Euler Hermes Economic Research

Weekly Export Risk Outlook

12 March 2014

FIGURE OF THE WEEK

16

March date of the independence referendum in Crimea

In the Headlines

Ukraine & Russia: Crimea crisis intensifies

On 6 March, Crimea's local parliament asked to be assimilated into Russia and set a referendum for 16 March. Russia pledged support to the region if it votes to leave Ukraine. Tens of thousands of people have held rival pro-unity and pro-Russian rallies across Ukraine, with eastern and southern parts of the country facing increased risk of violence as the referendum approaches. While the Ukrainian economy remains highly vulnerable to the outcome of the standoff, the interim government in **Ukraine** made progress towards securing external financial support and this has stabilised financial markets, for now. The EU unveiled an EUR11 billion bailout package to be disbursed over two years, which adds to aid from the US (USD1 billion), the EBRD (EUR5 billion by 2020) and the World Bank (USD3 billion in 2014). However, only USD3 billion from the EU and the US will be available immediately for budget financing while most of the EU package will be contingent on a new deal with the IMF. A Fund mission is already in the country but agreement on a funding programme – which will certainly include politically difficult, unpopular and painful economic reforms – is not expected before the presidential election scheduled for 25 May. The interim government now has two months to prepare a roadmap of austerity measures to ensure that the EU and IMF bailout packages can start being implemented by June. Even if this works out, implementation risk will remain as a threat to the economy. Meanwhile, foreign exchange reserves have continued to fall, to USD13.7 billion at end-February (down 15% from end-January and 27% year-to-date) and now cover just 1.6 months of imports. The government's debt-servicing obligations are far larger – current estimates suggest perhaps USD35 billion in the period to end-2015 – and subject to exchange rate risk as approximately half of the total is denominated in foreign currency. The announcement by Russia's Gazprom that from April it will cancel the 33% gas price discount agreed with Ukraine at end-2013 will add to the country's financing needs. With regard to **Russia**, the EU imposed some "soft" sanctions last week and is considering additional measures, including travel bans and asset freezes. However, these are unlikely to have a significant impact. The biggest risk to the Russian economy remains a potential acceleration of capital outflows as investor confidence deteriorates in the wake of the ongoing Crimea crisis.

US: Continuing weak data – still probably weather related

The economy created 175,000 jobs in February after weakness in the previous two months, putting the three-month average at an anaemic 129,000. The report was somewhat stronger than expected but still suggests a weak labour market. Unemployment edged back up to 6.7%, as the workforce increased slightly, and the average duration of unemployment increased to 37.1 weeks from 35.4. Hourly earnings gained 0.4% m/m in February but hours worked fell 0.3%. Meanwhile, the ISM non-manufacturing index slipped to 51.6 in February (from 54.0), just staying above the expansionary 50 level, and the employment component of the survey was down 8.9 points to 47.5, the second largest fall on record, again underscoring the weak labour market. The Fed's Beige Book of anecdotal evidence repeatedly noted that adverse weather had impeded economic activity, but also reported that conditions have now improved modestly in eight of the 12 reporting districts. Recent data have been affected adversely by poor weather over the past three months, so pent up demand may cause a rebound in the spring.

Eurozone: Apparent further progress towards a banking union

An interim agreement appears to have been reached by the Eurogroup of finance ministers on several aspects of the second pillar of the banking union, but negotiations with the European Parliament continue and there is still a divergence in views. The Eurogroup proposes an Intergovernmental Agreement that, together with the Single Resolution Mechanism (SRM) directive to enter into force on 1 January 2015, will give legal rights to the use of a Single Resolution Fund (SRF). Its size will be 1% of covered deposits by 2025, approximately EUR55 billion according to the Commission's estimates, and contributions will come from bank levies, which will be fully mutualised in an 8-10-year transitional phase. The SRF cannot be used to cover losses or to recapitalise banks before 8% of the involved bank's liabilities have been bailed-in (the bail-in directive to be effective in 2016). Furthermore, the Fund's intervention cannot exceed 5% of the bank's liabilities. A final agreement is expected after the European Parliament's plenary session on 14-17 April and this will enable the proposed regulation to be adopted before the end of the current legislature in May. However, negative surprises cannot be excluded.

