Euler Hermes Economic Research

Weekly Export Risk Outlook

6 April March 2016

FIGURE OF THE WEEK

USD2tn

Saudi Arabia's planned sovereign wealth fund

In the Headlines

Saudi Arabia: Gulf stream?

Recent announcements outline the policy response to weak oil revenue.
Firstly, the part-privatisation of the state oil company, Saudi Aramco, will move ahead although only around 5% will be sold in an IPO in 2017 (or 2018). Saudi Aramco will become an industrial conglomerate, which could diversify into further downstream activities and non-oil and gas businesses.
Secondly, a mega sovereign wealth fund will be created of around an initial USD2tn. This could encapsulate existing funds including those controlled by SAMA and the Public Investment Fund. It will hold incomes from the privatizations of Saudi Aramco and some other state-controlled entities.
Thirdly, the country will not consider an oil output freeze unless other major producers (including Iran) similarly commit.
The announcements give evidence of a commitment to economic reform, including diversification away from oil. The new mega-fund centralizes the country's financial resources and is intended to show markets and analysts that those assets provide a cushion against even a protracted downturn.

Germany: Not so bad news

German industrial production fell by a less-than-expected -0.5% m/m in February after it had increased by a 4.5-year record high +2.3% m/m in January (revised down from a preliminary +3.3%). Moreover, in y/y terms, industrial production surged by +4.9% in February after a -1.3% decline in January, so that average industrial production growth picked up from +1.5% y/y in Q4 2015 to +1.8% in January-February. Both turnover and new orders in manufacturing showed a similar pattern at the start of this year – modest declines in m/m but strong rises in y/y terms. Likewise, real retail sales fell by -0.4% m/m in February (-0.1% in January) but rose by +5.4% y/y (-1.2%). Further, economic sentiment indicators such as the IFO, ZEW and GfK indices and PMIs have signaled stabilization or small improvements in March after some moderation in late 2015 or early 2016.
Overall, the latest high-frequency indicators support our expectation of a moderate acceleration of real GDP growth to +1.7% in 2016 (after +1.4% in 2015).

U.S.: Labor market strong, but Q1 GDP weak

Jobs rose by a strong +215,000 in March. Unemployment ticked up +0.1% m/m to 5.0%.
The labor force gained +396,000, the sixth consecutive increase, driving the participation rate up to 63.0% from a low of 62.4% in September. Wages rose +0.3% m/m but the y/y rate remained unchanged at +2.3%. The ISM non-manufacturing index gained +1.1 to 54.5 in March; only one component fell and only one is below 50. The ISM manufacturing index was also strong, rising above 50 for the first time since August, gaining +2.3 to 51.8. New orders rose a sharp +6.8 to 58.3 in February, nine of 10 components increased, and six of them are now above 50.
However, that report was contradicted by a loss of -29,000 manufacturing jobs in March, and by factory orders which fell -1.7% m/m in February to a -3.0% y/y rate. Further, the trade deficit widened from USD45.9bn to USD47.1bn in February, weighing on Q1 GDP.
While the labor market is strong, much recent data, especially personal consumption, suggests a weak Q1 GDP.

Emerging Markets: Spring buds in Asia

Some green shoots are evident throughout the emerging world, even if there are still divergences. An aggregate manufacturing PMI computed by Euler Hermes shows strong improvement in March, growing to 49.9 (best figure since February 2015) and not far from expansion territory.
Fear Factors are now well behind. Commodity prices stabilized, China growth worries are receding, and capital flows to emerging markets recovered. The main contributor: The Chinese industry's recovery (official PMI 50.2), felt across Asia Pacific where PMIs are also improving. In anticipation, some commodity prices (iron ore, oil) have rebounded, as demand is now expected to remain broadly stable. Emerging market currencies have benefited from this friendlier environment.
However, some commodity exporters (Brazil, Russia) still feel the pain of negative price shocks which have cut national savings and hurt private sector demand. A long-awaited recovery appears to finally come from China and its neighbors but has not spread everywhere.

