Euler Hermes Economic Research

# Weekly Export Risk Outlook

28 January 2015

## In the Headlines

FIGURE OF THE WEEK

+2.6%

UK GDP growth in 2014

### Ukraine & Russia: No end in sight to the political and economic crises

The conflict in eastern **Ukraine** has escalated further since last week and the Ukrainian government declared a state of emergency in the separatist Donetsk and Luhansk regions, diminishing the prospect of a near-term international peace summit for the region, which had looked possible as recently as mid-January. On the economic front, Ukraine is expecting the release of the third IMF loan tranche, which was postponed from mid-December 2014 because of reform slippage, while the EU this week agreed a third loan of EUR1.8 billion. This is positive in the short term, but a sovereign debt restructuring is likely later in 2015. Ukraine is experiencing a full-blown balance-of-payments crisis as the UAH has lost half its value over the past year and FX reserves have dwindled to USD6.6 billion (just one month of import cover). Meanwhile, the EU is considering new sanctions against **Russia** in response to the surge in violence in eastern Ukraine and S&P this week became the first major sovereign rating agency to downgrade the country to speculative grade (BB+), and assigned it a negative outlook. S&P's move is mainly based on reduced monetary policy flexibility, deteriorated economic prospects and difficulties for the banking sector. Euler Hermes expects the Russian economy will contract by -5.5% in 2015 (for more details see also WERO 15 January 2015).

### UK: Count on the BoE to support growth

Q4 2014 GDP increased by +0.5% q/q (compared with +0.7% in Q3 and expectations of +0.6%) and GDP growth reached +2.6% in 2014 as a whole. The main driver for growth in Q4 remained services (+0.6pps) while construction and production contracted (-0.1pps). A breakdown by demand will be released on 26 February. We expect private consumption will have remained the main driver of GDP growth as suggested by strong retail sales. Indeed, continuation of the recovery in the labour market (unemployment fell -0.2pps to 5.8% in October 2014), a moderate pick-up in wages and lower savings are all supportive of private consumption. In the coming months, we expect low oil prices will also be supportive of private consumption (an additional EUR4 billion) and give a boost to non-financial corporations' margins (+0.4pps). In contrast, total investment is expected to have slowed in Q4 as construction activity decreased and capacity utilisation rates in industry fell. All in all, we expect GDP growth of +2.5% in 2015 (and +2.2% in 2016), but downside risks to this forecast prevail. We think that the slowdown in growth combined with low inflation (1% on average in 2015) will support a late BoE monetary tightening (H2 2015) with a risk of drift into early 2016, given that oil prices are expected to remain relatively low until 2016.

### U.S.: Confidence and housing buoyant

The leading index of consumer confidence increased sharply in January (+9.8 to 102.9), piercing the 100 level associated with a strong economy for the first time since August 2007, five months before the recession started. Gains were widespread throughout the survey. Additionally, the housing market firmed in December 2014 as median prices for new houses gained +2.2% m/m and median prices for existing homes ended a five-month period of decline, increasing by +1.1%. Unit sales of existing homes gained +2.4% m/m, while sales of new homes increased sharply, by +11.6%, and housing starts reversed the previous month's decline and increased by +4.4%. Permits were the only negative housing result in the latest data, sliding -1.9% in December. Given the erratic nature of the housing market, it is too early to call an end to the slump, but the month's data are encouraging. However, orders of durable goods were less positive in December, falling -3.4%. While such data are notoriously volatile, orders of non-defence capital goods (excluding aircraft), a proxy for future business spending, have fallen for four consecutive months, a worrisome trend.

### Canada: BoC surprises

The Bank of Canada (BoC) surprised global financial markets last week when it unexpectedly cut its overnight interest rate from 1% to 0.75%, the first cut in six years. Until now the BoC had widely been expected to follow in the U.S. Fed's footsteps, increasing rates later in 2015. The BoC was blunt in its reasoning, saying "This decision is in response to the recent sharp drop in oil prices, which will be negative for growth and underlying inflation in Canada." The move reflected a growing dependence on oil, which accounts for 14% of exports, and also supports provincial housing markets, spurs investment and provides government revenue. The BoC also downgraded its 2015 GDP growth forecast from +2.4% to +2.1%. Since the announcement the Canadian dollar (CAD) weakened by a further -2.5% against the USD, after losing -11% in 2014.

