Euler Hermes Economic Research

Weekly Export Risk Outlook

8 July 2015

In the Headlines

FIGURE OF THE WEEK

USD57

Barrel price of benchmark Brent crude oil (-48% y/y)

Greece: A five-day countdown

The unresolved situation is getting increasingly alarming. A worrying development is the clear deadline from the European side (Sunday 12 July) to find an agreement. We expect that the Greek bank 'holiday' and the country's capital controls will be extended by next Monday. However, the banks are rapidly running out of liquidity and we are concerned that the restrictive measures will have to be tightened in order to avoid bankruptcies and a systemic failure of the banking system. The IMF and the European Council President are adopting mediatory roles between the two sides but we fear that, without a credible new proposal for reforms from Greece (to be submitted on 9 July, at the latest), the political blockage will only deepen.

Lack of agreement by this weekend will mean that the ECB will cut access of Greek banks to the ELA emergency credit line (currently at EUR89 bn with a 45% haircut on the Greek collateral). In turn, this will immediately mean that Greek banks are cut off from the Eurosystem, with no access to funding in order to fulfil demands for cash withdrawals and financing of the economy. The only viable solutions to save the banking system will then be: (i) strong bail-in measures on shareholders and depositors. However, after the large outflows, beginning November 2014, total deposits at the end of June are estimated to have been around EUR130 bn, which might necessitate (ii) the issuance of IOU certificates that will trade at a discount to the EUR. This last path will be the first step in the introduction of a new currency that will likely function in parallel with the EUR for a period of time. Technically speaking, the issuance of a new currency will take a minimum of two or three months and it could take more than six months to distribute it around the whole country. Given Greece's dependence on the Eurozone in terms of exports of goods and services, we think the country is likely to remain open to 'euroizated' where the EUR remains freely acceptable within the country. A peg of the new currency to the EUR is technically possible but will be difficult to defend as we think a devaluation of 30-40% is likely after introduction of the currency and FX reserves are limited.

Germany: Outlook is for steady but unexciting growth

Seasonally- and working day-adjusted industrial production stagnated in May, following a +0.6% m/m increase in April. Monthly declines in construction (-0.5%) and energy production (-3.1%) dampened the May figure while the core manufacturing sector was up by +0.4% m/m, itself driven by a strong +1.3% m/m increase in production of consumer goods. New orders in manufacturing were down by -0.2% m/m in May but this followed a strong +2.2% m/m rise in April. Meanwhile, after two months of decline, both the manufacturing and services PMIs increased again in June, to 51.9 and 53.8, respectively, thereby remaining firmly in expansionary territory. The overall GfK Consumer Climate Indicator edged up to 10.2 in June (from 10.1 in May) but is forecast to fall back to 10.1 in July. The Economic Expectations component fell markedly, probably dampened by the crisis in Greece. All in all, these high frequency indicators point to stabilisation of domestic demand driven growth and continue to support Euler Hermes' forecast of +1.7% real GDP growth in 2015.

China: Active policy implementation

Policy measures are being eased to limit volatility and arrest the recent sharp fall in the stock market. After cutting the key policy interest rate and the Reserve Requirement Ratios for banks lending to SME and rural companies, the Central Bank unveiled a new set of measures. These include a six-month loan facility of RMB250 bn extended to 11 banks to bolster liquidity and an injection of funds into China Security Finance Corp to allow it to refinance market players. Meanwhile, the authorities relaxed market rules for some players such as pension funds, which can now invest 30% of funds in shares and infrastructure, and rules on margin trading were also relaxed. The 21 largest brokerages were encouraged to invest in a RMB120 bn fund in an attempt to push the Shanghai Composite Index back up to 4500. Going forward, financial tensions will persist ahead of potentially disappointing Q2 GDP figures. In that context, support will probably be increased to keep growth on target (+7%). While contributing positively in the short term, these measures may encourage risk taking, further increase private debt and, more importantly, increase reliance on stimulus measures.

