Euler Hermes Economic Research

Weekly Export Risk Outlook

22 February 2017

In the Headlines

FIGURE OF THE WEEK

+1.8%

The UK's 2016 GDP growth (revised 2nd estimate)

U.S.: Consumption, manufacturing, and inflation all accelerate

Recent data provide a strong start to 2017. Consumers may finally be following through on their confidence and actually spending, as January retail sales rose +0.4% m/m, higher than expectations of +0.1% m/m, while December was revised up from +0.6% m/m to +1% m/m. Sales grew +5.6% y/y as compared to only +3.9% in November. Manufacturing is improving as two Fed regional surveys were quite strong, including a leap in the Philly Fed Index to the highest level in 33 years. Manufacturing industrial production rose +0.2% m/m, the fifth consecutive increase, although the y/y rate remains a weak +0.3%. Inflation rose in January, as consumer prices gained +0.6% m/m, putting the y/y rate at +2.5%; last July it was only +0.9%. Much of the increase was due to energy prices which rose +4% m/m, the fifth consecutive increase, to a very stiff +11.1 y/y rate. Gasoline prices surged +7.8% on the month, also the fifth consecutive big increase, to a blistering +20.3% y/y pace. The NFIB Small Business Optimism survey, which leapt a record amount in December, maintained that level in January as exuberance over "Trumponomics" continues in the business community.

UK: Resilience in 2016, but likely to fade from mid-2017

Q4 GDP growth was revised up by +0.1pp to +0.7% q/q while past quarterly data were revised down, taking full-year 2016 growth to +1.8% (the first estimate was +2%). Services continued to drive growth in Q4, contributing +0.6pp. Looking at the demand side breakdown, consumer spending remained resilient (+0.7% q/q) despite the rise in inflation. Business investment fell by -1% q/q while the construction sector showed positive signs (+1.6% q/q). Stocks subtracted a large -1.2pp from growth and imports fell by -0.4% q/q, both driven by the depreciation of the GBP. The positive surprise came from exports which grew strongly by +4.1% q/q (mainly exports of goods). We expect the economy's resilience to persist until direct Brexit negotiations with the EU Commission begin (likely in mid-2017). However, growth is forecast to slow down markedly in H2 with consumer spending, the main driver of growth until now, expected to take a hit as inflation rises while investment flows should be much lower given the ongoing uncertainty. We expect GDP growth to slow to +1.4% in 2017 and +1% in 2018.

Greece: A compromise is possible

Recent concerns are related to the high bond redemptions in July 2017 (EUR6.2bn) that are only partly covered by the public deposit holdings, estimated at EUR5.9bn. The political deadlock among international institutions seems to moderate only slightly. The Eurogroup meeting on 20 February suggested that the teams will assess ways to implement new structural measures. There seems to be a common ground that maintaining confidence is key for the Greek economic performance and thus fiscal targets. As a reminder, the IMF said that fiscal targets set by the Europeans are not realistic without a nominal debt haircut or new measures. The recent short-term debt relief measures approved in January, aimed at reducing the interest burden, are certainly positive given the fact that 80% of Greek debt is held by institutions, mainly European, and that principal repayment will not start before 2034. We believe a compromise would be to accept the IMF as a technical advisor and not financial contributor as Greek financing needs are substantially lower than planned (EUR65bn maximum vs. EUR86bn agreed).

Germany: Strong business sentiment at the start of the year

The Ifo Business Climate Index climbed to 111.0 in February, offsetting the -1.1 points loss in January. The business situation component soared to a 66-month high of 118.4 (from 116.9 in January) while the expectation component increased to 104.0, regaining +0.8 of the -2.3 points loss last month. The positive outlook is supported by the February flash PMI Composite Output Index which rose to a 34-month peak of 56.1 (from 54.8) as a result of a rebound in the Services PMI Activity Index to 54.4 (from 53.4) and a surge in the Manufacturing Output Index to 59.4 (from 57.5). The headline Manufacturing PMI rose to a 69-month high of 57.0 (from 56.4). A look at the sub-components of both the Ifo Business Climate Index and the Manufacturing PMI reveals a marked acceleration of new orders and the PMI also shows a strong rise in new export orders. Global trade was weak last year but is forecast to accelerate somewhat in 2017. Euler Hermes expects German export volumes, which grew by just +2.2% in 2016 (goods and services), to benefit and pick up markedly this year.

