Euler Hermes Economic Research

Weekly Export Risk Outlook

5 April 2017

FIGURE OF THE WEEK

+2.9%

Turkey's 2016 GDP growth

In the Headlines

South Africa: Junk status is not a game changer

S&P downgraded South Africa's long-term foreign currency sovereign credit rating from BBB- to BB+, with a Negative outlook, being the first rating agency to lower the sovereign to speculative grade status. This is significant as S&P had granted the sovereign with investment grade status since 2000. The downgrade was triggered by the decision of President Zuma to fire Finance Minister Gordhan. That decision was driven by an increasing divide within the ruling ANC party in the run up to the next presidential election in 2019. As FM Gordhan was well respected by financial markets, the ZAR has depreciated by -8.3% since the beginning of dismissal rumors. Overall, the rating downgrade was long expected and also reflects three years of subdued economic growth. As GDP growth will recover only gradually from the 2016 low (+0.3%) to +1% in 2017, public debt is likely to increase. However, in our view this trend is not alarming yet as public debt will amount to about 55% of GDP by end-2018.

Turkey: Growth rebound in Q4, but subdued outlook for 2017

According to official data released on 31 March, real GDP rebounded to growth of +3.5% y/y in Q4 2016, after it contracted by -1.3% y/y in Q3. The latter was revised up from the initial estimate of -1.8% y/y. The figure for Q2 was also revised up to +5.3% y/y, from +4.5% previously. The figure for Q1 remained unchanged at +4.5% y/y. As a result, full-year 2016 growth came in at +2.9%, less than half the +6.1% recorded in 2015. The sharp cyclical downturn in Q3 and subsequent rebound in Q4 largely match a similar cyclical down and up in consumer spending and exports. This reflects the destabilization of the economy in Q3 by the attempted coup in July 2016 and the subsequent recovery in Q4, but also the general slump in tourism as Q3 is the most important quarter for tourism in Turkey (tourist arrivals dropped by -36% y/y in Q3). Still, the economy lost momentum as growth dropped from an average +4.9% y/y in H1 to +1.1% in H2 2016. Early indicators for 2017 are mixed, with industrial production and the Manufacturing PMI improving while retail sales and consumer confidence remain weak. We forecast full-year GDP growth to slow to +2% in 2017, followed by +2.5% in 2018.

UK: Testing post-Brexit vote resilience

In 2016, the UK recorded a slightly widening current account deficit (-4.4% of GDP vs. -4.3% in 2015) and a financial account surplus. This illustrates post-Brexit resilience that we detail along with economic scenarios in our Brexit report. In Q4 2016, net financial account inflows rose to +GBP53bn, almost double the Q3 figure. Net FDI inflows were particularly high in Q4, at +GBP110bn (up from +GBP29bn in Q3) as the weaker GBP boosted inward direct investment. Portfolio investment recorded net outflows of -GBP8bn (after high net inflows of +GBP73bn in Q3). The weaker GBP boosting foreign demand partly mitigated Brexit-related uncertainty, although job creation decelerated. Meanwhile, service sector activity registered a strong rise in March, indicated by the Services PMI rising to 55.0 (from 53.3 in February). But the Manufacturing PMI edged down to 54.2 from 54.5 in February, its lowest level in 8 months. This was driven by slow growth in consumer goods amid continued price pressures. The Construction PMI dropped to 52.2 from 54.2 in February. Weaker house building activity, lower job creation and declining input buying due to inflation explain this drop.

China: Mixed news

Business surveys have been quite encouraging recently. The official manufacturing PMI edged up to 51.8 in March (51.6 in February) with a broad improvement of sub-components such as new orders, output and employment. The official non-manufacturing PMI continued to indicate solid growth with a reading at 55.1 (54.2 in February). But hard data do not confirm yet the bullish business sentiment since early 2017. January-February figures show a modest pick-up in industrial production growth (+6.3% y/y, after +6% in December 2016) but weaker growth in retail sales (+9.5%, after +10.9% y/y). Trade figures also provide a mixed picture as strong growth of imports points to a rise in domestic demand while a decrease in exports indicates that opportunities remain limited. Overall, the outlook is still fragile. Externally, it is all about trade relation with the U.S. In that respect, the meeting between President Xi and President Trump this week will be highly scrutinized. Domestically, a more cautious monetary policy stance could act as a drag on growth through lower credit expansion. Against this background, we expect real GDP to grow by +6.3% in 2017.

