Euler Hermes Economic Research

Weekly Export Risk Outlook

9 April 2014

In the headlines

FIGURE OF THE WEEK

EUR20bn

New tax cuts in France

Ukraine & Russia: Crisis update

Tensions remain high after Russia annexed the Crimea region of Ukraine last month. Pressure was building over the past week in eastern Ukraine for more areas to cede to Russian control. Pro-Russian protesters have seized state buildings in several cities, including the city hall in Donetsk where they declared a "people's republic" on Monday, but security forces reportedly reclaimed the city hall. Kiev accuses Moscow of fomenting the unrest, which Russia denies. On a positive note, the EU, Russia, the US and Ukraine announced to hold talks next week to discuss the situation in Ukraine, the first four-party meeting since the crisis began. On the economic front, Ukraine imposed import bans on a number of Russian food companies after Russia's Gazprom almost doubled the price of gas it supplies to Ukraine. Russia retaliated with similar import bans on selected Ukrainian dairy producers. Ukraine's FX reserves stood at USD13.3bn at end-March, down -3% m/m and -42% y/y, sufficient to cover just 1.5 months of imports. The UAH has continued to weaken, having lost 6% against the USD in the first week of April and 21% since end-February when the Crimea crisis escalated. In contrast, the RUB has regained all the losses it suffered in the first half of March.

France: New government, new reforms

The new French PM Manuel Valls announced on Tuesday an ambitious reform package. For corporates, new tax cuts would be fully in place by 2017: employers' social contributions paid on the minimum wage would be cut in 2015 and progressively reduced on wages up to 3.5x the minimum wage between 2016 and 2017; corporate standard tax rate will be cut gradually from 33.3% to 28% by 2020; and social solidarity contribution ('C3S') for large firms would be eliminated by 2017. Corporates' margins and investment rates should benefit from these efforts aiming at regaining competitiveness. For consumers, employees' social contributions will be reduced starting in 2015 for those earning up to 1.3x minimum wage, hence boosting purchasing power and consumption (0.2 points of GDP growth in 2015). Note that these cuts mean an additional EUR20bn for their financing. Precisely, the PM also confirmed a massive spending cuts program of EUR50bn by 2017, EUR19bn coming from the state, EUR10bn from the health insurance scheme, EUR11bn from social transfers and the remaining from the rationalization of local governments. Uncertainties remain on the execution of this plan, as France continues to struggle to reduce its fiscal deficit– EH estimates that 3% is only feasibly by 2017. Further details will be announced in the coming weeks but a weaker euro and stronger GDP growth will be necessary for this plan to succeed.

UK: Aiming at boosting exports

Chancellor George Osborne announced new measures to help exporters raise financing. The changes will allow banks to use export credit notes guaranteed by the government's trade promotion agency as collateral at the BoE that should incentivize banks to lend extra-money to exporting British firms. The Finance ministry said that this measure should help reduce the cost of private-sector export finance loans by 5 to 10bps. In addition, the government's direct-lending programme through UK Export Finance aimed at financing exporters would be doubled in size (to GBP3bn) and at reduced interest rates. The government targets to double exports by 2020. These measures are positive and should reinforce business confidence. They come on top of other supportive economic policies such as a cut in corporate tax rates, an increase in infrastructure spending, BoE Funding for Lending scheme and additional financing for strategic industries.

US: Mixed signals

The March employment report showed moderately strong gains of 192,000 jobs while the unemployment rate stayed at 6.7%. Wages were unchanged but the workweek rose from 34.3 to 34.5 hours, boosting average weekly earnings by 0.5%. Yet the positive signs in this report still don't outweigh the labor market's weak condition; there are still 437,000 jobs fewer than before the recession, the participation rate remains at lows not seen since 1978, the average duration of unemployment is still a very high 36 weeks, real weekly earnings growth is an anemic 0.6% y/y, and the unemployment rate remains higher than it ever got in the previous recession. Other reports were also mixed. March factory orders rose for the first time in three months, gaining a robust 1.6%, but critical core orders fell by 1.4%. The trade deficit widened in February from USD39.3bn to USD42.3bn, dragging on Q1 GDP. One unqualified success in March was the strong 6.9% rebound in auto sales after a difficult winter.

