Euler Hermes Economic Research

Weekly Export Risk Outlook

29 October 2015

In the Headlines

FIGURE OF THE WEEK

+0.5%

UK Q3 q/q GDP growth

U.S.: Mixed signals on likelihood of monetary tightening

Real GDP increased at an annualised rate of +1.5% q/q in Q3, compared with +3.9% in Q2. Consumption was up +3.2% and, after stripping out inventories, GDP increased by +3%. Investment contracted by a sharp -5.6%, while core inflation increased by only +1.3% annualised. As expected, the Federal Reserve announced that the Fed Funds rate was left unchanged at 0%. The accompanying statement had a subtle mix of slightly more hawkish and dovish changes but a more significant change was that the Fed explicitly mentioned the “next meeting” as a potential time for liftoff, a possibility markets had heavily discounted beforehand. Even so, other recent data have been weak. Consumer confidence dropped -5 points to 97.6, with respondents indicating that there were fewer jobs available and that they were harder to get. Durable goods orders fell -1.2% m/m, the second consecutive loss, and by -3% y/y. Orders for non-defence capital goods (ex-aircraft) also fell for a second month and contracted by -7.3% y/y. Housing data were mixed in September as existing home sales increased by +4.7% m/m while new home sales, likely affected by a +13.5% y/y price increase, dropped -11.5%.

UK: Slowdown, despite growth in services

In Q3, GDP growth slowed to +0.5% q/q from +0.7% in Q2, in line with our forecast but below consensus expectations. The slowdown was driven largely by the construction sector (-2.2% q/q) and the manufacturing sector (-0.3% q/q). Activity in the services sector increased by +0.7% q/q (compared with +0.6% in Q2) and contributed +0.6pps to GDP growth, mainly because of a pick-up in financial services. The GDP breakdown will be published on 11 November. We expect consumer spending will have remained the main driver of growth in Q3, reflecting advances in real wages and a recovery in the labour market (unemployment, at 5.4%, is at its lowest level since mid-2008 equivalent to a +140,000 increase in employment). GDP growth is expected to be +2.4% in 2015 but slow to +2.2% in 2016. We expect the Bank of England will increase interest rates in Q2 2016, for the first time since 2008, but uncertainty related to the referendum on EU membership remains a key downside risk to the economy and delays in monetary policy tightening are likely.

South Korea: One-off boost or clear signal?

Preliminary data suggest that GDP growth accelerated to +1.2% q/q in Q3 (+0.3% in Q2). Domestic demand was the main driver, with government expenditure (+1.9% q/q), investment (+2.9%) and private consumption (+1.1%) rebounding sharply. This upturn reflects cyclical factors rather than structural trends. In particular, consumption recovered as risks of the Middle East Respiratory Syndrome virus faded. Investment and public spending increased as a result of a stimulus package deployed by the government. Going forward, economic fundamentals are improving but do not point to a strong and sustained recovery. On the demand side, low export growth and weak new manufacturing orders continue to weigh on the outlook. Producer prices extended their decline in September (-4.5% y/y) suggesting further pressure on corporate margins. Financing conditions remain positive as the Central Bank is still in accommodative mode, with a low policy rate (1.5%) and prospect of a further rate cut if demand shows clear signs of weakness in the coming months.

Eurozone: Not so bad, but not great either

October PMI for both manufacturing output (53.3, unchanged) and services (54.2, up from 53.7) suggest activity will continue to expand at a moderate pace in the coming months. However, momentum in the manufacturing sector softened, with the orders-to-inventory ratio at the lowest level in nine months. Downside pressures on company turnover are not over as selling prices of goods were reduced for a second consecutive month in an attempt to boost sales. The **German** Composite PMI increased to a two-month high but the manufacturing sector weakened because of softer new export orders, mainly from Russia and China. In **France**, the Composite index improved to a four-month high (52.2), reflecting advances in both manufacturing and services. All this suggests that Eurozone GDP growth will be +0.4% q/q in Q4, a threshold difficult to surpass since H2 2014. With the boost from low oil prices/low EUR starting to fade, the ECB is expected to announce an increase in its QE programme size and duration (currently EUR60bn per month until September 2016) as soon as December.

