

FIGURE  
OF THE WEEK

Mid-2014

Expected  
tapering of  
the Fed QE  
program

## In the headlines



### Eurozone: Credit conditions for firms are less (but still) tight

The ECB Bank Lending Survey for Q3 revealed that credit conditions remain tight for eurozone firms, albeit to a lesser extent compared to Q2. The lack of credit is likely to undermine the recovery over the next few quarters. On the supply side, banks reported that borrowers' credit risk and macroeconomic uncertainty are the main drags on their lending policy. On the demand side, fixed investment continues to be the main negative contributor (albeit to a lesser extent) to firms' loan demand. Indeed, firms continue to prefer alternative sources of finance (internal financing and debt issuance) to bank loans. Going forward, banks expect a slight easing of credit standards on loans to firms, for the first time since Q4 2009. The ECB will launch in the coming weeks a review on the asset quality and liquidity positions (in collaboration with the EBA) of more than 100 eurozone financial institutions, before taking over its role of Single Supervisory Body in November 2014. Results will be published in October 2014. At this date, the European leaders are supposed to have found an agreement on the Single Resolution Mechanism, the second pillar of the banking union, aiming to create a framework for orderly banking resolution at the national level and avoid a vicious cycle between banks and sovereign.



### US: Weak recent data further delays QE tapering

Industrial production rose 0.6% in September but most of it was due to increased utility production from cold weather; manufacturing production rose only 0.1%. Pending home sales, which lead existing home sales by 1-2 months fell a sharp 5.6% in September, the fourth consecutive drop. Retail sales fell 0.1%, dragged down by a 2.2% drop in auto sales which have otherwise been strong this year. Stripping out the volatile auto and gasoline components, retail sales grew 0.4%, the same as the long-term average. The Case-Shiller Home Price Index rose 0.9% in August and is now up 12.8% y/y vs. a long term average of 3.4%. October consumer confidence was damaged by events in Washington and plunged 9.0 points from 80.2 to 71.2. The generally weak tone of the recent data, especially last week's employment report means that the Fed is unlikely to start tapering its QE programs until well into 2014.



### China: 8 key medium-term reforms on the agenda

The Development Research Center, a top government think tank, unveiled a set of propositions to be discussed during the 3rd Plenary Session of the 18th Communist Party Congress, expected mid-November. At this stage, only some extracts of the reform project are available. Eight areas are targeted: (1) *Governance* should be enhanced with an improvement in government effectiveness and a fight against corruption. (2) Some markets like railways, electricity and telecom should be more opened to *competition*. (3) *Land property rights* should be reinforced. (4) *Financial market liberalization* should continue with less State interventionism, marketization of interest rates and exchange rates. (5) *Public finances* will be reformed to be more redistributive, more transparent and more efficient. (6) The role of the *State owned Enterprises* should be optimized. (7) *Innovation* and *investment in green economy* must be favored. (8) *International cooperation*, especially in the region, has to be strengthened through free trade areas.



### United Kingdom: Positive surprises to continue

GDP increased by 0.8% q/q in Q3, the third consecutive quarter of positive growth. On the supply side, output increased in all four main industrial sectors. Services had the largest contribution to output (+0.57pp), now 0.4% above its pre-crisis peak, followed by construction (+0.15pp). On the demand side, the breakdown will be published on November 27. Given the strong performance of retail sales in Q3 (+1.5% q/q, the highest rise since mid-2006) and the improvement in consumer confidence (at its highest level since 2010), private consumption is likely to have had one of the strongest contributions to Q3 GDP. Investment is also likely to have led GDP growth in Q3 as business confidence has been continuously rising since last April and the fiscal environment remains business friendly. The policy mix is set to remain favorable with slowing fiscal consolidation and accommodative monetary policy into 2014 and 2015. The Bank of England announced several non-conventional measures (to enter into force in 2014) aiming to provide liquidity to banks, even after the end of the QE program. In this context, EH revised upwards its GDP growth forecasts: to 1.3% in 2013 (from +1.1%) and to +2.1% in 2014 (from +1.6%), but remains slightly below consensus.