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Countries in Focus

Americas

Brazil: The hidden face of debt

Country risk in Brazil has improved as a result of fading inflationary pressures and the considerable narrowing of the current account deficit. In contrast, the public sector is expected to register once again a substantial fiscal deficit in 2017 that will add to public debt which already rose to 74% of GDP in Q3 2016, up from 58% recorded two years earlier and compared to an average 48% of GDP for emerging economies. However, it is crucial to put into context the sustainability of Brazil's public debt. Foreign exchange reserves covered 231% of the country's external financing needs in 2016, with an improving outlook for 2017, so that the impact of a negative tail risk event diminishes. This allows Brazil to hold the current level of public debt and puts it among the best emerging economies with regard to reserve adequacy. Meanwhile, businesses and households held debt below the average of emerging economies, at 44% and 23% compared to 37% and 106% of GDP in Q3 2016, respectively.

Europe

Bulgaria: Government instability to be continued?

The early parliamentary election on 26 March left Bulgaria with the prospect of continued government instability. The former ruling center-right GERB party of ex-PM Borisov, which resigned in November 2016 after its candidate failed to win the presidential election, took 32.7% of the vote (95 seats out of 240), followed by the center-left BSP (27.2%; 80 seats), the nationalist UP coalition (27 seats), the ethnic-Turkish MRF (26 seats) and the nationalist-leaning Volya (12 seats). Given deep animosities between the GERB and the BSP and MRF, the likely coalition options are GERB + UP (+ Volya) or BSP + UP + MRF. Both options comprise parties with different views on many policy issues so that the next government is likely to be unstable and will probably not last a full term. Crucially, urgently needed stronger anti-corruption efforts and improvements of the law enforcement process and judiciary are unlikely, raising the prospect of protests being initiated by civil society groups.

Africa & Middle East

Saudi Arabia: Modest but more balanced growth in 2017

Data released by the General Authority for Statistics (GAS) show that real GDP grew by +1.2% y/y in Q4 2016, slightly up from +0.9% y/y in Q3, taking full-year 2016 GDP growth to +1.4%, confirming an earlier estimate. The GAS also provided the demand-side details of full-year growth. Private consumption grew by +2.3% in 2016 while strict fiscal austerity caused government consumption to drop by -18.8% and fixed investment by -15.9%. The sharply trimmed domestic demand led to a contraction of real imports by -24.3% in 2016 while real exports managed to grow by a modest +1.4% as oil output (and exports) was kept high in order to get a good bargaining position ahead of the OPEC meeting in November 2016, where production cuts were agreed. As Saudi Arabia will comply with these cuts, oil sector growth (+3.4% in 2016) will ease in 2017 but easing fiscal austerity should help the non-oil sector (+0.2% in 2016) to recover. Overall, we expect still tepid GDP growth of +1.5% in 2017.

Asia Pacific

Vietnam: False start

Economic growth slowed markedly to +5.1 y/y in Q1 2017 from +6.7% in Q4 2016. Bad weather and a weak net trade performance due to a relatively strong rise of imports compared to exports are among the reasons. In the short term, we see room for a gradual upturn. Business surveys are well oriented. The Manufacturing PMI has recovered rapidly from a weak performance in January (51.9) to 54.6 in March. The breakdown reveals a sharp rise in new orders and production and an increase in job creation. Exports and industrial production are set to recover gradually. As for many Asian markets, the long-term outlook will highly depend on the global trade development. The economy is very competitive and should benefit from the current global trade recovery. However, a potential shift in U.S. trade policy towards protectionist policies could halt the momentum. We cautiously expect real GDP to rise by +6.5% in 2017, slightly below the government target (+6.7%).

What to watch

- April 6 – Germany February factory orders
- April 6 – Russia March consumer prices
- April 6 – Russia Q1 consumer confidence
- April 7 – Romania Central Bank meeting
- April 7 – France February current account balance
- April 7 – Germany February industrial production
- April 7 – Germany February current account balance
- April 7 – UK February industrial production
- April 7 – UK February trade balance
- April 10 – France March BoF business sentiment
- April 10 – Italy February industrial production
- April 10 – Turkey February industrial production
- April 11 – Germany March ZEW survey
- April 11 – Mexico February industrial production
- April 11 – Turkey February BOP
- April 11 – UK March CPI and PPI

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