Euler Hermes Economic Research

Weekly Export Risk Outlook

5 March 2014

In the Headlines

FIGURE OF THE WEEK

+2.4%

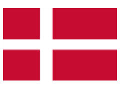
US q/q annualised Q4 2013 GDP growth (↓ revision)


Ukraine & Russia: Crimea crisis and spillover effects

Over the last week, the political crisis in Ukraine escalated into a conflict with Russia. The new government in Kiev is not one of national unity as it comprises only former opposition parties but not the former ruling Party of Regions. As a result, it has limited connection with Ukraine's Russian-speaking east where tensions increased between supporters of the new government and pro-Moscow protesters. The latter occupied parliament buildings and airports in the Crimea province and, over the weekend, Russian troops effectively took control of the peninsula. The US and the EU strongly condemned the Russian military intervention and may consider sanctions. In a statement on 3 March, President Putin indicated that he does not want war but stressed that Russia retained the right to use military force in Ukraine in defence of ethnic Russians and Russian speakers in the east. Triggers for further escalation therefore remain. There are considerable negative economic implications of the Crimea crisis and these will increase in line with the severity of the conflict. In **Ukraine**, the ongoing economic crisis and recession will deepen, perhaps exacerbated by a (temporary) cut-off in Russian gas supplies. Downward pressure on the UAH will increase (the UAH lost 25% against the USD since it floated on 7 February and half of that was over the past week). The risk of sovereign default has increased further. In **Russia**, financial markets were immediately hit by the Crimea crisis, with the RUB falling to an all-time low against the USD and stock markets tumbling on 3 March, despite the 150bps hike in the central bank's key policy interest rate to 7%. Going forward, downward pressure on the RUB will strengthen, adversely affecting consumer spending (via rising inflation and costlier imports) and posing problems for many companies that are heavily indebted in foreign exchange. Moreover, capital outflows will intensify as foreign investors will be more wary of Russian assets, thereby slowing investment and economic activity. Western economic sanctions against Russia, if imposed, could exacerbate the situation, although effective sanctions are unlikely to be implemented in the near term. Overall, the Russian economy, already close to stagnation (GDP increased by just +1.3% in 2013), could slide into recession. **Worldwide**, net importers of grains and energy may experience spillover effects from the crisis as prices for these goods are likely to rise. Higher gas prices and a disruption to gas transit volumes from Russia via Ukraine are likely to weigh on **Europe,** in particular, as it receives 30% of its total gas consumption from Russia.

US: Large downward revision in GDP growth

GDP growth in Q4 2013 was revised down sharply, to +2.4% q/q annualised (from an earlier figure of +3.2%) with consumption revised down to +2.6% from +3.3%. Real disposable personal income and personal consumption expenditures both increased by +0.3% in January, although the former was flat in the three months ending in January compared with the preceding three-month period. Housing data continue to be highly erratic as new home sales increased by 9.6% m/m in January, the highest level in the recovery. Given recent extreme weather, the data prompts some questions. The pending home sales index was up only 0.1% m/m in January, but it was the first increase since June 2013 when the index was 17% higher. More positively, there was a rebound in the ISM manufacturing index in February, to 53.2 from 51.3 in January (there had been a sharp 5.2 point drop in that month). New orders also increased, to 54.5 from 51.2. Auto sales may be poised for a spring rebound, given that volumes remained stagnant at around 15.3 million annual units in the three months ending in February.



Nordics: High intra-regional divergence

Q4 2013 GDP data continue to indicate a marked regional divergence, with GDP in Sweden and Norway above pre-crisis levels while Finland and Denmark continue to be laggards. In **Sweden**, GDP growth continued to recover in 2013 (+1.5%) reflecting resilient domestic demand that offset trade weakness due to a strong SEK. The positive trend is likely to continue: +2.4% in 2014 and +2.8% in 2015. In contrast, the ongoing household deleveraging in **Denmark** was a drag on private consumption, which fell to its 2009 lows. This restrained firms from expanding investment (+0.8% over the whole year). The DKK peg to the EUR dampened corporate competitiveness and limited export growth. As a result, GDP growth is likely to remain moderate at +1.2% in 2014 and +1.4% in 2015. Significant losses in global export market share in recent years have been registered in **Finland** and a period of industrial restructuring is currently ongoing. This was a drag on GDP that contracted for the second consecutive year in 2013 (-1.4%). It remains 6% below the Q1 2008 peak and growth is likely to remain subdued at +0.4% in 2014 and +1.4% in 2015, reflecting weak domestic demand.