Countries in Focus

Americas

U.S.: Labour market concerns

Labour market issues suggest that the Fed will not increase interest rates until Q4. Non-farm payrolls increased by 223,000 in June but the previous two months were revised down -60,000. Other disappointments include a sharp decrease in the participation rate to 62.6% from 62.9%, a recovery low and the lowest since October 1977. Hourly wages, hours worked and weekly earnings remained unchanged m/m and, after stripping out core inflation, hourly and weekly wages increased by only +0.2% y/y. A separate report shows job openings at a near-record high but the hiring rate remained at a long-term average, suggesting employers cannot find the right candidates, an impediment to job growth. Labour market disruptions were also seen in the employment component of the ISM non-manufacturing survey, which fell for the second consecutive month. However, both the non-manufacturing and the manufacturing surveys ticked up for the month, gaining +0.3 and +0.7 points, respectively.

Europe

Russia: Slump in domestic demand fuels deepening recession

Revised data show that the economy was already in recession in mid-2014, contracting by -0.3% q/q in Q3, -0.6% q/q in Q4 and -1.3% q/q in Q1 2015. The downturn accelerated in all categories of domestic demand, reaching -9% q/q for private consumption, -0.3% q/q for government consumption and -4.2% q/q for fixed investment in Q1 while a significant -33% q/q fall in gross capital formation indicates that inventories fell sharply. Imports declined by -33.1% q/q while a surprise rebound in exports (+2.2% q/q), probably a result of the weakening RUB, helped the Q1 GDP contraction to be less severe than expected. High-frequency data show that the decline in output accelerated further in Q2 (see WERO 18 June 2015) while the June PMIs for manufacturing (48.7) and services (49.5) remain in contraction territory. Euler Hermes expects domestic demand will be further trimmed and the GDP decline will deepen in coming quarters, resulting in full-year contraction in GDP of -4% in 2015.

Africa & Middle East

Morocco: Growing?

An expected bounce in agricultural output (+7.7% q/q and +12% y/y) because of better growing conditions (good rainfall in early 2015) and associated greater crop yields boosted Q1 GDP growth, which increased by +4.1% (y/y). This followed +1.8% growth in Q4 2014. Also in Q1, manufacturing output increased by +4.3% q/q and retail trade expanded by +6.6%, although other non-agricultural sectors and services were more subdued. Relatively low inflationary expectations (food and fuel prices) and improved fiscal and current accounts (reduced subsidies and lower oil import bill) also suggest a positive outlook. However, recent terrorist attacks in Tunisia and Egypt indicate ongoing regional security risks with the potential for contagion damage for Moroccan tourism and investment flows. We expect GDP growth of around +4.5% in both 2015 and 2016, although this assumes that non-agricultural sectors will provide a greater boost in the latter year and that security and stability will be maintained.

Asia Pacific

Japan: Encouraging signs

The BOJ delivered an upbeat assessment of the country's regional economies, citing a pick-up in output and tightening in job markets. In particular, the outlook for Hokkaido has improved as robust private consumption permitted companies to increase prices. Meanwhile, Japan recorded its second highest monthly current account surplus in five years at +JPY1.880 tn in May (+JPY1.326 tn in April). This enlarged surplus reflects a strong income balance (+JPY2.013 tn) because of high revenues from overseas investments and a reduced trade deficit (-JPY0.04 tn from - JPY0.146 tn). Low commodity prices combined with a weak JPY resulted in lower imports of goods and merchandise exports fell only marginally. The outlook is for the current account surplus to remain large in 2015, at +1.8% of GDP (after +0.6% in 2014) reflecting a lower import bill because of weak commodity prices. Exports are set to pick up, but at a slow pace as a result of the moderate growth in global demand.

What to watch

- July 09 – China June CPI
- July 09 – UK BoE interest rate decision
- July 09 – Germany May current account
- July 09 – South Africa May mining production
- July 09 – South Africa May manufacturing output
- July 10 – France May industrial production
- July 10 – India May industrial production
- July 10 – Romania June CPI
- July 14 – Germany June CPI
- July 14 – U.S. June retail sales
- July 14 – Germany July ZEW survey
- July 15 – U.S. June PPI
- July 15 – U.S. June industrial production

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