Countries in Focus

Americas

Argentina: An air of change?

In last Sunday's presidential elections, Daniel Scioli of the ruling party, supported by the incumbent President Cristina Fernandez de Kirchner, received most votes but only led his rival Daniel Macri by a small margin. Recent polls had suggested an outright victory for Scioli in the first round but now a runoff will be held on 22 November, the first in the country's history. In addition, Sergio Massa, a dissident from the ruling party and critical of Kirchner's mandate that gathered around 14% of votes, decided not to support him in the second round. Against this background, most pollsters seem to indicate a potential victory for the outsider. If elected, Macri has vowed to dismantle capital controls and trade restrictions on his first day in office. He is perceived as more business-friendly and capable of negotiating with the debt holdouts. As a result, the election news was received positively by investors, with a clear rebound in the Merval stock exchange.

Europe

Poland: Parliamentary majority for eurosceptic PiS

The conservative Law and Justice Party (PiS) won a landslide in Sunday's legislative election, securing 37.6% of the vote and an outright majority in parliament (235 out of 460 seats). It is the first time since the transition to democracy in 1989 that a single party will be able to govern alone. Civic Platform (PO) and the Polish People's Party (PSL), which ruled in coalition for the last eight years, won 24.1% (138 seats) and 5.1% (16 seats), respectively. The forthcoming PiS government led by PM-designate Beata Szydlo will be more eurosceptic and is likely to lean more towards state interventionism than its predecessor. It also advocates fiscal loosening and has announced more welfare spending and some tax increases, although it intends to remain committed to the EU's fiscal rules. However, Euler Hermes does not expect any significant impact from the government change on the near-term economic outlook and continues to forecast GDP growth of around +3.3% in both 2015 and 2016.

Africa & Middle East

Sub-Saharan Africa: Poll dancing?

Since **Nigeria**'s successful elections and transfer of power in March, Africa's political progress has been chequered, as evidenced by events in **Burkina Faso** and the **CAR**. This week's tightly contested elections in **Tanzania**, with polls in Zanzibar annulled, engender more uncertainties and attempts to amend constitutions in several countries to allow incumbents to extend periods in power are also of concern. More positively, and after a recent record of electoral violence and instability, elections this week in **Côte d'Ivoire** were deemed free and fair and President Alassane Ouattara was re-elected for a second term (almost 84% of the vote). Côte d'Ivoire now has the prospect of regaining its status as an economic power in West Africa – the AfDB returned its HQ to the country in September 2014 - and EH expects GDP growth of around +7% in 2015 and 2016 (annual average +9% in 2012-14). As ever, commercial prospects in the wider region require careful consideration and selectivity.

Asia Pacific

China: Time for long-term solutions

The Central Bank eased monetary policy further last week as GDP growth fell below the +7% threshold. In particular, the one-year benchmark lending rate was cut by -25bps to 4.35% and the RRR reduced by -50bps to 17.5% for financial institutions (with an additional cut of -50bps for loans to rural areas, the agricultural sector and SMEs). The impact is likely to be positive in the short term as favourable credit conditions will boost demand growth. In the longer term, the rising debt burden will probably act as a drag if the authorities fail to enhance new growth drivers that are less credit intensive and with higher value-added content. In that respect, it is likely that the Party's 5th plenum will stress the need to move to quality GDP growth, including lowering expectations of expansion to +6.5% in 2016. More guidance on policies relating to business (including SOE reforms and financial liberalisation) and economic strategy - domestic (industry upgrade) and external (One Belt One Road) will be key.

What to watch

- October 30 – Austria, Latvia & Lithuania Q3 GDP (1st e.)
- October 30 – Russia interest rate decision
- October 30 – Turkey September trade balance
- October 30 – UK October GfK's consumer confidence
- October 30 – Germany September retail sales
- October 30 – France September consumer spending
- October 30 – Spain & Belgium Q3 GDP (preliminary)
- October 30 – UK October Lloyds business barometer
- November 01 – South Africa Sept. electricity output
- November 02 – EU October PMI
- November 03 – Turkey October CPI
- November 04 – Poland interest rate decision
- November 04 – Egypt October international reserves