Euler Hermes Economic Research

Weekly Export Risk Outlook

1 June 2016

FIGURE OF THE WEEK

+7.9%

Q1 2016 y/y GDP growth in India

In the Headlines

India: "Relative calm in an ocean of turmoil" R. Rajan

GDP growth picked up to +7.9% y/y in Q1 2016, from +7.2% in Q4 2015, with private and public consumption the main drivers. However, exports contracted further and investment growth deteriorated. On the production front, activity was supported by strong growth in the wholesale and retail, manufacturing and financial sectors. Additional positive news came from growth in the mining sector, which accelerated, and agriculture, which recovered from contraction. Overall, full-year growth in FY2015/2016 was +7.6%. Looking ahead, private consumption will remain a strong driver, reflecting low inflation and a positive wage boost (7th Pay Commission hike) and government expenditure will remain broadly supportive. Cause for concern is the sluggish investment growth. The latter weakened despite strong monetary easing and the measures of the government to accelerate public investment. One key reason is that credit growth did not pick up strongly as banks were still reluctant to provide new credit, preferring to make provisions for bad loans. As long as this situation persists, economic activity will remain fragile. We expect GDP growth will stabilise at +7.6% in FY2016/2017.

Italy: Domestic demand drives growth

The second estimate of Q1 GDP confirmed growth of +0.3% q/q. Excluding stocks, GDP growth was a meagre +0.1%. Looking at the breakdown, private consumption increased by +0.3% q/q, the same pace as in Q4 2015. Total investment increased by +0.2% q/q, the lowest growth since Q2 2015, as investment in construction continued to contract (-0.5% q/q). However, fixed investment (machinery and transport) increased by +1% q/q, the highest growth since end-2010. Net trade contributed negatively to growth (-0.2pps) as exports fell more strongly (-1.5% q/q) than imports (-0.9% q/q). In terms of sectors, value added increased by +1.2% q/q in industry, by +0.2% in services but contracted by -2.4% in the agricultural sector. Nominal GDP in Q1 increased by +0.7% q/q and by +1.8% y/y (compared with +1.4% in Q4 2015) and the highest level since 2011. Going forward, we expect an average quarterly pace of real GDP growth of +0.3% that will bring overall 2016 growth to +1%. For 2017, we expect GDP growth will reach +1.2%.

U.S. & Canada: A tale of two countries

In the **U.S.**, Q1 GDP growth was revised upwards to +0.8% q/q annualised, from +0.5%. A sharp fall in business investment shaved -0.5pps off the headline rate and net exports and inventories cut an additional -0.2pps each. Q1 consumption was +1.9% q/q annualised, but April consumption increased by a rapid +0.6% m/m and +3% y/y, suggesting strong Q2 GDP growth. As a result, we expect the Fed will now hike interest rates either in June or July. Although consumers spent more in April, confidence contracted in May (92.6 from 94.7). Expectations fell to 79.0 from 79.7, the lowest in 28 months. The Fed's favoured inflation gauge, the PCE core rate, gained 0.2% m/m and 1.6% y/y. Corporate profits rebounded after two consecutive quarters of reduction, gaining +1.9% q/q, but still in contraction y/y (-3.6%). Meanwhile, after a promising start, the **Canadian** economy took a sharp downturn. Q1 GDP increased by +2.4% q/q annualised (expectations of +2.8%) but January was the only month to show growth. Furthermore the Alberta wildfires are likely to send Q2 GDP into negative territory.

UK: Subdued growth momentum

The second estimate of Q1 GDP confirmed growth of +0.4% q/q, a slowdown from +0.6% in Q4 2015. Services increased by +0.6% (+0.8% in Q4) and were the main contributor to growth. Output in the manufacturing and the construction sectors contracted, by -0.4% q/q and -1%, respectively. On the demand side, consumers remained the main growth driver (+0.4pps) which they have been consistently since end-2013. Total investment increased by +0.5% q/q, largely reflecting strong growth in transport equipment. However, business investment fell (-0.4% q/q) for the second consecutive quarter, reaching the lowest level since Q4 2014, as lending conditions tightened, Brexit uncertainty continued (see our Economic Insight) and global demand remained soft (notably in the U.S. and China). Overall, we expect the soft momentum will prevail and GDP growth will slow to +0.3% in Q2 and reach +1.9%, at best, in 2016 (+2.3% in 2015). In this context, the BoE is likely to remain dovish, at least until the end of the year, as inflation is expected to remain below 1% in 2016.

Countries in Focus

Americas

Chile: Q1 rebound illusory?

