Euler Hermes Economic Research

Weekly Export Risk Outlook

19 September 2013

FIGURE OF THE WEEK

22

September date of German legislative elections

In the headlines

US: Fed delays tapering

Against market expectations, the Federal Reserve announcement yesterday did not include a start in its tapering of the quantitative easing (QE) programme. In justifying the decision, the Fed cited concerns over "tightening financial conditions" that could slow the economy, including an increase in mortgage interest rates. Fed Chairman Ben Bernanke also noted that "conditions in the job market today are still far from what all of us would like to see", including high unemployment and the falling labour force participation rate. Moreover, the Fed cited concerns relating to the ongoing budget cuts, the possibility of a government shutdown and the forthcoming debt ceiling debate. The Fed Funds rate was left unchanged at 0%-0.25%. Official forecasts for GDP growth have been lowered, with 2013 now expected within a range of 2%-2.3% (from 2.3%-2.6% in June) and 2014 at 2.9%-3.1% (from 3%-3.5% in June).

Germany: Merkel won't make it alone

Legislative elections will be held on 22 September. According to Forsa, a local pollster, voter intentions as at 17 September show that the centre-right party CDU/CSU is leading the polls (39%) and that the parties that are likely to obtain the minimum threshold required to enter the Bundestag (requirement of 5% of the total seats) are the centre-left party SPD (25%), the left party Die Linke (10%), the Greens (9%) and the liberal FDP (5%). Two options appear possible if the current coalition of CDU/CSU + FDP cannot continue because it no longer commands a majority. Firstly, a 'grand coalition' CDU/CSU + SPD can be formed and, secondly, a coalition CDU/CSU + Greens may be forged. In both options Merkel will remain as Chancellor. A 'grand coalition' could prove positive for Europe as the SPD is open to the idea of creating a fiscal union and to the mutualisation of debts (ERF), while it is in favour of balanced public finances but wants to preserve growth and jobs. At a national level, parties on the political left call for tax increases (income tax, introduction of a wealth tax and creation of a single public healthcare system) while the CDU opposes such ideas and promotes measures that support family tax-policy and pension increases for some social categories.

Eurozone: Busy roadmap for the banking union

On 12 September, the European Parliament approved the Single Supervisory Body (SSM) that will give the ECB direct supervisory powers over the largest banks (about 150). This allows the implementation of the SSM in H2 2014 and marks a positive move towards a banking union in Europe. Once the SSM is in operation, the European Stability Mechanism (ESM) will be able to recapitalise on a case-by-case basis (and under strict conditionality) insolvent banks (up to EUR60 billion out of EUR500 billion total financing capacity available for this purpose). Last Friday, the EU-28 Finance Ministers (Ecofin) discussed the other pillar of the banking union, the common resolution scheme. The Single Resolution Mechanism (SRM) was proposed by the European Commission in July and will now have to get final approval from the European Council and the European Parliament. This sits alongside the Bank Recovery and Resolution Directive (BRRD) proposed last year that aims to create a framework for orderly banking resolution. The goal is to implement both SRM and BRRD by January 2015 (and to vote on them by May 2014, before the European elections), but negotiations continue to be difficult. Indeed, the European Commission suggests that the bail-in provision (covering banks' losses through shareholders, subordinated creditors and unsecured bondholders) and the Single Bank Resolution Fund should be operational as soon as 2016, although some want a delay until 2018. The next key dates are the 14-15 October and 22-23 November Ecofin meetings and the 24-25 November and 19-20 December European Council meetings.

France: Confirmation of fiscal slippage

The government revised upwards its forecast for the budget deficit this year, with -4.1% of GDP now projected, compared with -3.7% in an announcement in April. The official forecast of -3.6% for 2014 remains unchanged. The revised 2013 forecast reflects the impact of the sluggish economic outlook on fiscal revenue generation, but also an amendment to the country's financial contribution to the European Union. EH expects the fiscal deficit to improve to -4.3% of GDP in 2013 from -4.8% in 2012, and decrease moderately to -4.1% in 2014, partly reflecting continuation of a low growth environment.