# Countries in Focus

Americas

## Colombia: Enough tools to soften the negative oil shock

Petroleum products account for over 55% of total exports, so Colombia is among regional countries directly impacted by the fall in oil prices, which will affect negatively its trade balance and widen the current account deficit, which was -3.9% of GDP in Q2 2014. However, the negative spillovers to the real economy may be softened because of sound financial and fiscal positions. Foreign exchange reserves are comfortable and cover over seven months of imports, enough to avoid liquidity shortages. In the absence of inflationary pressures (2.9% on average in 2014, close to the target of 3% +/-1pps), the Central Bank is likely to ease monetary policy by cutting the key policy interest rate. In addition, fiscal deficits in recent years (budget deficit of -0.9% of GDP in 2013) provide the government with scope to implement fiscal stimulus. Overall, Euler Hermes expects real GDP growth will be +4% in 2015 (after +4.9% in 2014), still among the most rapid expansion rates in the region.

Europe

## Greece: New government, same problem. New solution?

As expected, Syriza emerged as the winner of legislative elections, with 149 out of 300 seats, and formed a coalition with the right-wing Independent Greeks (13 seats). Solving the debt issue (to avoid default) is a priority. We expect an extension of the current bailout by mid-July, followed by a new precautionary credit line by end-2015, accompanied by further debt relief in the form of frozen interest payments on EU and IMF loans for a limited period of time and longer loan maturities. Europe can afford to be (more) patient with Greece. Although Greek Value-at-Risk has declined by 40% for corporates and 70% for financials, the impact of a Grexit (5% likelihood) would be unprecedented and systemic. For now, our baseline scenario for 2015 remains GDP growth of +1.4% and business insolvencies -4%. However, uncertainty and too rapid weakening in competitiveness could lower GDP growth by as much as -0.5pps. (See also Economic Insight January 2015.)

Africa & Middle East

## Zambia: New leader, policy continuity

Edgar Lungu of the ruling Patriotic Front (PF) narrowly won the presidential by-election on 20 January (48.33% of the vote, compared with 46.67% for Hakainde Hichilema of the UPND). The poll was marked by a very low turnout of 32.36% but the electoral commission and observers declared the elections fair. The low turnout and relative peaceful acceptance of the result perhaps reflect the need for further elections in 2016 – President Michael Sata died in office at the end of October 2014, so Lungu is fulfilling the remainder of his term. In the interim, EH expects policy continuity to prevail, with focus on poverty reduction, health service provision and infrastructure improvements but also implementation of a new royalty tax on the mining sector (20% and 8% on open-pit and underground mining, respectively). Even if there is scope for tax regime amendments, potential mine closures and job losses at a time when copper prices are weak suggest a challenging 2015.

Asia Pacific

## China: A difficult start for industrial companies

Industrial profits continued to decline in December 2014, by -8% y/y (after -4.2% in November), the biggest decrease since 2011. For the full year, profit growth was +3.3%. This mirrors other industrial indicators: output below trend (+7.9% y/y in December 2014 compared with a five-year average of 12% and weak producer prices (PPI in negative territory for the 34th consecutive month). In the short term, there are no indications of significant improvement, with business sentiment remaining weak (HSBC manufacturing PMI at 49.8). The government lowered its industrial production growth target to +8% in 2015 (from +9.5% in 2014), suggesting this year will be challenging for companies. Indeed, the authorities will probably focus on reducing excess capacity and on fostering the change in the overall growth model to one with an increased focus on services. Against this background, GDP growth is expected to continue to slow, to +7.3% (from +7.4% in 2014).


## What to watch

- January 29 – Japan January CPI
- January 29 – South Africa SARB interest rate decision
- January 29 – Eurostat January confidence indicators
- January 29 – Germany January CPI (preliminary)
- January 30 – Eurozone December 2014 unemployment
- January 30 – U.S. Q4 2014 GDP
- January 30 – Spain, Belgium & Austria Q4 2014 GDP
- January 30 – Eurozone January CPI (preliminary)
- January 30 – Canada November 2014 GDP
- February 02 – South Africa January manufacturing PMI
- February 02 – EU January manufacturing PMI (final)
- February 02 – U.S. Dec. 2014 personal income & outlays
- February 02 – U.S. January ISM manufacturing index
- February 03 – Italy January CPI (preliminary)
- February 04 – Egypt gross and net international reserves
- February 04 – EU January services PMI (final)



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Contact Euler Hermes Economic Research Team
research@eulerhermes.com

Publication Director
Ludovic Subran, Chief Economist
ludovic.subran@eulerhermes.com