Countries in Focus

Americas

Ecuador & Uruguay: Adverse external environment

Recent data releases for Q4 2015 GDP further illustrate the effect of the slump in commodity prices.
In **Ecuador**, where oil accounts for 50% of total exports, there was a sharp deceleration in economic activity in 2015: GDP expanded by only +0.3%, compared with +3.7% in 2014. We expect the economy to be in recession in 2016, reflecting significant fiscal consolidation and the USD appreciation's impact on export competitiveness.
In **Uruguay**, the economy continues to be adversely affected by low prices for agricultural produce and weaknesses in neighboring Brazil and Argentina. Real GDP increased by only +1% in 2015, after +3.2% the year before. Although sound fundamentals, including high foreign exchange reserves that provide import cover of around 18 months, will partly offset the adverse external environment, we expect the economy will remain relatively sluggish, with GDP growth of around +1.1% in 2016.

Europe

Cyprus: Successful exit from the bailout program

As expected, Cyprus recently exited the bailout program it had signed with the European Commission in 2013. Fiscal consolidation and debt restructuring since then, along with external positive developments such as Eurozone recovery and low oil prices, have helped the economy recover in 2015 with GDP growth at +1.6%, after three consecutive years of recession. In addition, the country recently issued bonds of short (3 years with a yield of 1.83%) to longer (8 years with a yield of 3.23%) maturity, thus providing enough resources to end the program without having to use its last tranche (EUR2.7bn). Yet to ensure a sustainable growth path for the country, some issues need to be tackled: non-performing loans still represent 39% of all Bank of Cyprus loans.
Going forward, we expect the Cypriot economy to gain momentum in 2016, with growth at +2.3%.

Africa & Middle East

South Africa: Court (dis)order

The Constitutional Court ruled that President Jacob Zuma failed to comply with constitutional requirements in relation to reimbursing non-security-related state spending on his private residence. The ruling ANC party acknowledged the judgment and Zuma will now pay back part of the money for the building upgrades. However, opposition parties and civil society groups again called for Zuma to step down or for the ANC to recall him (effectively removing him from the party leadership and therefore as head of state).
Impeachment proceedings are unlikely to be successful as the ANC still holds an outright parliamentary majority. One could expect, at the least, protests and associated bad publicity for the country. The latter is a major concern for the ANC at a time of controversy over perceived business influence in ministerial appointments and when rating agencies are considering further sovereign downgrades. All this adds to commercial uncertainties.

Asia Pacific

India: On Easing Mode

The Central Bank of India cut its policy rate (-25bp) to 6.5% and unveiled measures to enhance liquidity in the Banking sector. External economic conditions are weak with modest demand improvement in advanced economies, subdued demand growth in emerging markets and still difficult financing conditions. Domestically, inflationary pressures remain low (+5.2% y/y in February) and within authorities' targets band. The investment cycle is still fragile as reflected by the low level of capacity utilization (72.5). Credit growth did not improve sufficiently provided the stimulus unveiled by the central bank. Finally, the government's commitment to continue fiscal consolidation creates the need for further monetary easing.
Looking ahead, near-term indicators still point to firm growth. Both Nikkei/Markit Manufacturing and Services PMI increased in March to 52.4 and 54.3 respectively. We expect GDP growth to increase slightly to +7.6% in the fiscal year 2016-17 (from +7.5% in FY 2015-16).

What to watch

- April 07 – South Africa March international reserves
- April 07 – Spain February industrial production
- April 07 – Brazil March inflation
- April 07 – Mexico March inflation
- April 08 – Canada March housing starts
- April 08 – Canada March unemployment
- April 08 – UK February industrial production
- April 08 – France & UK February industrial production
- April 08 – France February industrial production
- April 08 – UK February industrial production
- April 11 – Kenya Q4 2015 GDP
- April 12 – UK March inflation (PPI, CPI)
- April 13 – US March producer inflation
- April 13 – US March retail sales

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