Euler Hermes Economic Research

Weekly Export Risk Outlook

18 June 2015

In the Headlines

FIGURE OF THE WEEK

-2.2%

Russia's revised Q1 y/y GDP contraction

U.S.: Getting nearer to the change

As expected, the Fed kept interest rates unchanged this week but continued to hint that a hike was coming. The number of Fed members expecting more than one hike in 2015 fell from 14 to 10, suggesting a slower pace of increase. The median estimate for the Fed Funds rate at the end of 2015 remained unchanged at 0.625%. The policy statement is slightly more upbeat, stating that "economic activity…expanding moderately… underutilization of labor resources diminished…the housing sector has shown some improvement." We believe the first rate increase will not be until Q4, particularly as inflation is expected to remain markedly below the 2% target (May core PPI was only 0.6% y/y) and substantial labour market slack remains evident. Other recent economic data were mixed. Positives include housing permits surging for the second consecutive month, by +25% y/y in May, the Housing Market Index gaining 5 to 59 in June and retail sales in May rising for the third consecutive month. Negatives include housing starts falling -11% in May, industrial production contracting by -0.2% (fourth decline in six months) and capacity utilisation falling for the sixth consecutive month.

Russia: Q1 GDP decline revised downwards

A second estimate by RosStat showed that Q1 real GDP contracted by -2.2% y/y, a downward revision from the -1.9% flash estimate. A breakdown by sector reveals that only agriculture (+2.9% y/y) and mining (+4.9% y/y) expanded, while consumer-oriented service sectors contracted severely – trade -22.1% y/y, hotels and restaurants -19.5%, real estate -25.5% and other personal services -16.4% – indicating that private consumption is now falling. Manufacturing was more resilient in Q1, down by just -0.6% y/y, but high-frequency data show that the decline in output accelerated to an average -7.8% y/y in April-May. Additionally, the Manufacturing PMI fell to 47.6 in May (48.9 in April), with the volume of new orders declining at the most rapid rate in six years. As financing remains difficult, it is likely that investment will be further trimmed. Euler Hermes expects that the decline in GDP will continue to pick up in coming quarters and forecasts a full-year contraction of -4% in 2015. The Central Bank lowered its key policy interest rate by 100bps to 11.5% this week as inflation eased slightly to 15.8% y/y in May.

Greece: Looking for a last-minute agreement

This week is crucial, with meetings of both the Eurogroup (Eurozone finance ministers) and Ecofin (EU finance ministers). Given recent press statements, it seems that a European Summit could be scheduled on Sunday. An agreement by the end of June is needed as Greece needs to reimburse part of the IMF facility (EUR1.5 bn). In our view, the latest deadline for an agreement (new extension of the current bailout for 6-9 months) is 26 June in order to allow time for the German parliament to adopt it. However, a last-minute agreement would not solve the problem and we believe a third bailout or a debt restructuring will be needed to allow the economy to return to positive growth (we expect GDP will contract by -0.2% in 2015). However, in recent weeks, the probabilities of no agreement by end-June and of non-payment to the IMF have increased (although these are not part of our central outlook scenario) and could lead to the introduction of capital controls, similar to Cyprus, for a limited period. In these circumstances, we expect a strong recession, a credit crunch and possible payment delays.

Brazil: Combating recession with infrastructure programmes

President Dilma Rousseff announced on Tuesday a five-year USD65 bn infrastructure package. Equivalent to 3.5% of GDP, the plan includes new projects involving airports, roads, ports and railways. However, some projects had already been announced in 2012, while others will only take place in 2018, resulting in a total package that appears unlikely to meet the country's infrastructure gap or to promote economic growth in the short term. Moreover, even if the BNDES (the national development bank) plays a major role, public financing will be limited, given ongoing fiscal consolidation. The projects are therefore expected to be partially funded with private financing and developed through Private-Public Partnerships (PPP). Meanwhile, restrictive economic policies will continue to weigh against growth. With a fiscal goal of +1.2% of GDP as a primary surplus in 2015 and the hawkish stance adopted by the Central Bank (to fight inflation the SELIC rate has been raised by +225bps since September 2014, to 13.25%), we expect GDP will contract by -1% this year.

