Euler Hermes Economic Research

Weekly Export Risk Outlook

11 June 2014

In the Headlines

FIGURE OF THE WEEK

+1.8%

EH's forecast for GDP growth in Brazil in 2014

Brazil: The World Cup will generate more inflation than growth

Preparations ahead of the 2014 FIFA World Cup and 2016 Olympic Games did not prevent a sharp economic slowdown in the last three years. Real GDP growth slowed again in Q1 (+0.2 q/q after +0.4% in Q4 2013) and the trend is unlikely to change. EH expects growth will remain low at +1.8% in 2014, with the sporting mega events contributing, at best, only +0.2pps and the impact will decline gradually thereafter. However, inflation is expected to remain high at 6.3% in 2014, with more than +0.5pps contributed by the mega events. Moreover, the inflationary pressures will remain strong, perhaps through to 2020. These diverging trends highlight the inherent weaknesses in the Brazilian economic model. Inadequate infrastructure, chronic under-investment, protectionism, high levels of taxation and a complicated business environment prevent the country from fully benefitting from the additional economic activity these events generate. As the surge in inflation is already causing social unrest, the sporting calendar could also shape the political one as presidential elections are scheduled for October. Deep structural reforms, if adopted, could be the real mega event for the economy in 2014 (see our Economic Insight '2014 World Cup: more inflation than growth for Brazil').

Eurozone: The ECB is (finally) helping

The ECB announced conventional and unconventional measures in response to the rapid fall in inflation in the region. The main measures are: (1) a 10bps cut in the main refinancing rate (to 0.15%); (2) a 10bps cut in the deposit rate for banks (to -0.1%); (3) a EUR400 billion programme of targeted liquidity for non-financial corporations (TLTRO) until September 2018; (4) the start of preparatory work for purchases of securitisation of private loans (ABS) by the ECB; and (5) an increase in money supply (EUR164 billion through suspension of the weekly sterilisation of the SMP programme). EH views these measures as positive and expects the ECB to do more towards the autumn. A positive impact at a country level is expected in 2015, through a progressive private credit recovery, lower financial fragmentation between countries, lower pressures from the euro and moderately-rising inflation. However, downside risks remain and notable among these is continuing uncertainty relating to bank willingness to lend to the real economy. The ECB forecasts inflation will remain below the 2% target until at least 2017 and this prolonged period of low inflation is, in itself, bad news as real interest rates will remain too high.

Turkey: Q1 GDP growth surprises on the upside

Q1 real GDP increased by an unexpectedly strong +4.3% y/y and +1.7% q/q, largely as a result of a one-off boost to exports. Gold exports (mainly to Switzerland) increased markedly, by +53.4% y/y – in an apparent move to reduce reserves before an anticipated fall in gold prices – lifting overall export growth to +11.4% y/y, while imports edged up by just +0.8% y/y. Accordingly, net exports made a large positive contribution to Q1 growth. Meanwhile, currency depreciation, rising inflation and monetary tightening sharply reduced private domestic demand, with household consumption growth slowing to +2.9% y/y and private investment declining by -1.3%. In contrast, increased government spending supported growth, with public consumption expanding by +8.6% y/y and public investment by +4.1%. While the export surge is unlikely to continue for the remainder of the year (excluding gold, exports were up just +3.4% y/y in Q1), domestic demand may gain some momentum if the central bank relaxes monetary policy against a background of recent currency stabilisation. EH expects full-year real GDP will grow by +3.3% in 2014 and +4.2% in 2015.

U.S.: There's good news and there's…

The labour market performed moderately well in May, gaining 217,000 jobs and both unemployment and the labour force participation rate remained unchanged, at 6.3% and 62.8%, respectively. Job gains were widespread, with manufacturing registering growth for the 10th consecutive month. Indeed, the latest employment report marks a milestone as it showed that the economy has finally regained all of the jobs lost during the downturn. Even so, it took over six years to do it and that is 58% longer than the previous record and, compared with previous recoveries, the economy should have 5-10 million more jobs than it does now. Meanwhile, the trade deficit in April widened much more than expected, to USD47.2 billion from USD44.2 billion, which may exert downward pressure on Q2 GDP. The Fed's Beige Book of anecdotal evidence once again used the terms "modest" or "moderate" to characterise economic growth. The week's most positive news was that the ISM Non-Manufacturing Index improved by 1.1 to 56.3, markedly above the 50 level and indicating expansion. Within the overall index, both the business activity and new orders components were strong, at 62.1 and 60.5, respectively.