Countries in Focus

Americas

Latin America: Still focused on the US short-term outlook

Since the first hint of Fed QE tapering in May 2013, several regional exchange rates have been volatile. Between May and August, the Brazilian BRL depreciated by 14.35%, the Chilean CHP by 7.87%, the Argentinian ARS by 7.63% and the Mexican MXN by 5.52%. Likewise, stock markets were generally down, with benchmark indices losing 13.6% in Chile, 6.4% in Brazil and 6.1% in Mexico. This financial and currency volatility reflects weak fundamentals, including persistent current account deficits in Brazil, Chile and Mexico and weak foreign reserves and import cover in Argentina, Venezuela and Chile. Recent US data have reversed some of the negative trend, as they lowered Fed tapering expectations (see US above). The return of net inflows to emerging markets and the modest bounce in some currencies in early September suggest an improvement in regional financial and exchange rate stability, but investors and markets will continue to monitor Fed decisions.

Europe

Hungary: Gradually emerging from recession

The economy moved out of recession in Q2 as real GDP increased by +0.5% y/y, the first y/y expansion after five quarters of decline (-0.9% in Q1). In q/q seasonally-adjusted terms, Q2 GDP increased by +0.1%, after +0.6% in Q1. All major demand-side sub-components of GDP expanded in Q2. Household consumption was up by +0.3% y/y, government consumption by +0.6% and fixed capital formation by +4.9%, the first increase since Q4 2008, which was supported by strong state-backed and EU-funded investment activity. Exports increased by +3% y/y in Q2 and imports by +4.7%, so net exports made a negative contribution to overall Q2 growth. As a result of a negative carry over from 2012, EH expects full year GDP growth of just +0.2% in 2013, followed by around +1% in 2014. The HUF has been relatively stable since the beginning of 2013, avoiding the recent emerging market sell-off as Hungary was not a target of foreign capital inflows in previous years.

Africa & Middle East

Rwanda: Elections unlikely to change outlook

The ruling coalition led by the RPF won yesterday's parliamentary elections, with expected ease. This partly reflects the absence of an effective political opposition but also perceptions that the country's leadership is strong and that the economy, spurred by inward foreign investment, is doing well. Policy direction is unlikely to change in the short term, particularly as a five-year plan (Economic Development and Poverty Reduction Strategy) was recently unveiled, promoting private sector development and projecting annual GDP growth of +11.5% in 2013-18. That target appears ambitious but an annual average +8.1% was recorded in the previous five-year plan. Nevertheless, some obstacles will have to be overcome and these include international concern relating to Rwanda's alleged direct involvement in the conflict in DR Congo, with some aid agencies limiting disbursements to Rwanda. EH expects GDP growth of +7% in 2013 and +7.5% in 2014.

Asia Pacific

Malaysia: Weakening external demand, moderate depreciation

Q2 real GDP growth edged up to +4.3% y/y from +4.1% in Q1. Domestic demand remained the growth driver as private consumption expanded by +7.2% (+7.5% in Q1) and government spending surged by +11.1% (+0.1% in Q1), thereby more than compensating for the moderation in fixed investment growth to +6% (+13.1% in Q1). External trade activity weakened further and the contribution of net exports to Q2 growth was again negative as exports contracted by -5.2% y/y (-0.6% in Q1) while imports declined by -2% (+3.6% in Q1). EH expects full year GDP growth of around +4.4% in 2013. The MYR depreciated by 7.5% against the USD during the emerging market sell-off in May-August. However, a currency crisis is not on the horizon as the central bank has ample foreign exchange reserves, standing at USD135 billion at end-August, which is sufficient to cover around 6.5 months of imports or more than twice all external debt payments due within the next 12 months.

What to watch

- September 19 – Japan July all industry activity index
- September 19 – US Q2 current account
- September 19 – US August leading indicator
- September 19 – US August existing home sales
- September 19 – UK August retail sales
- September 19 – South Africa interest rate decision
- September 19 – Ireland Q2 GDP
- September 20 – Canada August CPI
- September 20 – Germany August retail sales
- September 20 – EC September consumer confidence
- September 22 – Germany parliamentary elections
- September 23 – EZ September PMI (preliminary)
- September 24 – France budget goes to Parliament

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