Euler Hermes Economic Research

# Weekly Export Risk Outlook

2 September 2015

## In the Headlines

FIGURE OF THE WEEK

-1.9%

**Brazil's Q2 q/q contraction in GDP**

### Brazil: Worse than thought

GDP contracted by -1.9% q/q (-2.4% y/y) in Q2, worse than expectations, and Q1 GDP was revised downwards to -0.7% q/q (-0.2% initial projection). Investment continued to fall markedly, by -8.1% q/q, recording the worst q/q contraction since 2009, completing eight consecutive quarters of decline and falling back to its early-2012 level. Private consumption contracted by -2.1% q/q, as unemployment hit a five-year high in July (7.5%) and inflation surged to +9.6% y/y (more than double the Central Bank's 4.5% target). The external sector was the only engine of growth in Q2, with exports expanding by +3.4% q/q but imports contracting sharply, by -8.8%. Meanwhile, the primary budget deficit widened to -0.89% of GDP from -0.80% in the year ending in June and the government eased its target for the second time in a month and now expects a deficit of -0.2% of GDP this year, compared with a target of +0.15% a month ago and +1.1% at the beginning of the year. The deterioration in public finances raises strong concerns that Brazil may lose its investment grade credit rating, which would limit access to capital markets, increase capital flight and strengthen downward pressures on the currency.

### China: Walking a tightrope

Recent business surveys point to a relatively weak outlook. The official manufacturing PMI decreased to 49.7 in August (50 in July) signalling that the sector was in contraction, with most sub components down. In particular, new orders fell to 49.7 (from 49.9) and the employment component was down to 47.9 (48). Activity in the non-manufacturing sectors showed resilience (53.4 in August from 53.9 in July) but growth slowed. Key sub-indicators point to short-term weaknesses, especially a decrease in new orders and employment. As a result, financial sentiment remains volatile, despite strong intervention by brokerage firms and official supportive measures. In the short term, risks are tilted to the downside. Economic data for September will probably be weak, reflecting trends in employment in both manufacturing and non-manufacturing sectors and a downward trend in new orders, dampened by weak external and domestic demand. Against this background, the authorities will add further to easing measures to support growth. EH expects growth will decelerate to +6.8% in 2015 and +6.5% in 2016.

### U.S.: Stronger GDP and consumer, manufacturing mixed

Q2 GDP growth was revised up from +2.3% to +3.7%, driven by investment, which was updated from +0.3% to +5.2%. Consumption grew at a healthy +3.1%. EH continues to expect +2.5% GDP growth for 2015 and +2.7% for 2016. Real personal consumption expenditures (PCE) increased in July to a three-month average annual rate of +3.4%, boding well for Q3 GDP. Real disposable income was up +0.4% in July, pushing the three-month average from +1.3% to +1.8%. The Fed's favoured gauge of inflation, the core PCE price index, slipped -0.1pps to +1.2% y/y, markedly below the target of +2%. EH expects the Fed will most likely delay its first rate hike until December. Data from the manufacturing sector were mixed. Orders for non-defence capital goods (ex-aircraft) rose a strong +2.2% in July, the second consecutive increase, and the three-month average for all durable goods was up a steep +6.1% annualised rate. The ISM manufacturing index fell from 52.7 to 51.1 in August, uncomfortably close to the cut off 50 level, signalling expansion or contraction. New orders dropped -4.8 points to 51.7.

### Italy: Lower oil prices and EUR drive moderate recovery

GDP growth for both Q1 and Q2 was revised upwards by +0.1pps, to +0.4% and +0.3%, respectively. Lower oil prices and low inflation spurred household purchasing power, allowing final private expenditure to grow at +0.4% q/q, the highest since Q4 2010. The lower EUR also contributed to an acceleration in export growth (+1.2% q/q, notably driven by exports of goods), although stronger growth in imports (+2.2% q/q) triggered a negative contribution from net exports (-0.2pps). Investment growth fell back into negative territory, mainly because of the construction sector (-0.8% q/q), but domestic and external demand spurred a rebound in equipment investment from the beginning of 2015. Overall, GDP growth was driven by domestic demand, but exports doubled their contribution to GDP growth compared with Q1 (+0.4pps). EH expects GDP growth in 2015 will reach +0.7% and will accelerate to +1.1% in 2016. Upside risks may materialise from a higher than expected pick-up in investment and from a more rapid implementation of structural reforms.

