Euler Hermes Economic Research

Weekly Export Risk Outlook

16 July 2015

FIGURE OF THE WEEK

+7%

China's Q2 y/y GDP growth

In the Headlines

Iran: The door is unlocked. Will it be opened?

Caution is required in suggesting that we are witnessing a significant shift in global geo-politics but a signed agreement between Iran and the P5+1 grouping may emerge as a defining moment in recent world diplomacy. The agreement, which still requires ratification by national authorities, will lift some sanctions against Iran in exchange for limitations on the country's nuclear programme. The sanctions (particularly those affecting Iran's access to financial and energy markets and that freeze assets held overseas) will be repealed following verification by the international nuclear watchdog, the IAEA, that Tehran is abiding by the restrictions on its nuclear activities. This could take until the end of the year, so the main economic boost for Iran will come in 2016, although domestic consumer and investor confidence will receive a short-term impetus. Markets already factored in an increase in global supplies of crude oil but prices are likely to remain under downward pressure. Much could still go wrong but if the agreement holds commercial opportunities will emerge in the energy, civil aviation and automobile sectors, with openings in tourism and retail sectors likely to follow as Iran's re-assimilation consolidates.

Greece: A Pyrrhic victory for Greece and the Eurozone?

Greece and its creditors agreed to a bailout programme of around EUR85 bn over the next three years and bridging finance to cover short-term liquidity needs. However, as a prerequisite, the Greek parliament had to pass a bill encompassing a set of stringent reforms, including a streamlining of the VAT system, broadening of the tax base, pension reforms and quasi-automatic spending cuts in case of deviations from primary surplus targets. The package passed with 229 votes in favour (out of 300) but 38 Syriza lawmakers abstained or voted against the government. This will probably lead to a government reshuffle but paves the way for the first disbursement of the funds. Meanwhile, the IMF will not disburse the EUR16.4 bn provisioned without a clear agreement on debt relief (haircut and longer grace period). Even though Grexit has been avoided, for now, the economy is paying a heavy price for closure of its banking system and capital controls. Moreover, the new austerity measures imposed by the Eurogroup will impact negatively on growth; we now expect GDP will contract by -2% in 2015.

U.S. & Canada: Interest rates moving in different directions

In Congressional testimony, **U.S.** Fed Chair Yellen reiterated that "If the economy evolves as we expect…" it would be "…appropriate at some point this year to raise the federal funds rate …", although she also noted that "labor market conditions …are… not yet consistent with maximum employment." EH expects the Fed's first rate hike is likely to come in December. Other economic data also show a still weak economy. Retail sales disappoint (-0.3% m/m in June, compared with expectations of +0.3%), manufacturing production was flat in June for the second consecutive month leading to an anaemic +1.8% y/y growth rate and core producer inflation is running at only 0.8% y/y, markedly below the Fed's 2% target. Meanwhile, **Canada** cut its key interest rate by -0.25% to 0.5% and cut its 2015 GDP forecast to +1.1% from +1.9%. The BoC noted that "The downward revision reflects further downgrades of business investment plans in the energy sector…weaker-than-expected exports…Real GDP is now projected to have contracted modestly in the first half of the year…".

UK: Mixed signals from the labour market

After three years of weak wage growth and strong job creation, a mixed picture has emerged for policy makers. Wage growth during the March-May period (+3.2%) accelerated at the most rapid rate in over five years but did so alongside the first increase in unemployment in two years, 5.6% in May (5.5% previously). Even so, it looks like the increase in pay growth was largely driven by a base effect and it should abate over the coming months. Employment numbers fell by -67,000 in the quarter ending in May (+114,000 in February-April), the first decline since March 2013, as the fall in part time workers (-97,000) was only partially offset by growth in full-time employment (+30,000). Despite recent comment that the BoE is close to increasing the policy rate, these mixed signals make the timing of a potential hike unclear. Indeed, higher unemployment may signal that the recovery remains fragile but wage growth does seem to be picking up somewhat. We believe the BoE should not rush to raise rates.