Countries in Focus

Americas

Mexico: Real activity slowed at the end of 2013

Real GDP growth slowed sharply in Q4 2013 (+0.2% q/q in seasonally-adjusted terms, after +0.9% in Q3), resulting in expansion of +1.3% for 2013 as a whole, the slowest pace since 2009. The slowdown in real activity reflects still fragile domestic demand, as well as weakness in the construction and manufacturing sectors. This situation is likely to have continued in Q1 as consumer and business confidence remain weak, although the economy is expected to gain momentum later in the year. The improvement is likely to arise through two areas: (i) exports will benefit from recent MXN depreciation and from recovery in the US economy and (ii) implementation of recent structural reforms (including in the energy sector, labour markets and tax system) will strengthen domestic demand as a result of improvements in business and consumer confidence. EH expects GDP growth of +3.3% in 2014 and +3.9% in 2015.

Europe

Switzerland, Slovenia & Croatia: Q4 2013 real GDP growth

In **Switzerland**, surging imports led to a slowdown in Q4 2013 GDP growth; +0.2% q/q (+0.5% in Q3) and +1.7% y/y (+2.1%). In 2013 as a whole, GDP increased by +2% (+1% in 2012) mainly driven by private and public consumption (+1.3pps and +0.3pps) and investment (+0.3pps) while net exports made only a small contribution (+0.1pps). EH forecasts GDP growth of +2.2% in 2014, with private consumption remaining robust and exports benefiting from the European recovery. **Slovenia** moved out of recession in Q4, with GDP growth of +2.1% y/y, after eight consecutive quarters of decline, reflecting a surprise surge in investment (+5.9% y/y), strong inventory restocking (+2.2pps) and the conclusion of a slide in consumer spending. EH expects growth of +0.4% in 2014, following -1.1% in 2013. In **Croatia**, the recession continued, with Q4 GDP down by -1.2% y/y, making 2013 the fifth full year of contraction (-1%). EH expects a return to modest growth of +0.5% in 2014.

Africa & Middle East

South Africa: Fiscal prudence

Last week's budget continued the country's recent record of generally sound fiscal management, despite a temptation for budgetary expansionism in an election year. Indeed, the budget deficit is projected to fall to -2.8% of GDP in FY2016/17 (-4% in 2013/14 and also in 2014/15) and government debt will stabilise at 44.3% of GDP. Meanwhile, Q4 2013 GDP growth rebounded to +3.8% q/q annualised (+0.5% in Q3), boosted by manufacturing output (+1.9pps contribution) and mining (+0.8pps) and the PMI for February moved above the break-even point, at 51.7 after 49.9 in January. However, with monetary policy tightening to protect the ZAR and international reserves and fraught labour relations restricting output growth in some key sectors, particularly mining, GDP is unlikely to achieve rates of expansion of +5% or above that are considered necessary to assist socio-development needs. EH expects GDP growth of +2.8% in 2014 and +3.5% in 2015.

Asia Pacific

Australia: Moderate growth of +2.8% forecast for 2014

GDP growth accelerated to +0.8% q/q in Q4 2013 (from +0.6% in Q3) and took full year growth to +2.4% (from +3.6% in 2012). For the second consecutive quarter, net exports remained the main growth engine, with a contribution to overall GDP of +0.6pps. On the domestic front, final consumption expenditures were supportive (+0.5pps) but their effects were somewhat offset by investment (-0.3pps). Indeed, mining investment, which had been a key engine of growth (7.7% of GDP) continued to decelerate and the non-mining sector failed to compensate. Against this background, the economy is expected to expand at only a moderate pace, with a rebalancing away from mining. In particular, GDP growth is projected to remain below the long-term average of +3.3% at +2.8% in 2014, limited by a cautious fiscal policy stance, a fall in mining projects and lower demand from China (+7.5% in 2014).

What to watch

- March 6 – Eurozone March ECB interest rate
- March 6 – UK March BoE interest rate
- March 6 – Egypt February international reserves
- March 7 – Canada February unemployment
- March 7 – South Africa February international reserves
- March 7 – Germany January industrial production
- March 7 – Japan January leading indicator
- March 7 – US February employment report
- March 10-11 – Eurogroup/Ecofin meetings
- March 11 – Portugal Q4 2013 GDP (2nd estimate)
- March 11 – Italy Q4 2013 GDP (2nd estimate)
- March 11 – Mauritius Q4 2013 GDP