increasing output.

Asia Pacific

China: Quality growth and opening up

China's National People's Congress just ended and it's time to take stock about what has been announced. One, the economic growth target has been set at around +6.5%. This is in line with our scenario of "slower but still solid" growth of +6.5% in 2018. Two, the public deficit target has been cut for the first time since 2012, to -2.6% of GDP in 2018 from a target of -3% in 2017. We pencil in a slightly higher deficit of -3% this year, reflecting efforts to keep growth around +6.5% in the context of a tougher protectionist stance of the U.S. Three, efforts to curb financial risks should continue in the form of stronger supervision and tighter regulation. High corporate debt and shadow banking will remain the main targets. Four, measures to open up the country further are set to increase. They would consist of lower tariffs for certain consumer goods (automotive, medical products, e.g.) but also less restrictions on foreign investment in sectors such as telecoms, medical services and financial industry.

What to watch

- March 23 – Brazil February current account and FDI
- March 23 – Lithuania February industrial production
- March 23 – Russia Central Bank meeting
- March 23 – U.S. February durable goods orders
- March 23 – U.S. February new home sales
- March 24 – Poland February retail sales
- March 26 – France Q4 corporate margins
- March 27 – Argentina Central Bank meeting
- March 27 – Hungary Central Bank meeting
- March 27 – China January-February industrial profits
- March 27 – Spain February retail sales
- March 27 – Spain March inflation (flash estimate)
- March 27 – Ukraine February industrial production
- March 28 – France March consumer confidence
- March 28 – South Africa monetary policy meeting

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