Countries in Focus

Americas

Argentina: Beware of currency collapse

According to official data, Q1 GDP expanded by +1.1% on a year-earlier basis, but the quarterly pace slowed to +0.2% (after +0.3% in Q4 2014), narrowly beating expectations. Public consumption was the main engine of growth and rebounded by +8.5% y/y, the strongest pace since Q1 2012. However, private consumption and investment remained sluggish (+0.8% y/y and +0.3%, respectively). Despite an easing in FX and import controls, the fall in real imports continued, -6.5% y/y, completing six consecutive quarters of contraction, while exports fell for the seventh consecutive quarter, registering a decline of -1.5% y/y. Against a background of ongoing economic concerns, significant capital flight has put downward pressures on the ARS. Although the depreciation of the ARS against the USD has been broadly controlled by the authorities, a further collapse in the currency cannot be ruled out in the coming months as international reserves are now low (covering less than four months of imports).

Europe

Russia: Current account surplus disguises weak fundamentals

First official estimates indicate that the current account surplus in H1 was USD48 bn, an increase of +USD10 bn from H1 2014, despite weak oil prices, ongoing sanctions and an associated decline in goods exports of -USD73 bn (-29% y/y). Goods imports declined by an even stronger -39% y/y, reflecting the impact of a weaker RUB, heightened inflation and interest rates on domestic demand, but the much higher level of exports provided for a -USD14 bn drop in the trade surplus. However, this was more than offset by improving deficits on the services account (+USD8 bn) and incomes account (+USD16 bn), the latter due to decreases in net remittances outflows and net interest outflows as sanctions make it more difficult for Russian borrowers to roll over external loans. Euler Hermes expects the annual current account surplus of USD58 bn (3.1% of GDP) in 2014 to be exceeded in 2015 but the weak fundamentals re-affirm our view that the recession will continue (see also WERO 8 July 2015).

Africa & Middle East

Botswana: Still an African gem

GDP contracted by -1.3% q/q in Q1 (+3.3% in Q4 2014), reflecting weak household spending (-0.7%) and fixed investment (+1.8%). Exports of goods and services were moderately positive (+2.9%) and government expenditure remained resilient (+6.8%). At a sector level, mining contracted by -8.7% q/q, partly reflecting a fall in copper/nickel production following a mine closure, and agricultural output was down by -4.7% (drought conditions). The drought, relatively weak commodity prices and subdued recovery in key export markets (non-metallic minerals account for 80% of exports, largely diamonds) have weakened economic activity but, with low inflationary expectations (oil accounts for 11% of the import bill), the Central Bank has scope to maintain a loose monetary policy and EH expects overall GDP growth of around +3% in 2015. Economic fundamentals remain healthy, although longer-term challenges include the need for diversification away from mining and alleviation of poverty and income inequalities.

Asia Pacific

China & Singapore: Adjusting to external headwinds

China's Q2 GDP growth stabilised at +7% y/y. June activity data indicate improvement in industrial output (+6.8% y/y from +6.1% in May) and in retail sales (+10.6% y/y from +10.1%). Urban fixed asset growth YTD stabilised at +11.4% y/y. Trade figures show modest improvement as nominal goods exports recovered (+2.8% y/y after three months of contraction) and import contraction slowed to -6.1% y/y (from -17.6%). Downward price pressures persist in the industrial sector, with June's producer prices decreasing (-4.8% y/y), the 40th consecutive month of price decline. **Singapore's** Q2 output growth decelerated sharply, to +1.7% y/y (from +2.8% in Q1), as the manufacturing sector contracted further (-4% y/y from -2.7%) and services weakened (+3% from +4.2%). These releases indicate that a weak rebound in global demand continues to weigh on growth in Asia and local authorities need to promote pro-growth measures to keep annual expansion at around +7% in China and +2.5% in Singapore.

What to watch

- July 17 – U.S. June CPI
- July 17 – U.S. June housing starts & permits
- July 17 – Poland June retail sales
- July 21 – Mexico Banamex survey of economists
- July 21 – Israel June leading 'S' indicator
- July 21 – Australia RBA July meeting minutes
- July 21 – Hungary monetary policy meeting
- July 22 – South Africa June CPI
- July 22 – Japan May All Industry Activity index
- July 22 – Argentina June trade balance

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