Euler Hermes Economic Research

Weekly Export Risk Outlook

7 June 2017

In the Headlines

FIGURE OF THE WEEK

+0.8%

Q1 2017 q/q GDP growth in Spain

Eurozone: A genuine pick-up in growth

Real GDP growth was confirmed at +0.5% q/q in Q1, up from +0.4% in Q4. We believe the recovery will be sustained going forward, especially because (i) ECB monetary policy will stay supportive until mid-2018 at least as inflation will reach +1.7% on average this year and next, (ii) fiscal policy in the Eurozone has shifted away from its restrictive course, and (iii) the EUR remains relatively stable which together with the global economic uptick should support the Eurozone's exports. In addition, the marked improvement of the labor market should support a gradual increase in wages. Overall we expect export growth to accelerate in 2017. Stronger investment growth and stable consumption growth should also boost import growth. Looking at countries, key southern European countries surprised on the upside: Real GDP increased by +0.4% q/q in **Italy**, +0.8% q/q in **Spain** and +1% q/q in **Portugal**. In **Italy**, domestic demand was the main growth driver in Q1, with private consumption up by +0.5% q/q, investment in construction up by +0.6% q/q, and stocks contributing +0.4pp. In contrast, investment in machinery and equipment (-2% q/q) as well as exports (+0.7% q/q) disappointed. If the political environment remains stable, GDP growth should come in slightly above +1% in 2017, the highest rate since 2010. In **Spain** and **Portugal**, economic growth was driven up by strong investment, notably in machinery and equipment, and a rebound in exports that beat expectations. The latter expanded by +4% q/q in Spain and by +3.1% q/q in Portugal, the fastest paces since 2007 for both countries. However, as we expected, private consumption began to decelerate on the back of higher inflation and base effects after two years of high growth.

Qatar: Under pressure from neighbors

On 5 June, Saudi Arabia, the UAE, Bahrain and Egypt cut their diplomatic relations with Qatar, accusing Doha of supporting Islamist groups and terrorism. In addition, the states announced the suspension of air, sea and land transport and travel with Qatar. And, with the exception of Egypt, Qatari citizens are required to return home within two weeks. These restrictions, especially the fact that Qatar's land border with Saudi Arabia – its only land crossing – will be suspended, are more severe than those during a previous eight-month dispute in 2014, when Saudi Arabia, the UAE and Bahrain withdrew their ambassadors from Doha over similar accusations. At that time, trade and travel links were maintained.

In the near term, a military conflict appears unlikely, but a further escalation of economic measures, in particular against Qatari banks, is possible. With an estimated USD335bn of assets in its sovereign wealth fund, Qatar looks able to avoid an immediate economic crisis, but parts of the economy could suffer severely if the dispute drags on for months. Exports of natural gas and oil, accounting for almost 85% of Qatar's exports, should broadly continue though the UAE's ban of Qatari-linked vessels from its waters are complicating shipments somewhat. But the suspension of Qatar's land border with Saudi Arabia will affect the imports of food (of which an estimated 40% come via this route) and construction materials (needed especially for the projects related to the FIFA World Cup 2022). Air transport will face higher costs as Qatari airlines are forced to make long detours. And companies servicing Gulf states from Qatar are likely to find it increasingly difficult to operate. Overall, we expect inflation to rise in the next months, and we have revised down our 2017 GDP growth forecast by -1pp to +1.8%.

India: Q1 GDP hit by demonetization – what's next?

Economic growth decelerated markedly to +6.1% in Q1, from +7% in Q4 2016, hit by "demonetization". Private consumption growth slowed to +7.3% (+11.1% in Q4) and investment contracted by -2.1% y/y. But soaring government expenditures (+31.9% y/y) supported Q1 growth. External trade activity was mixed as a good export performance was offset by higher import growth. On the production side, construction was hit severely (-3.7% y/y) and manufacturing growth slowed down to +5.3% y/y (+8.2% in Q4). Looking forward, there are signs that the negative effects of demonetization are abating and the economy will gather momentum in the upcoming quarters. On the activity front, domestic passenger car sales rose by +17.4% y/y in April, after +10% y/y in Q1. Business surveys point to improved activity, with both the Manufacturing (51.6 in May) and Services PMIs (52.2) signaling expansion. On financing, a strong rise in deposits gives banks more leeway to cut lending rates. Against this background, we expect real GDP growth to rise gradually to +7.2% in FY2017-18 (after +7.1% in FY2016-17).