Countries in Focus

Americas

Brazil: Inflation to restrain growth in 2014

According to data released today, consumer prices accelerated strongly in March, increasing by 0.9% m/m in seasonally adjusted terms after 0.5% m/m in February and 0.3% m/m in January. The inflation rate reached 6.2% y/y, the highest level since July 2013, which was mainly due to a sharp rise in food and transport prices. As inflation remains at the high end of the target range (4.5% ±2%), the Central Bank decided last week to increase the key interest rate (SELIC) to 11% (+0.25pp) after nine previous rate hikes since April 2013. Despite a slight easing, EH expects inflation to remain close to 6% in 2014. As a consequence, the Brazilian economy is expected to expand by +2.0% in 2014, a very moderate pace compared to an annual average growth rate of +4.8% between 2003 and 2008.

Europe

Hungary: Election result indicates policy continuity

The ruling centre-right Fidesz party of Prime Minister Viktor Orban clearly won the parliamentary election last Sunday, gaining 45% of the votes and, although down from 53% in 2010, is likely to narrowly retain its two-thirds constitutional majority in parliament, with 133 out of 199 seats. The Socialist-led opposition Unity Alliance got 26% (38 seats), followed by the far-right Jobbik (20%, 23 seats) and LMP, Hungary's Green party (5 seats). Fidesz' past four years in power were overshadowed by unpredictable and business-unfriendly, unorthodox policies as well as a row with the EU over constitutional changes in Hungary, which were criticised as undermining democratic checks and balances and brought the country at the brink of financial crisis in early 2012. After corrective measures by the government, the economy stabilised and has meanwhile entered a gradual recovery path. Nonetheless, expect foreign investors to remain wary of policy uncertainty.

Africa & Middle East

Nigeria: Africa's new top economy?

The Nigerian National Bureau of Statistics released new GDP estimates that take into account a broader economic base including new sectors such as telecoms, the movie/music industries and e-commerce. Since 1990, there had been no change in the GDP components, probably underestimating the size of the Nigerian economy. Indeed, with the new methodology, the 2013 GDP estimate almost doubled from about USD292bn to USD509.9bn. The structure of the economy changed radically, with services now accounting for more than half of the GDP (against 29% previously) while the share of crude oil and natural gas decreased from 32.4% to 14.4% of GDP. Thus, with more than 170 million inhabitants, Nigeria is becoming a major player on the world economic scene, accounting for 22% of regional GDP, far above South Africa (12%). The new data propelled Nigeria to become the 25th world economy against the 37th world economy previously.

Asia Pacific

BOJ policy: No additional measures announced

While markets were expecting a new round of Quantitative Easing, the Bank of Japan decided to keep its monetary stance unchanged: the monetary base is expected to increase at an annual pace of 60-70 trillion yen; the size of asset purchases remained unchanged. The monetary authorities stick to their optimistic outlook of increasing growth and rising inflation (1.5% y/y in February). Still, they acknowledged that growth prospects could be affected by the sales tax hike and weak export performance. The authorities' outlook could be too optimistic as advanced indicators, especially consumer confidence, have been on a downward trend since November 2013. Although the February current account surplus has been well received as it shows the first surplus in five months and thus signals the positive impact of *Abenomics*, caution is still needed. Indeed, this trend was mainly driven by a slowdown of imports (+13% y/y compared to +30% in January) in preparation of the sales tax increase. GDP growth is expected to slow down to +1.2% in 2014 (from +1.5% in 2013).

What to watch

- April 10 – Industrial production in France, Italy (February)
- April 10 – Romania CPI (March)
- April 11 – Germany and Hungary CPI (March)
- April 11 – Industrial Production in Mexico and India (February)
- April 13 – Q1 GDP in Singapore
- April 14 – Private estimate of inflation in Argentina (March)
- April 14 – Industrial Production in Eurozone (February)
- April 15 – Germany ZEW survey (April)
- April 15 – Retail sales in Brazil (February)
- April 15 – ZEW survey in Germany (April)
- April 15 – Industrial production in China (March)
- April 16 – Industrial production in the US (March)
- April 16 – US Housing starts and building permits (March)

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