Countries in Focus

Americas

Latin America: Inflationary pressures largely under control

In **Mexico**, price growth decelerated to 4.2% y/y in February, after 4.5% in January. Inflation on a y/y basis is expected to remain above the official target range (3% +/-1%) throughout 2014 as some tax increases were implemented early in the year (on some food, drink and fuels). However, inflationary pressures are likely to remain muted while activity is still in its recovery phase. Prices accelerated in **Peru**, increasing by 3.8% y/y in February (3.1% in January), above the inflation target range (3% +/-1%). However, the central bank is expected to keep unchanged its policy interest rate (4%) in the short-term as growth remains close to potential. In **Chile** and **Colombia**, February inflation (3.2% and 2.3 % y/y, respectively) remained within target but, after being low in the last six months, gradual upward price pressures are expected in both countries as economic activity strengthens. Even so, for these countries, EH does not expect inflation to be a short-term policy concern.

Europe

Southern Europe: Finally bottoming out

In **Italy,** Q4 2013 GDP growth was +0.1% q/q and driven mainly by exports (+1.2%). Domestic demand remained in negative territory reflecting contraction in private consumption and inventories but investment increased by +0.9% q/q. Going forward, EH expects moderate growth of +0.3% in 2014 and +0.8% in 2015. In **Portugal,** Q4 GDP growth was revised upwards (+0.1point to +0.6% q/q). Domestic demand expanded by +0.4%, with strong investment (+3.4% q/q) but falling private consumption (-0.5% q/q). Net exports were in positive territory (+0.2pps) because of good export growth (+1% q/q). Going forward, EH expects growth to pick-up to +1% in 2014 and +1.3% in 2015. Q4 GDP was also revised upwards in **Greece** (to -2.3% y/y from -2.6%) with the external sector the only support as domestic demand continues to be adversely affected by budgetary adjustments. EH expects GDP growth to stabilise in 2014 (-0.1%) and to pick-up moderately in 2015 (+0.6%).

Africa & Middle East

Gulf Co-operation Council: A temporary spat?

Saudi Arabia, Bahrain and the UAE withdrew their ambassadors from fellow-GCC member Qatar last week, citing a breach by Doha of a pledge of non-interference in other countries' internal affairs. Qatar, which is the home of the Al Jazeera media network, has a track record of not always abiding by general GCC foreign policies. Behind this most recent rupture is the fact that Qatar supports what are deemed (by other GCC states) revolutionary groups, including the Moslem Brotherhood. Saudi Arabia and the UAE, in particular, are supportive of the current military-backed regime in Cairo. There is a risk of escalation as Qatar's only land border is with Saudi Arabia, which also controls key flight paths into that country. Complicating the relationships is the fact that Qatar hosts significant US military and naval bases. However, EH expects the GCC to instigate intra-conciliatory negotiations and, at this stage, there is little likelihood of marked disruptions to commercial activity.

Asia Pacific

Thailand: Limited impact from monetary easing

Today, the central bank reduced its policy interest rate to 2% from 2.25% in a move designed to support the economy. However, since November 2013, the government has had to deal with a discontented opposition and periodic violent demonstrations and, despite some relative stability in recent days, the government and opposition are yet to reach a negotiated agreement. As a result, while the economy recorded positive growth of +4% per annum in 2000-09 supported by external factors and appropriate economic fundamentals, problems are mounting: (i) political turmoil is limiting reform implementation and infrastructure projects (ii) demand from China is expected to be less buoyant, with that country's GDP growth down to +7.5% in 2014 and (iii) foreign investors are expected to be more cautious with all emerging market risks. Investment applications fell by 60% y/y in January-February and EH now expects GDP growth of a muted +3.5% in 2014.

What to watch

- March 13 – China February industrial production
- March 13 – Ireland Q4 2013 GDP (1st estimate)
- March 13 – France February CPI
- March 14 – Germany February CPI
- March 14 – India February WPI
- March 14 – Japan January industrial production
- March 14 – Argentina February CPI
- March 15 – Slovak Republic presidential elections
- March 16 – Serbia parliamentary elections
- March 16 – Ukraine, Crimea referendum on independence
- March 17 – Japan Q4 2013 GDP (2nd estimate)
- March 17 – US February industrial production
- March 18 – Chile Q4 2013 GDP (1st estimate)
- March 18 – Turkey monetary policy meeting
- March 18 – Germany March ZEW surveys
- March 19 – US February housing starts and permits
- March 19 – New Zealand Q4 2013 GDP
- March 20 – US Fed Reserve meeting

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