# Countries in Focus

## Americas



### Argentina: Opposition gaining momentum

After a decade of family rule in Argentina, the midterm elections held on the 27th of October gave new momentum to the opposition. The Renewal Front party, led by Sergio Massa, won against President Cristina Fernández, of the Front for Victory. The Constitution now blocks Mrs. Kirchner from running for a third consecutive term. Mr. Massa is expected to start building up for a presidential bid in 2015 by gradually fracturing Mrs. Kirchner's Peronist support structure. One important issue to tackle is the legal fight with hold-out creditors over the restructuring of Argentina's 2001 sovereign default in US courts. If Argentina gets an unfavorable ruling, it could file a new Supreme Court appeal. President Kirchner suggested in August that the country could swap existing debt, which has been issued under New York law, into debt which would be issued under local law. That way, the government would be able to continue to pay these debt holders, though it will leave debt holders at the mercy of the Argentine judicial system. The legal fight could continue for months or even years. However, it could result in a new (technical) default, which could further restrict Argentina's already limited access to foreign finance.

## Europe



### Czech Republic: Election results in fragmented political scene

The legislative election held on 25-26 October proved to be a protest vote against traditional parties as many dissatisfied voters turned to political newcomers. The social democratic CSSD won the poll (20.5% of the vote; 50 out of 200 seats) but this was its lowest voter support since the formation of the country in 1993. Newcomer ANO (Action of Dissatisfied Citizens) came in second (18.7%, 47 seats), followed by the communist KSCM (14.9%, 33 seats). The former ruling centre-right parties TOP09 (12%, 26 seats) and ODS (7.7%, 16 seats) suffered particularly heavy defeats as they were down from 41 and 53 seats in the 2010 election, respectively. Two other newcomers complete the parliament: Usvit (6.9%, 14 seats) and KDU-CSL (6.8%, 14 seats). Expect negotiations for the formation of the next government to be lengthy – especially as the CSSD is also facing internal splits – with ANO possibly playing a kingmaker role. The Czech Republic's history of unstable coalition governments is likely to continue.

## Africa & Middle East



### South Africa: Medium-Term Budget Policy Statement

Last week, Finance Minister Pravin Gordhan delivered an updated Medium-Term Budget Policy Statement (MTBPS) that projects a fiscal deficit of -4.2% of GDP for FY2013/14 (-4.6% was forecast in the February annual budget) and improvements thereafter, with a deficit of -3% in 2016/17. The Treasury forecast for overall GDP growth is now +2.1% in 2013 (down from +2.7% in the budget) and +3% in 2014 (3.5%), so an improved fiscal balance will need to be driven largely by more efficient revenue generation and expenditure consolidation rather than organic growth in tax and other receipts. EH expects that the message of fiscal discipline, combined with low external debt obligations, will keep sovereign ratings stable. However, capped state spending means that structural rigidities (including high unemployment, rural poverty, skewed income distribution and weak education provision) are unlikely to receive sufficient corrective attention.

## Asia Pacific



### Japan: Positive data from both demand and supply side

In September, industrial production rose by +1.5% m/m, after declining by -0.9% m/m in August. This increase was driven by production of communication equipment (+4.9%), electronic devices (+4.7%) and transportation equipment (+3.9%) while production of electronic and general machinery decreased (respectively by -0.6% and -2.6%). In parallel, vehicle production increased by +13% y/y in September, the first increase in a year. Advanced indicators for the demand side also showed positive signs. Retail sales increased by +1.8% m/m (after rising by 0.9% m/m in August) and overall household spending was up by 1.6% (after declining by -0.5%). Moreover, the unemployment rate decreased slightly in September (0.1pp to 4.0%). Private consumption is expected to gain further momentum until the rise of the VAT rate in April 2014. All in all, EH expects Japanese economic activity to remain dynamic in 2013 (GDP growth at 2.0%) before slightly slowing down in 2014 (1.5%).

## What to watch

- October 31 – Spain September industrial production  
France September consumer spending  
Eurozone September unemployment rate  
Canada Q3 GDP
- November 1 – US October Manufacturing ISM  
EU-27 October Manufacturing PMI  
BRIC October Manufacturing PMI
- November 5 – Indonesia Q3 GDP  
Romania Monetary Policy Decision  
Poland Monetary Policy Decision
- November 6 – UK September industrial production  
Eurozone September retail sales  
German factory orders

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