Euler Hermes Economic Research

Weekly Export Risk Outlook

19 August 2015

In the Headlines

FIGURE OF THE WEEK

+0.3%

Eurozone Q2 q/q GDP growth

China: Turbulent times

July's activity figures (exports, retail sales and industrial production) were disappointing and business surveys (manufacturing PMI and MNI) indicate a weaker short-term outlook. Meanwhile, financial sentiment is volatile, reflecting concerns about the new exchange rate formation mechanism. As from 11 August, the daily opening fixing rate of the RMB is based on the previous day's closing. This move was followed by significant currency depreciation (-5% against the USD). Stock market and currency volatility increased as market players expect further depreciation to support exports. To date, there is no strong evidence of such intention and the recent move is likely to have a limited impact on exports as its magnitude is unlikely to increase significantly China's price competiveness. Moreover, a steeper currency depreciation is not without risks and its economic impact is questionable as (i) the main constraint on exports in the current environment is probably the lack of global momentum (ii) currency depreciation takes time (more than six months) to show trade benefits and (iii) financing conditions can deteriorate with higher costs of borrowing and higher capital outflows.

Eurozone: Still a modestly nascent recovery

Q2 GDP growth was moderate, at +0.3% q/q, in line with expectations but with France, Italy and The Netherlands disappointing. Two thirds of overall growth was accounted for by Germany (+0.4% q/q) and Spain (+1%). In **Germany**, data suggest a positive net trade contribution (reflecting a lower EUR), continued strong household and public consumption but still weak total investment, notably in construction. In **Spain**, GDP growth was the highest since 2007, with domestic demand the main driver. In **France**, GDP stagnated as domestic demand decelerated strongly. Total investment fell by -0.3% q/q as the fall in household investment gained pace, public investment is back in contractionary territory while company investment slowed. Net trade contributed positively to growth (+0.3pps). In **Italy**, GDP increased +0.2% q/q, slightly below expectations. Advanced indicators suggest that net trade contributed negatively while household consumption increased as a result of lower oil prices, fading fiscal consolidation and a gradual pick-up in credit, which should support a modest recovery in private investment. We expect **Eurozone** GDP growth will reach +1.4% in 2015 and +1.7% in 2016.

Greece: New programme, but still strong recession

EUR25 bn out of the EUR86 bn 3-year loan is set aside for bank recapitalisation. A first tranche (EUR26 bn) will be disbursed by November, of which EUR10 bn is for immediate bank recapitalisation. The new programme appears likely to keep reforms going, avoiding delays and lack of implementation. However, fiscal targets will prove challenging as the economy will contract. Greece continues to receive minimal support from Europe in terms of new institutions that help corporate financing. Lack of confidence, political uncertainty and an undercapitalised banking system suggest that capital controls will not be lifted before year-end, but will be progressively softened. Meanwhile, GDP figures show a surprising +0.8% q/q growth in Q2 (-0.7% in nominal terms) presaging a very bad H2. Growth in Q2 reflects increased consumption ahead of the capital controls and declining imports. Local surveys show that the controls have cut SME business activity by around half. We expect GDP will contract by -2% in 2015 and by -0.5% in 2016. Business insolvencies are expected to increase by +15% in 2015.

Turkey: Continuing political uncertainty will dent sentiment

Coalition negotiations between the two largest parties in parliament, the ruling AKP and the CHP, broke down last week and, unless a last-minute coalition deal is reached by 23 August (the deadline to form a government following the 7 June election), a snap election will be held, most likely in late November. Although this outcome was a distinct possibility, markets reacted negatively, with the TRY today hitting new record lows against the USD (1:2.90) and the EUR (1:3.20) and are likely to remain volatile in the next weeks. The prospect of continuing political uncertainty adds to a discouraging list of problems facing Turkey, including heightened security concerns arising from recent terror attacks by IS and PKK and the intensified Turkish military campaign against both, a large current account deficit, slow growth and the looming U.S. Fed tightening. In this context, the central bank kept its policy interest rates on hold this week and is likely to tighten monetary policy by year-end as inflation is likely to pick up again from the 26-month low of 6.8% y/y reached in July.

