Euler Hermes Economic Research

# Weekly Export Risk Outlook

25 June 2014

## In the Headlines

FIGURE OF THE WEEK

+3.5%

Hungary's Q1 y/y GDP growth)

### Eurozone: The recovery is uneven

The PMI Composite Index in June softened to a sixth-month low, at 52.8 (53.5 in May), but it remains in expansionary territory. The Services PMI fell to 52.8 (53.2 in May) and the Manufacturing PMI decreased to 51.9 (52.2 in May). In the manufacturing sector, output increased in June but new orders fell. In contrast, output and new orders both increased in the services sector. At a country level, divergence is still evident, with PMI indices showing expansion in business activity in Germany but a continued contraction in France. In Germany, the PMI Composite Index edged down to 54.2 in June (55.6 in May), the Manufacturing PMI index increased moderately to 52.4 and the Service PMI decreased to 54.8. In France, the Composite PMI fell to 48.0 (49.3 in May), the Services PMI was down to 48.2 and the Manufacturing PMI down to 47.8. However, for the rest of the region encouraging trends are visible, with output and new orders posting the highest increase since July 2007. EH expects GDP growth will be +1% in 2014 and +1.4% in 2015, supported by a progressive pick up in credit to the private sector and in consumer prices following the announcement (as expected) of support from the ECB.

### Hungary: Monetary easing supports economic recovery

The Monetary Council (MC) lowered its key policy interest rate by another 10bps to 2.3% this week, the 23rd consecutive cut since August 2012, citing the continued low inflation environment, subdued medium-term inflationary pressures and expectations, a degree of spare capacity in the economy and moderate wage growth. Indeed, headline inflation fell to an average -0.04% y/y in the first five months of 2014, although this partly reflects a one-off 10% adjustment in regulated energy prices for households in 2013. As this effect is waning, EH expects inflation will rise again modestly to within the MC's target range of 3% ± 1pps and also a cessation of monetary easing by the end of the year. Meanwhile, the economic recovery gained further momentum as a result of strengthening domestic demand. Q1 real GDP increased by +3.5% y/y, with private consumption up by +1.6%, government consumption +3.5% and fixed investment +13.3%. Exports increased by +7.5% and imports by +7.6%, so that net exports made a small positive contribution to growth. EH expects the recovery to continue in the next few quarters, although the growth rates are likely to moderate somewhat because of base effects, resulting in full year growth of around +2.6% in 2014 and +2.5% in 2015.

### Argentina: Unexpected GDP contraction in Q1

In Q1, GDP contracted by -0.8% q/q, surprising on the downside (consensus at +0.1%), driven by very weak domestic demand. Investment fell for the fourth quarter in succession (-1.1%) and private consumption stagnated. Net exports contributed positively overall (+0.2 points of growth) but this is explained by a stronger fall in imports (-1.2%) than in exports (-0.3%). The economy is adversely affected by strong upward price pressures (inflation reached 21.3% in May) and a tightening in monetary policy established as a consequence. The country is expected to slip into recession in 2014 (-0.8%) before recovering moderately in 2015 (+0.3%). Meanwhile, the country is also at risk of default, as President Kirchner appears to have run out of legal options to avoid payment of the USD1.3 billion demanded by some investors before reimbursement to other bondholders, whose next installment falls due on 30 June. If Argentina fails to pay more than USD900 million in interest payment next Monday it will be in technical default, although it will still have a 30-day grace period in which to pay or to find agreement with its creditors.

### Iraq: Update

This is a follow-up to last week's report (WERO 18 June 2014: Regional quagmire). The militant Sunni extremist group ISIS appears to have consolidated its hold on large areas of the north and west but the Kurds control approximately one-fifth of the country in the north east and the Shia-led government in Baghdad appears capable of defending the south (site of 90% of total oil output). This is a de facto split of the country that may become entrenched if one side does not prevail (which seems unlikely) or if a government of national unity (including Shia, Sunni and Kurds) is not formed (very challenging but perceived as the best option). Meanwhile, ISIS will continue its plan to create a new state (it already has sources of finance, power supplies, control of some border crossings and some institutional capacity) and this constitutes a potential risk for all the Levant, as well as key regional powers, including Turkey, Iran and Saudi Arabia. Meanwhile, benchmark oil prices are currently around USD114/barrel, after starting the year at USD108/barrel.