Countries in Focus

Americas

Colombia: Output remains below trend

Despite a moderate recovery, overall output remains affected by the impact of weaker prices for the oil sector (55% of exports) and slowed investment. Real GDP expanded by +3.3% q/q in annualised terms, after +2.4% in Q4 2014, a rate that remains below average growth of +4.8% in 2010-14. Notably, Q1 output was driven by the construction sector (+17.9% q/q annualised, after -13% in Q4 2014), partly supported by the fourth generation Private-Public-Partnership infrastructure programme of road concessions. Agriculture and mining also regained momentum, but manufacturing contracted for the fourth consecutive quarter. Against this background, the government pledged to implement a package of supportive measures. Monetary policy loosening is also likely if weakness in economic activity persists, as the strengthening of inflation (4.4% y/y in May, above the Central Bank target of 3% +/-1pps) is mainly related to supply shocks on food prices and increases in electricity charges.

Europe

Hungary: Q1 GDP growth retains momentum

Q1 real GDP increased by +3.5% y/y and +0.8% q/q, slightly up from Q4 2014 (+3.3% y/y) and just below the outcome for 2014 as a whole (+3.6%). Private consumption growth picked up to +2.6% y/y (+0.7% q/q) in Q1, supported by lower energy prices and declining unemployment, while government spending declined by -5.4% y/y (-2.3% q/q). Fixed investment was down by -6.7% y/y, although base effects played a role as it expanded by +2.7% q/q. Exports increased by +10.3% y/y (+2.7% q/q), outpacing imports, +7.8% y/y and +1.9% q/q, so that net exports became the key growth driver in Q1. We expect the recovery that started at end-2013 will continue in the coming years but growth should become more balanced and moderate to around +3% in 2015 and +2.5% in 2016 as the investment boom (+12%) from 2014 will gradually abate. Meanwhile, inflation moved back to positive territory (+0.5% y/y in May) after eight consecutive months of deflation and should continue to pick up gradually.

Africa & Middle East

Africa: Integration plans

A Tripartite Free Trade Area (TFTA) agreement was signed last week by officials of three of the continent's existing trade blocs - SADC, EAC and COMESA. Hurdles have yet to be cleared and implementation is some way off but the intention is to reduce internal duties and to harmonise trade regulations. The benefits for current and prospective international traders, as well as those within the TFTA, are potentially significant; a 'unified' market incorporating 26 of Africa's 54 countries would comprise 600 mn people and have a combined GDP of around USD1 tn. The TFTA is considered a launching pad for the establishment of a future continent-wide FTA, which would also include ECOWAS (encompassing Nigeria). While a formal trade agreement will take time to achieve – the TFTA implementation timeline of 2017 appears ambitious – intra-African trade flows, currently only 12% of the total (50% in developing Asia), may expand through closer informal links.

Asia Pacific

China: Stabilising?

Recent data continue to provide a mixed outlook. While industrial production (+6.1% y/y in May from +5.9% in April) and retail sales (+10.1% from +10%) are up, investment in fixed assets remains on a downward trend (+11.4% y/y in Jan-May). The property market shows some encouraging signs as average new home prices in 70 major cities increased for the first time in 13 months (+0.2% m/m). On the financing front, foreign investment has gained traction, with FDI in May up +7.8% y/y, compared with +2.2% in February. Moreover, recent accommodative measures are proving effective; M2 money supply growth accelerated (+10.8% y/y from +10.1% in April) and aggregate financing flows, including bank loans and off balance sheet credit, increased to RMB1,220 bn in May (RMB1,050 bn in April). Financing conditions should improve in the short term with further monetary easing and progress in financial liberalisation. We expect GDP growth will stabilise at +7% in 2015.

What to watch

- June 19 – Canada May CPI
- June 22 – Eurozone June consumer confidence
- June 22 – Ghana Q1 GDP
- June 22 – Qatar Q1 GDP
- June 22 – Mexico April retail sales
- June 23 – Eurozone June manufacturing PMI
- June 23 – Eurozone June services PMI
- June 23 – Italy April retail sales
- June 23 – South Africa Q1 current account
- June 23 – Jordan Q1 GDP
- June 23 – Argentina May trade balance
- June 23 – Argentina June consumer confidence
- June 23 – Hungary monetary policy meeting
- June 23 – Turkey monetary policy meeting
- June 24 – Germany June Ifo business climate
- June 24 – Brazil May current account
- June 24 – France May total jobseekers

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