Countries in Focus

Americas

Brazil: The sky continues to darken

Short-term indicators suggest recession has deepened. Industrial production fell by -5.5% y/y in June and retail sales by -3%, while business and consumer confidence are at record lows. Inflation hit a 12-year high in June, 9.6% y/y and was more than double the Central Bank target level (4.5%), driven by increases in controlled prices (notably energy and fuel) and by BRL depreciation (-35% y/y against the USD). In July, the Central Bank further increased the policy interest rate, to 14.25% or +300bps since October 2014, and widened its intervention in FX markets in an attempt to curb the BRL weakening. In addition, declining tax revenues led to downward revision of the government's primary surplus targets, to +0.15% of GDP from +1.1% in 2015 and +0.7% from +2% for 2016. Fiscal consolidation appears essential to limit public debt growth (63% of GDP) but austerity measures generate strong political and social tensions, with the popularity rate of President Roussef plunging to record lows.

Europe

Russia: As expected, recession deepened in Q2

A flash estimate by RosStat indicates that Q2 real GDP plunged by -4.6% y/y, following a -2.2% y/y decline in Q1. A full breakdown by GDP sub-components is not available as yet but accelerating declines in Q2 retail sales (-9% y/y, after -6.9% in Q1) and expenditures on fixed investment (-6.5% y/y, after -6.1% in Q1) suggest that domestic demand weakened further. On the supply side, the deterioration in industrial production in Q2, down by -4.9% y/y after just -0.4% in Q1, was the main trigger for the deepening recession, suggesting that import substitution is not a long-term solution for the increasingly isolated economy. The outlook for Q3 remains gloomy, with oil prices again weakening markedly, resulting in a renewed slump of the RUB (currently down by -34% from a temporary peak in mid-May). Euler Hermes expects that the recession may bottom out towards the end of the year, at the earliest, and continues to forecast full-year 2015 GDP will contract by -4%.

Africa & Middle East

Egypt: Less waiting time and a quicker passage

The "New Suez Canal" was officially inaugurated earlier this month. The USD8.2 bn project (financed through domestic investment certificates) enables two-way traffic through a new 35-km parallel channel of the existing 190 km waterway and a further 37 km was deepened and widened. The project was completed in one year, despite a three-year original projection, thereby providing a short-term boost to domestic confidence in the government's ability to regenerate the economy. However, doubts have already been raised in relation to the official projections for the Canal's additional vessel usage and transit revenue-earning capacity against a background of subdued world trade growth and the impact on it of currently weak commodity prices. The extended and improved Canal is just part of an overall plan that envisages the waterway becoming a global logistics hub. To that end, exporters may find future commercial opportunities opening up in construction, transport and related services.

Asia Pacific

Asia: Difficult times ahead

Weak global demand, downward price pressures and difficult financing conditions translated into weaker than expected Q2 GDP growth. **Taiwan** (+0.5% y/y from +3.8%) and **Singapore** (+1.8% y/y from +2.8%) experienced a correction; **Japan** continued to remain on quicksand (+0.7% y/y but -0.4% q/q); **Indonesia** (+4.7% y/y in both Q1 and Q2) and **Malaysia** (+4.9% y/y from +5.6%) showed some weakness; and **Hong Kong** proved resilient (+2.8% y/y from +2.4%). Going forward, risks are tilted to the downside, with a wide array of uncertainties. On the demand side, the short-term global outlook does not support a strong export-led recovery, particularly as **China** is going through a difficult transition. On the financing side, a period of volatility is expected ahead of U.S. Fed tightening**.** Buffers, including domestic demand and policy support measures, will matter and countries such as **Malaysia** and **Indonesia**, already prone to currency shocks and economic weaknesses, are likely to remain short-term concerns.

What to watch

- August 20 – Brazil July unemployment
- August 20 – Mexico & Peru Q2 GDP
- August 20 – Germany July PPI
- August 20 – UK July retail sales
- August 20 – Greece EUR32 bn ECB repayment
- August 20 – U.S. July existing home sales
- August 20 – U.S. July leading indicator
- August 21 – Mexico June retail sales
- August 21 – Germany Aug. GfK consumer confidence
- August 21 – EU August PMI (preliminary)
- August 21 – Canada July CPI
- August 25 – Germany Q2 GDP (2nd est, with details)
- August 25 – Germany August Ifo business climate
- August 25 – South Africa June mining output
- August 25 – South Africa Q2 GDP
- August 25 – Hungary monetary policy decision

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