

FIGURE
OF THE WEEK

311

Seats won by the
CDU/CSU in
Germany's
legislative polls

In the headlines



US: Risk of partial government shutdown

After last week's Fed decision not to taper its quantitative easing programmes, four regional Fed bank presidents gave speeches relating to the decision. The strongest evidence indicates that, given an anaemic economy and a precarious fiscal situation, tapering is also unlikely in October. Perhaps seeing the same weak economy as the Fed, consumer confidence fell slightly in September from 81.8 to 79.7, well below a level indicating even a stable economy. Existing home sales did rise 1.7% m/m in August, but the National Association of Realtors said future sales might be "uneven", given rising mortgage rates. Existing home prices have fallen for two consecutive months, while another measure, the Case-Shiller index, showed prices rising in July, but at the slowest pace in 10 months. A limited government shutdown looms next Tuesday unless Democrats and Republicans can agree on spending priorities, including controversial funding for Obamacare, and shutdowns have happened before.



Germany: Merkel triumphs but needs new coalition partner

Angela Merkel and her centre-right CDU/CSU won a resounding victory in the parliamentary election held last Sunday, gaining 41.5% of the vote (up +7.7pps from 2009) but, with 311 out of 630 seats, just missed gaining an absolute majority. Moreover, a coalition partner, the liberal FDP and for the first time in its history, failed to enter the Bundestag (with 4.8% of the votes, below the 5% threshold). Other parties represented in the new Bundestag will be the centre-left SPD (25.7%, 192 seats), the Greens (8.4%, 63 seats) and the left-wing Die Linke (8.6%, 64 seats). The euro-sceptic and anti-bailout party AfD, founded just seven months ago, received a noteworthy 4.7% of the vote. Based on the results, several coalitions are now possible. A grand coalition of CDU/CSU and SPD is the most likely but negotiations will be difficult as the SPD will be wary of a repeat of a loss in popularity during its membership of the last grand coalition (2005-2009). Another possibility is a coalition of CDU/CSU and the Greens. A coalition of the SPD, Greens and Die Linke is also possible, theoretically, although the first two of these have ruled out such an option definitively for this legislature. Expect lengthy coalition talks – formation of the 2005 grand coalition took about two months.



Eurozone: Business surveys suggest stabilisation in Q3

The composite PMI increased to a 27-month high in September (to 52.1) suggesting modest expansion in activity for the third consecutive month. The PMI for manufacturing output deteriorated somewhat but continued in expansionary territory (52.1). Improving prospects for demand are indicated by rising new orders and new export orders, for the third consecutive month. The services PMI in September was 52.1, a 27-month high, and registered its fastest rate of expansion since June 2011. Positively, expectations about activity in one year's time also improved significantly, to a one-and-a-half year high. Germany continues to record improvements in business activity, with its composite PMI at 53.8, in expansionary territory for the fifth consecutive month (with manufacturing at 52.7 and services at 54.4) but France continues to struggle, notably in manufacturing. Indeed, France's manufacturing output PMI deteriorated further (to 47.8, a four-month low). Even so, an increase in the services PMI to a 20-month high (50.7) brought the French composite PMI into expansionary territory for the first time since early-2012. Overall, business confidence surveys suggest Eurozone GDP growth of 0%-0.2% q/q in Q3.



China: Sun rising again?

The latest flash China Manufacturing Gauge, HSBC's index PMI, increased to a six-month high at 51.2 (50.1 last month) beating the consensus projection of 50.9. With the exception of employment (below the 50 threshold, but rising), all the main components of the survey are positive. In particular, new orders (domestic and export) increased suggesting that economic prospects are favourable going forward. This improvement in business sentiment is in line with other data released recently. Indeed, exports increased by +7.2% y/y in August, retail sales rose +11.6% y/y in September and industrial production increased by +10.4% y/y. However, it remains too early to forecast a strong recovery. According to market surveys, inventories of goods increased in September after two months of decrease. There is a risk that supply again overshoots demand in the coming months. EH expects GDP growth of +7.4% in 2013, compared with +7.7% in 2012.