# Countries in Focus

Americas

## Colombia: Most rapid GDP growth since 2011

Q1 GDP growth surged to +6.4% y/y, mainly driven by a strong rise in construction activity (+17.2%) while utilities (+3.1%) and manufacturing (+3.3%) registered more modest growth. President Santos was re-elected in elections on 15 June, suggesting continuity in economic and fiscal policies (supportive, while pursuing rigorous management of public finances). Peace negotiations with FARC are likely to proceed positively as Santos is in favour of more talks and has already made some major progress towards a potential treaty. Given the strong dynamism in the economy, the central bank on 20 June increased the key policy interest rate for the third consecutive time, by +0.25bps to 4%. The main concern of the monetary authorities is inflation and its rapid convergence towards the 3% target (in May, the CPI growth rate was 2.9%). Overall, the economic outlook is positive and EH expects GDP growth of +4.5% in 2014 and +4.6% in 2015.

Europe

## Czech Republic: Recovery on track but deflation risks loom

The gradual economic recovery that began in H2 2013 gathered momentum in Q1 2014 as domestic demand improved and external trade activity picked up. Q1 real GDP growth accelerated to +2.5% y/y and posted +0.4% in q/q seasonally-adjusted terms. Private and public consumption increased at the same rate (+1.4% y/y) while fixed investment increased by +5% y/y. Growth in exports and imports picked up, to +9.7% and +10.6% y/y, respectively, so that net exports made a small positive contribution to Q1 GDP growth (the level of exports is higher than that of imports). EH expects the recovery will stabilise, resulting in full year growth of around +2% in 2014. Despite the recovery, inflation fell to an average 0.2% y/y in January-May 2014 (1.4% in full year 2013). EH expects the central bank will continue to fight deflationary pressures by intervention to weaken the CZK (started in November 2013) aimed at bringing inflation back within the CNB's target band of 2% ±1pps.

Africa & Middle East

## Kenya: Bonded?

Despite periodic terrorist attacks perpetrated by al-Shabaab and affiliates, including in the Westgate mall last year and at coastal resorts this month, the economy continues to perform relatively well. Indeed, a rebasing of GDP calculations suggests that the economy in 2009 was 20% larger than previous projections, which would equate to a 2013 GDP of around USD50 billion. This would classify Kenya as a middle income country. Officials released this fact ahead of a roadshow aimed at securing demand for a sovereign bond of at least USD1 billion. Such funding will be used to repay some debts falling due but also to finance part of the country’s infrastructure development plan (power and transport). Appetite for the bond appears good, with investors buoyed by the relatively successful elections in March and potential in the energy sector. EH expects GDP growth of +5% in 2014 and +5.5% in 2015, subject to maintenance of political and social stability.

Asia Pacific

## China: Manufacturing PMI – after rain comes fair weather

Details of the HSBC/Markit flash PMI signal a gradual recovery in industry and in domestic demand. The overall index increased to a seven-month high in June (to 50.8 from 49.4 in May) and points to a boost to industrial growth, as above 50 suggests expansion. The overall improvement in the PMI was driven by increases in two key sub-components, with output up to 51.8 from 49.8 in May and new orders up to 51.8 from 50.0 in May. For the latter, the boost seems to have come mainly from domestic demand as new export orders weakened to 50.6 (from 53.6 in May). These latest findings confirm that the attempts made by the government to support domestic demand - through mini monetary and fiscal stimulus packages - are beginning to show benefits. After a difficult start in H1, EH now expects the economy to improve progressively through H2 and this will bring full-year growth to +7.5% in 2014.


# What to watch

- June 26 – Brazil May unemployment
- June 26 – U.S. May personal income and spending
- June 26-27 – EU leaders meeting in Brussels
- June 27 – Eurozone June consumer sentiment
- June 27 – France Q1 GDP (final)
- June 27 – Spain May retail sales
- June 27 – Germany June inflation (preliminary)
- June 27 – Japan May CPI (core)
- June 27 – Japan May retail sales
- June 27 – Japan May unemployment
- June 27 – UK Q1 GDP
- June 27 – UK Q1current account
- June 27 – Brazil June inflation
- June 28 – China May leading indicator
- June 30 – U.S. May pending home sales
- June 30 – Japan May industrial production
- July 1 – Romania monetary policy meeting
- July 1 – UK June manufacturing PMI
- July 1 – U.S. June ISM manufacturing
- July 1 – Mexico June manufacturing PMI
- July 2 – Brazil May industrial production