Countries in Focus

Americas

Mexico: Unexpected rate cut

The central bank announced a cut in the monetary policy rate (key interest rate) of 0.5pps to 3%, reflecting lower-than-expected real GDP growth in Q1 (+0.3% q/q in seasonally-adjusted terms). The weakness in economic activity in the U.S. weighed against exports, while domestic demand has been restrained after the tax increases implemented in January. Consumer prices increased by 3.5% in May, comfortably within the inflation target range of the central bank (3% +/-1pps). As inflationary pressures are low and economic activity remains subdued, further cuts in the key interest rate cannot be ruled out in the coming months. EH revised downwards its forecasts of real GDP growth to +3% for 2014, but decided to keep its +3.9% forecast for 2015 as economic activity from H2 2014 onwards is expected to benefit from the recently-adopted structural reforms that may sustain investment and capital inflows in the medium term.

Europe

Italy: Exports benefit the economy

GDP fell by -0.1% q/q in Q1 but, excluding stocks, it increased by +0.1%. Private consumption increased by +0.1% q/q in Q1 and public spending by +0.4% q/q, the most rapid rate since 2011. Total investment fell back in to contractionary territory (-1.1% q/q) reflecting weakness in both construction and equipment investments. As a result, domestic demand continued to contribute negatively to GDP growth. The good news comes from continuation of the positive trend for exports (+0.8% q/q in Q1), which provided the highest contribution to GDP growth for the third consecutive quarter. EH expects GDP growth will reach +0.4% in 2014 after two consecutive years of recession. However, downside risks remain from low inflation (+0.5% in 2014), large public debt stock (134% of GDP), contraction in credit availability to the private sector, high unemployment (12.6% in 2014) and concerns relating to the banking sector.

Africa & Middle East

Tunisa: Slow progress

Q1 GDP growth was +2.2% y/y and the figure for 2013 as a whole was revised down to +2.3% from a previous official estimate of +2.8%. In Q1, growth was constrained by ongoing weakness in industrial output, with manufacturing (+0.1%) and non-manufacturing (-1.6%) sectors affected by adversarial labour relations and political uncertainties. The transition remains challenging and elections later this year will indicate whether the consensual approach to politics – Tunisia's evolution is atypical of the region - is succeeding. Bilateral and international agencies remain supportive. The IMF approved a two-year Stand-By Arrangement in June 2013 (USD1.75 billion) and last month released a further instalment under that facility. EH expects GDP growth of +3% in 2014 (good harvest and increased phosphate output) and, subject to political stability and further strengthening in the eurozone, +5% in 2015, but there are considerable downside risks.

Asia Pacific

South Korea: A safe bet in Asia?

The country issued its first 30-year dollar-denominated bonds (approximating to USD1 billion) in conjunction with an issue of 10-year euro notes (EUR750 million).The bond sales will supplement the country's foreign exchange currency reserves, which already provide import cover of more than six months. Moreover, the economy performed soundly in the early part of this year, with real GDP in Q1 expanding by +0.9% q/q, while its main partners (China and the U.S.) were showing signs of weakness (GDP growth of +1.4% q/q and -0.2% q/q, respectively). In particular, domestic drivers in Q1 showed resilience, especially investment (up by +3.5% q/q), while external trade remained buoyant (exports up by +1.9%) in line with strong growth in manufacturing output (up by +2.2% q/q). EH expects the economic outlook will strengthen over the course of 2014, with overall GDP growth of +3.5%, compared with +3% in 2013.

What to watch

- June 12 – Eurozone April industrial production
- June 12 – France & Portugal May CPI
- June 12 – India April industrial production
- June 12 – U.S. May retail sales
- June 13 – China May industrial production
- June 13 – Panama Q1 GDP
- June 13 – Mexico April industrial production
- June 13 – Eurozone Q1 employment
- June 13 – Germany, Italy & Spain May CPI
- June 13 – Japan April industrial production (final)
- June 15 – Colombia presidential election (2nd round)
- June 16 – Eurozone May CPI
- June 16 – Croatia May inflation
- June 16 – U.S. May industrial production
- June 13 – Uruguay Q1 GDP
- June 17 – U.S. May housing starts
- June 17 – Germany June ZEW business climate survey
- June 17 – Japan May trade balance
- June 18 – U.S. Fed meeting
- June 18 – Thailand benchmark interest rate decision