Real GDP expanded by +1.3% q/q (+1.7% y/y) in Q1. The rebound from a relatively flat Q2-Q4 2015 was driven, in particular, by a strong recovery in domestic demand, particularly private consumption (+1.2% q/q after +0.3% in Q4 2015) and investment (+1.8% q/q after -0.9% in Q4). Despite a slight deceleration in exports (+2.1% q/q after +2.4% in Q4), net exports were a major contributor to GDP growth as imports contracted by -1.8% q/q (-2.7% in Q4). Short-term indicators reveal an uncertain outlook; retail sales rebounded in April by +8.5% y/y but inflation (4.2% y/y in April) is above the Central Bank target (3% +/-1pps) and unemployment was up to 6.4% in April (5.8% in January). Consumer confidence has fallen to its lowest since 2010 and business confidence has also deteriorated strongly; industrial production continued to contract in April (-1.5% y/y). Against this background, we expect GDP growth will be below +2% this year, compared with an annual average of +5.3% in 2010-2013.

Europe

Switzerland: Modest Q1 GDP growth

Q1 real GDP increased by just +0.1% q/q (+0.4% in Q4 2015). However, this was because of a sharp -32% q/q fall in exports of non-monetary gold, which accounts for around 20% of exports and is subject to highly-volatile trade activity. Excluding non-monetary gold and other valuables, exports increased by +2.1% q/q, outpacing imports (+1.2% q/q) so that net exports contributed +0.5pps to Q1 growth. Both private consumption (+0.7% q/q) and fixed investment (+1.7% q/q) rebounded in Q1 after weak performances throughout 2015 while, in contrast, government consumption lost momentum, falling by -0.8% q/q in Q1. Inventories (including net trade in non-monetary gold and valuables) subtracted -1.1pps from Q1 growth. In y/y terms, Q1 real GDP increased by +0.7% (up from +0.3% in Q4 2015) also held back in part by the fall in exports of non-monetary gold. Euler Hermes expects this effect will be balanced over the next quarters and forecasts full-year growth of +1.2% in 2016.

Africa & Middle East

Tunisia: Support group

Following a World Bank announcement earlier last month of a five-year USD5bn Country Partnership Framework agreement, the IMF board agreed a four-year Extended Fund Facility of USD2.9bn in support of the country's economic reform programme. The latter was supported by a previous Fund facility that expired in December 2015 and it targets fiscal consolidation, further exchange rate flexibility, banking and financial sector reforms, improvement of the business climate and modernisation of public institutions. Such multilateral support in addition to bilateral assistance is required to manage lingering twin deficits in the fiscal and current accounts and promote stabilisation of the economy, which remains subject to periodic attacks aimed at disrupting tourism and to a difficult political transition. With regard to the latter, the decision of al-Nahda, the country's largest parliamentary party (and a coalition partner) to prioritise political rather than religious goals appears a positive step.

Asia Pacific

Australia: Exports drive strong growth

GDP growth accelerated in Q1, to +1.1% q/q from +0.7% in Q4 2015. Household and government consumption increased solidly and exports increased markedly (+4.4% q/q) reflecting improvements in commodities and services (tourism). Negative news came from investment, which contracted further (-1.7% q/q). Fundamentals have improved, with unemployment on a declining trend and credit availability increasing with an easing in monetary policy. Additionally, export price competitiveness has improved with a lower AUD. However, economic expansion is likely to be relatively moderate: (i) external demand is still weak and Q1's expansion will probably moderate in the short term; (ii) business surveys show some signs of weaknesses; the AIG manufacturing PMI fell to 51 in May (58.1 in March) and the services index still points to contraction (49.7 in April); and (iii) non-payment risk is still high, with insolvencies expected to increase by +12% this year (+22% in 2015).

What to watch

- June 02 – Eurozone ECB monetary policy meeting
- June 02 – Spain May unemployment
- June 03 – Colombia Q1 GDP
- June 03 – Finland Q1 GDP (with details)
- June 03 – Italy & UK May services PMI
- June 03 – Eurozone April retail sales
- June 03 – Spain May services & composite PMI
- June 03 – Turkey May inflation
- June 03 – U.S. May employment report
- June 03 – U.S. May ISM non-manufacturing index
- June 03 – U.S. April factory orders
- June 06 – Germany April manufacturing orders
- June 06 – Russia May inflation
- June 07 – France April trade balance
- June 07 – Germany April industrial production
- June 07 – Eurozone Q1 GDP (with details)
- June 08 – Brazil Selic rate
- June 08 – South Africa Q1 GDP
- June 08 – China May trade figures
- June 08 – Poland interest rate decision
- June 08 – Hungary & Ukraine May inflation

View all Euler Hermes Economic Research online
http://www.eulerhermes.com/economic-research

Contact Euler Hermes Economic Research Team
research@eulerhermes.com

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