Euler Hermes Economic Research

Weekly Export Risk Outlook

28 June 2017

FIGURE OF THE WEEK

EUR17bn

Expected costs for bailout of two Veneto banks

In the Headlines

Italy: Bailing out two banks to the tune of EUR17bn

The ECB announced that two Italian banks from the Veneto region, Banca Popolare di Vicenza and Veneto Banca, are “failing or likely to fail”, thereby triggering the EU’s Single Resolution Mechanism (SRM). However, the SRM concluded that the conditions for a resolution action were not met as neither of these banks is considered systemic. Hence, the winding up of the banks could take place under national proceedings. Thus, the government published a liquidation decree protecting senior bonds and deposits with only junior bondholders and stakeholders set to take a hit. However, retail junior bondholders involved in the burden sharing can be refunded up to 80%, with EUR60mn set aside for the reimbursement. The plan has received preliminary approval from the European Commission and allows Italy to avoid a bailout under potentially tougher European rules. The Italian government will provide EUR5.2bn in state aid including EUR4.8bn for Intesa Sanpaolo to maintain its capital ratios following the acquisition of the two banks and EUR12bn in asset guarantees for the non-performing assets. In total this is about 2% of GDP which will add to the 133% of GDP total stock of public debt.

Romania: Despite political turmoil, the economy booms

Last week, lawmakers from the center-left PSD and the center-right ALDE ousted their own six-month-old coalition government in a no-confidence motion. It was a move against PM Grindeanu (PSD) who reportedly had fallen out with the PSD leadership after the government was forced to defer its plans in February to weaken anti-corruption laws, following the largest mass demonstrations since 1989. In a bid to end the political crisis swiftly, President Iohannis appointed outgoing economy minister Tudose, chosen by PSD party leader Dragnea, as prime minister, clearing the way for a new PSD-led government to be formed by the end of this week. We do not expect major changes in government policies. Attempts to soften anti-corruption laws as well as substantial fiscal stimulus are likely to continue. The latter has pushed economic growth to the highest in Eastern Europe since 2016 but also resulted in warnings from the European Commission that compliance with EU fiscal rules is at risk. Real GDP growth surged to +5.7% y/y in Q1, driven by vigorous private consumption (+6.7% y/y) on the back of successive VAT and excise tax cuts since 2015. Government consumption was flat and fixed investment contracted (-0.7% y/y) again in Q1. We expect full-year GDP growth of at least +4.4% in 2017.

U.S.: Consumer confidence may be boosting housing

Consumer confidence rebounded +1.3 points in June after a two-month slide, to a level of 118.9, still historically high. The percentage of respondents who said business conditions were good rose from 29.8% to 30.8%, and those who said jobs are plentiful rose from 30% to 32.8%. The present situation component jumped +5.7 points to the highest level in 16 years. That confidence may have supported new home sales which rose +1% m/m in June. High demand and a tight supply of only 5.3 months drove an +11.5% m/m surge in the median sale price. Similarly, existing home sales rose +1.1% m/m, and although prices rose only +3.2% m/m, it was the third consecutive month of gains greater than 3%. But the manufacturing sector produced another disappointment as durable goods orders fell for the second consecutive month, losing -1.1% m/m in May. Perhaps even more disappointing, after stripping out volatile components, core capital goods orders fell -0.2%.

Eurozone: Risks tilted to the upside

The Eurozone Composite PMI for June continues to suggest a sustained path of growth in both manufacturing and services sectors. The average index came in at a high level of 56.4 points in Q2, slightly above the reading in Q1, indicating that GDP growth should maintain a pace close to the +0.6% q/q posted in Q1. Manufacturing is the best in class as its PMI increased to 57.3 in June, the highest level in more than six years. New orders registered significant growth, mainly thanks to strong export sales (intra and extra regional). The slowdown in commodity prices, notably oil prices, has eased price pressures on inputs, benefiting company profitability. The Services PMI is down by -1.6 points to 54.7 in June, indicating easing momentum. Overall, we expect GDP growth to pick up to +1.9% in 2017 from +1.7% in 2016. Monetary policy should remain accommodative as there is no immediate pressure from rising prices. Statements on further tapering of QE starting in January 2018 are expected this autumn while a first deposit rate hike to -0.2% is likely in H2 2018.