Countries in Focus

Americas

Brazil: Strong growth in Q1

Economic growth surprised on the upside in Q1. Real GDP expanded by +1% q/q, after 8 consecutive quarters of contraction. However, this good figure was only explained by a larger rebound in exports (+4.8% q/q) which were driven up notably by a bumper soy harvest. Domestic demand continued to fall although at a softer pace. Public consumption contracted by -0.6% q/q, investment by -1.6% q/q and private consumption by -0.1% q/q. Although short-term indicators suggest that the recession continues to ease, signs of economic improvement could be challenged by the new political scandal. While an investigation was opened two weeks ago on allegations of President Temer being involved in bribery, the Superior Electoral Court (TSE) began this week to discuss over allegations of illegal campaign financing in the 2014 presidential election. If found guilty, Temer could be forced to step down from office just one year after Dilma Roussef's impeachment.

Europe

Azerbaijan: Banking crisis

At end-May, the International Bank of Azerbaijan (IBA) – a largely state-owned bank, holding 40% of total bank assets – presented a restructuring plan for its FX debt, reflecting its huge exposure to FX risk and unsustainable currency mismatch. The plan comprises a maximum 50% haircut on subordinated debt, a maximum 20% haircut on senior debt, and no haircut on trade finance creditors, but with maturity extension. The plan is likely to be agreed by at least 67% of the creditors, the required quota, as 76% of the obligations should avoid formal haircut, and implemented by end-2017. But it will also likely come at a high cost for the whole banking sector, reducing access to and raising costs of foreign funding. Moreover, it could push up the fiscal deficit to as much as -17% and public debt to 51% of GDP in 2017. However, combined FX reserves of the Central Bank and SOFAZ (the NWF) should still cover 15 months of imports, continuing to provide a sufficient buffer for standard trade finance.

Africa & Middle East

South Africa: A recession, to be short-lived

The country experienced a technical recession with two consecutive quarters of negative q/q growth (-0.2% in Q1, after -0.1% in Q4 2016). However, there was a change in the "growth" drivers. Commodities, the laggard in 2016, performed well in Q1, with agriculture up +5.1% q/q and mining +3%. Retail sales, which were resilient in 2016, weakened markedly in January and February. This came just after inflation peaked as a result of increasing oil and food prices (e.g. fuel prices rose by +16% y/y at the beginning of the year). This recession should prove short-lived since inflation has since decreased markedly (+5.3% in April). However, the negative carry-over effect has lowered growth expectations (from +1% to +0.6% for 2017, and from 1.5% to 1.2% for 2018). South Africa will probably stick to near stagnation. However, good news came from inflation. We now expect a decrease to a rate that is comfortable with the Central Bank's target rate (+5% in 2017 and 2018), allowing some monetary easing.

Asia Pacific

China: Slowing pace

April's economic activity data were disappointing. Real industrial production growth decelerated to +6.5% y/y (from +7.6% in March) and nominal fixed asset investment slowed to +8.9% y/y in the first four months of 2017 (after +9.2% y/y in the first three months). In May, manufacturing surveys pointed to a mixed outlook. On the one hand, the official NBS Manufacturing PMI survey came in at 51.2 points, indicating stable expansion. On the other hand, the private Caixin Manufacturing PMI survey posted 49.6 points, suggesting contraction. Going forward, economic growth is set to lose some pace as the PBoC and the financial regulator have stepped up measures to curb financial risks. The latter includes high corporate debt, increasing *shadow banking activities* and a bubbly property market. However, fiscal policy will remain expansionary to avert a sharp slowdown. Euler Hermes expects real GDP to grow by +6.7% in 2017.

What to watch

- June 8 – UK early general election
- June 8 – ECB Monetary Policy meeting
- June 8 – Argentina and Mexico May CPI
- June 8 – China May exports and imports
- June 8 – Germany April industrial production
- June 8 – Turkey April industrial production
- June 9 – China May inflation
- June 11 – France legislative election (1st round)
- June 12 – Romania April industrial production
- June 12 – Turkey Q1 GDP
- June 12 – Turkey April balance of payments
- June 13 – UK May CPI and PPI
- June 13 – Spain May CPI
- June 14 – Germany May CPI
- June 14 – Eurozone April industrial production
- June 14 – Hungary April industrial production

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