Countries in Focus

Americas

Peru: Bound to return

The Central Bank has kept its key policy interest rate at 4.25% for twelve months after tightening by 100bp between September 2015 and February 2016. That move came in response to the depreciation of the PEN by -14% in 2015 and rising inflation which eventually reached an average 3.6% in 2016, above the 2% +/-1pp target range, and meeting our forecast. Peru is the seventh largest economy in the region and one of the best performers in recent years. Euler Hermes estimates that real GDP increased by +4% in 2016, up from the +3.3% registered in 2015 but below the +5.9% average recorded in the previous decade. China is Peru's second largest export destination and doubled its share to 22% in the ten years to 2015. Ores have accounted for the largest share of exports to China since 2011, with an average share of 54%. The expected recovery in commodity prices could help the mining sector to gain momentum.

Europe

Turkey: Exports improve, private consumption remains weak

The current account deficit surged to –USD4.3bn in December 2016, taking the annual shortfall to –USD32.6bn (an estimated -3.8% of GDP), nearly the same as in 2015. External trade activity recovered in Q4, with nominal exports of goods up by +4.8% y/y (-4.5% in Q3), bringing the full-year decline to -1.2%. Nominal imports were up by +2.2% y/y in Q4 (-6.4% in Q3; -4.6% in full-year 2016). Likewise, industrial production recovered somewhat, expanding by +2.1% y/y in Q4 (after -1.8% in Q3). However, the Manufacturing PMI has been below 50.0 points since March 2016, posting 48.7 in January 2017 (after 47.7 in December), indicating contraction in the sector. Meanwhile, advance indicators point to continued weak consumer spending. Real retail sales fell by -1.7% y/y in Q4 (-0.6% in Q3) and the Turkish Statistical Institute's Consumer Confidence Index fell to a 16-month low of 65.3 points in February (vs. an average 73.1 since 2011). Overall, we expect consumer spending to decline in 2017.

Africa & Middle East

Ghana: Off track fiscal balance poses a risk to IMF support

The fiscal deficit deteriorated unexpectedly in 2016. From a baseline scenario of -3.8% of GDP, it was revised to -9% by the newly elected government. The previous administration increased public spending and suffered from poor tax collection. As a result, public debt is larger than previously thought (74% of GDP at end-2016, instead of expected 66%). These evolutions imply that Ghana is not rebalancing. Perceptions that public finances were in good shape helped to secure some market financing, given that Ghana was backed by IMF support. However, the current program is ending in April. The new government asked to extend it until October, but this is not very likely since acceptance by the Fund would require some efforts to improve public finance beforehand. As a result of the missed fiscal targets, the GHS has depreciated by -12% since early December. Moreover, import cover by foreign exchange reserves is fairly low at about 3 months. We expect the weakening of the GHS to continue.

Asia Pacific

Malaysia: Robust private demand, stronger exports

Real GDP growth accelerated to +4.5% y/y in Q4 2016 (+4.3% in Q3). Net trade made a positive contribution with a recovery of real export growth to +1.3% y/y (-1.3% in Q3). On the domestic front, private expenditures were firm as private consumption rose by +6.2% y/y (+6.4% in Q3) and private investment by +4.9% y/y (+4.7% in Q3). In contrast, government expenditures weakened further to -2.6% y/y (-0.2% in Q3). Full-year GDP growth slowed down to +4.2% in 2016 from +5% in 2015. Going forward, continued strong private consumption, an expected upturn in private investment and a recovery of exports thanks to improving commodity prices provide a favorable basis for growth in the short run. Moreover, the policy mix should remain cautiously supportive. Fiscal consolida-tion may continue but at a gradual pace (to maintain solid growth) while monetary policy should remain broadly accommodative to reinforce investment. Euler Hermes expects real GDP growth to pick up to +4.7% in 2017.

What to watch

- February 23 – Argentina January industrial production
- February 23 – France February business confidence
- February 23 – Germany Q4 GDP with breakdown
- February 23 – Germany Febr. GfK cons. confidence
- February 23 – Italy December retail sales
- February 24 – U.S. January new home sales
- February 27 – U.S. January durable goods orders
- February 28 – France and Italy Febr. CPI (preliminary)
- February 28 – Germany and Japan January retail sales
- February 28 – Hungary Central Bank meeting
- February 28 – Japan January industrial production
- February 28 – Nigeria Q4 GDP
- February 28 – U.S. Q4 GDP
- February 28 – U.S. February consumer confidence
- March 1 – EU countries February Manufacturing PMIs
- March 1 – Germany February CPI (preliminary)

View all Euler Hermes Economic Research online
http://www.eulerhermes.com/economic-research

Contact Euler Hermes Economic Research Team
research@eulerhermes.com

Publication Director
Ludovic Subran, Chief Economist
ludovic.subran@eulerhermes.com