Countries in Focus

Americas

Argentina: Clambering its way out of recession

Real GDP expanded by +1.1% q/q in Q1, faster than expected. Growth was driven by private consumption (+1.4% q/q) and investment which recorded the highest q/q growth in two years (+1.7%). Yet on a year-on-year basis, real GDP rose by just +0.1%, suggesting the economic recovery remains patchy. Indeed, although a deceleration of inflation is in sight (+24% in May) it has been less rapid than expected despite monetary tightening. The country's return to international capital markets is on track. Argentina successfully issued its first century bond last week. However, the country's request to win back its status as an Emerging Market in the MSCI benchmark equity index was rejected. It will remain a Frontier Market for at least one more year. MSCI asserted that the "irreversibility of the recent changes still remains to be assessed". In this sense, the legislative elections next October will be key. President Macri needs to win a majority for the pursuit of reforms and to regain lasting investor confidence.

Europe

Hungary: Inflation back to "normal" while growth picks up

The Monetary Council (MC) kept its key policy interest rate at 0.9% last week, unchanged since May 2016. As consumer price inflation and economic growth have picked up recently, we expect a gradual tightening cycle to be started by the end of the year. At an average 2.4% y/y in 2017 YTD, inflation has clearly left deflationary territory, even though it fell to 2.1% y/y in May, and we expect it to remain within the MC's target range of 3%±1pp in 2017. Meanwhile, seasonally adjusted real GDP surged by +3.8% y/y in Q1 2017, double the pace from Q4 2016, driven by a strong rebound in fixed investment (+21.5% y/y in Q1, after -14% in Q4) on the back of a markedly better use of EU funds. This also fed through to foreign trade activity, with real exports rising by +9.4% y/y in Q1 (up from +3.4% in Q4) and imports by +9.9% y/y (+2.9% in Q4). Consumer spending growth fell to +2.8% y/y while public spending dropped by -4.6% y/y in Q1. We expect full-year GDP growth of +3% in 2017 (after +2% in 2016).

Africa & Middle East

Gabon: Payment behavior should improve

The IMF announced a USD642mn three-year loan to Gabon on 20 June. This is good news for two reasons. First, there was evidence that Gabon delayed some payments from last year. The country presumably tried to secure enough foreign exchange (FX) reserves to maintain presentable liquidity ratios. But delayed payments were detrimental for confidence and the import cover of FX reserves decreased from 5 months in September 2016 to 2.5 months in March 2017. As there is no solvency problem, a better payment behavior is expected to go hand-in-hand with IMF surveillance. Second, there was evidence of fiscal profligacy (fiscal deficit of -4.6% of GDP in 2016) designed to smooth the oil price slump impact on GDP growth and to win elections. Normally, the conditionality attached to IMF support should help to achieve a more balanced fiscal policy in order to keep public debt (64% of GDP in 2017) under control. Overall, GDP growth is forecast at +1.5% in 2017, down from pre-crisis +4% in 2015.

Asia Pacific

Thailand: An export-led improvement

USD-denominated exports rose by +13.2% y/y in May (after +8.5% in April). The expansion was driven by higher demand growth from major trade partners, namely China, the EU and Japan, especially for manufacturing and agricultural products. The Business Confidence index strengthened to 52.3 points in May (from 49.6 in April). Going forward, any improvement in economic growth will likely continue to depend on external demand. The economy has performed relatively well in Q1 (real GDP up +3.3% y/y) supported by a rebound in global trade. Private domestic demand growth remains fragile. Firstly, consumer confidence struggles to recover strongly, decreasing to 76 points in May (from 77 in April). Credit growth remains weak, constrained by high household debt (79.9% of GDP), continued domestic (e.g. political) and external uncertainties (global trade outlook). Against this background, Thailand's economy is set to grow by +3.3% in 2017 (after +3.2% in 2016).

What to watch

- June 29 – Germany June GfK Consumer Climate
- June 29 – Germany June CPI (flash estimate)
- June 29 – Portugal June Consumer Confidence Index
- June 30 – Canada April GDP
- June 30 – China June official PMIs
- June 30 – France June Consumer Confidence Index
- June 30 – Germany May Retail Sales
- June 30 – UK Q1 current account balance
- June 30 – U.S. May personal income and outlays
- July 1 – Estonia takes over the EU Presidency until December
- July 3 – Romania Central Bank meeting
- July 3 – Turkey June CPI
- July 3 – U.S. June ISM manufacturing index
- July 4 – Russia Q1 GDP (with expenditure breakdown)
- July 5 – Mexico June Consumer Confidence Index

Contact Euler Hermes Economic Research Team
research@eulerhermes.com

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