# Countries in Focus

Americas

## Canada: Q2 contraction but improvement in June

GDP contracted for the second consecutive quarter in Q2, dropping by an annualised rate of -0.5% q/q. This followed contraction of -0.8% in Q1, therefore putting Canada in a technical recession in H1 2015. The fall was driven by a marked -12% (-17.7% in Q1) decline in investment in non-residential structures, machinery and equipment, a direct effect of the contraction in capital expenditures in the oil industry. However, much of the damage to the economy appears to be isolated to the oil sector as other economic indicators in the first two quarters were positive, including employment and household consumption, which gained +2.3% q/q in Q2. In addition, on a monthly basis, GDP increased +0.5% in June, breaking a string of five consecutive contractions and setting the stage for a stronger Q3. Euler Hermes expects that the continued weakness in commodity markets will limit 2015 GDP growth to +1.5% and to +1.7% in 2016.

Europe

## Austria & Switzerland: Moderate recoveries in Q2

**Austria**'s economy is recovering gradually. Q2 real GDP increased by +0.3% q/q, up from +0.2% in Q1 and nearly flat growth in each quarter in 2014. Domestic demand did not gain momentum in Q2, with private consumption up by +0.1% q/q and public consumption +0.4%, while fixed investment fell again by -0.1% q/q. Net exports made a turnaround as a result of improving demand from the Eurozone, with exports up by +0.2% q/q while imports were flat. EH forecasts full-year GDP growth of +0.7% in 2015 and +1.4% in 2016. **Switzerland** avoided recession as Q2 GDP increased by +0.2% q/q after the -0.2% drop in Q1, despite a sharp fall in inventories (-0.8pps). Private consumption grew by +0.3% q/q in Q2, public consumption +0.2% and fixed investment +0.9%. Net exports contributed +1.3pps to Q2 growth as imports (-7.6% q/q) declined more sharply than exports (-4.4% q/q). EH expects full-year GDP will expand by +1% in 2015 and +1.2% in 2016.

Africa & Middle East

## Lebanon: You Stink

Consensus politics in Lebanon may provide a salutary indicator to those who seek a way to balance Middle East sectarian divides. The Sunni, Shia, Christian and Druze communities all have powers established in the country's constitution but effective governance remains elusive. The presidency, vacated in May 2014, is yet to be filled because of power struggles and policy implementation depends on enforcement by groups loyal to political sects rather than national agencies. A recent dispute, which reflects the deeper malaise, resulted in uncollected rubbish in Beirut and demonstrations under a You Stink campaign. Some protests have turned violent. The lack of centralised and effective governance at a time of regional uncertainties that have led to an influx of an estimated 1.5 mn refugees in a population of 5.5 mn results in weakened commercial prospects and limited overall economic growth. EH expects annual GDP growth will be restricted to around +1/+2% in 2015 and 2016, at best.

Asia Pacific

## Australia & South Korea: Chinese whispers?

The **Australian** economy is adjusting to lower commodity prices and weaker external demand, particularly from China. Q2 GDP growth was +0.2% q/q, compared with a consensus of +0.4%, and much lower than the previous quarter (+0.9%). The downturn was led by a significant reduction in mining output (-3% q/q). On the demand side, the main detractor was net exports, subtracting -0.6pps from overall GDP growth. More positively, domestic demand was up +0.9 q/q. In **South Korea,** exports declined significantly in August (-14.7% y/y) as demand declined in China (-8.8%) and the Eurozone (-20.8%). The manufacturing PMI showed a slight improvement (47.9 in August, 47.6 in July) but continued to signal contraction in that sector. Going forward, these trends signal a challenging Q3 for Asia, reflecting unfavourable global conditions that include weak demand growth (particularly from China) but also volatile financing conditions. Domestic buffers will be key in supporting growth.

# What to watch

- September 3 – EU August composite PMI
- September 3 – Eurozone ECB meeting
- September 3 – Turkey August CPI
- September 3 – UK August services PMI
- September 3 – France August unemployment
- September 3 – South Africa July electricity output
- September 3 – U.S. & Canada July interntl. trade
- September 4 – U.S. & Canada Aug employt report
- September 4 – Hungary & Romania Q2 GDP
- September 4 – Finland Q2 GDP (2nd estimate)
- September 4 – Russia August CPI
- September 4 – Eurozone August retail PMI
- September 7 – Ukraine August CPI
- September 7 – Germany July IP
- September 7 – South Africa & Egypt Aug int reserves
- September 8 – Russia Q2 GDP (2nd estimate)
- September 8 – Hungary & Turkey July IP



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