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Countries in Focus

Americas

Latin America: Strong GDP in Q2

In Q2, GDP growth in **Brazil** accelerated to +3.3% y/y (after +1.9% in Q1), driven largely by strong investment (+9%) and by exports (+6.3%) while consumer spending remained weak (+2.3%). Economic activity also improved strongly in **Argentina**, as GDP increased by +8.3% y/y in Q2 (after +3% in Q1), reflecting strong domestic demand. Consumer spending increased by 9.2% y/y, government spending increased by 8.6% and investment by 16.2%, whereas net exports contributed negatively as exports grew moderately (+4.4%) but imports increased sharply (+21.3%). **Colombia** also surprised positively, with GDP growth of +4.2% y/y, after +2.7% in Q1. Both internal and external demand were drivers of growth in Q2, with private consumption increasing by +4.4% y/y, government spending by +5%, investment by +4.2% and exports by +7.6%. EH expects GDP growth in 2013 of +2.2% in **Brazil**, +1.8% in **Argentina** and +3.1% in **Colombia**.

Europe

Croatia: Economy remains in recession, decline slowed in Q2

Q2 marked the seventh consecutive quarter of contraction, but the decline in real GDP slowed to -0.7% y/y, after -1.5% in Q1 and -2% in full year 2012. All demand-side components returned to growth, with improving domestic demand mitigating the negative contribution from net exports. Private consumption expanded by +0.5% y/y in Q2, government consumption by +1.3% and investment by +0.9%. Exports increased by +0.8% y/y but were outpaced by import growth of +4.9%. Going forward, the sharp decline in industrial production by -4.1% y/y in July, after an average -0.8% y/y in H1, suggests that the end of the recession is unlikely to emerge in Q3 and will become apparent in the following two quarters. EH forecasts full year GDP will contract by -0.5% in 2013, before growth of around +1% in 2014. Meanwhile, last week, Fitch became the last of the major ratings agencies to move Croatia into speculative grade, downgrading its long-term sovereign rating to BB+ from BBB-.

Africa & Middle East

Kenya: Terrorist attack

The terrorist attack on a shopping mall in Nairobi that killed 67 people (expect the death toll to rise) is claimed to be the work of al-Shabaab, an extremist Islamic movement with a base in Somalia and previous links with al-Qaida. Kenya, which also has its own domestic militant Islamic groups, was the target of a high-profile bombing campaign in 1998, when multiple deaths were recorded around the US embassy. Terrorist groups will continue to attack African targets (Algeria, Nigeria and Mali have all been affected this year) even with tighter security. The Kenyan attack will have short-term adverse economic effects, principally through reduced tourism, but may act to solidify governance around President Kenyatta, who lost family members in this attack, and bring social cohesion around a common enemy. This, together with reconstruction work and international support, may have positive outcomes in the longer term. EH still expects GDP growth of +4.5% in 2013 and +5% in 2014.

Asia Pacific

Vietnam: GDP growth remains buoyant, but below target

Real GDP growth increased +5.1% in the first three quarters of this year from a year earlier, compared with +4.7% for the corresponding period of last year. Economic activity was driven largely by the service sector (+6.25% y/y) followed by the construction industry (+5.02% y/y). On the demand side, the breakdown is not yet available. However, the latest data suggest a positive contribution will be provided by exports (+16% y/y in the first eight months). Decelerating inflation in September (6.3% y/y from 7.5% in August) and a cut in key interest rates by the Central Bank (refinancing rate to 7% from 8% and discount rate to 5% from 6%, both in May) are likely to have helped domestic demand, which has been dampened by a generally weak banking sector which impairs credit growth. Against this background, EH expects GDP growth of +5.1% in 2013, compared with the official target figure of +5.5%.

What to watch

- September 26 – Brazil August unemployment
- September 26 – UK Q2 GDP (final)
- September 26 – Czech Rep monetary policy meeting
- September 26 – US Q2 GDP (final)
- September 27 – Brazil August budget
- September 27 – Spain cabinet to approve 2014 budget
- September 27 – EC business and consumer surveys
- September 27 – France Q2 GDP (final)
- September 29 – Austria legislative elections
- September 29 – Portugal municipal elections
- September 29 – Greece 5th review of 2nd adj prog
- September 30 – Cameroon legislative elections
- October 2 – ECB meeting
- October 2 – EU-27 PMI business surveys

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