Euler Hermes Economic Research

Weekly Export Risk Outlook

13 July 2016

FIGURE OF THE WEEK

+26%

Revised 2015 GDP growth in Ireland

In the Headlines

UK: Delays in investment decisions will be a drag on credit

In its Q2 Bank Lending Survey, the BoE revealed that the Brexit vote is expected to have an impact on both credit demand and financing conditions. Regarding the banks' financing, the long-term wholesale funding spreads increased following the outcome of the EU referendum. Expectations for Q3 indicate a continuation in the rising trend in spreads. Credit availability to households tightened slightly in the three months to mid-June and demand for credit is expected to fall in Q3. The downside adjustment is expected to be more pronounced for the housing market as suggested by the new buyer enquiries balance which was negative in May and recorded the lowest balance since June 2008. For companies, demand for credit is also expected to fall back in the short term from both large corporates and SMEs, partly reflecting some investment decisions being delayed and M&A activity slowing. The commercial real estate sector is impacted by a fall in credit availability for the first time since Q2 2012, a sign that there is a decline in confidence post the Brexit vote and the resilience of this sector appears fragile.

U.S. & Canada: Diverging trends on labour market

In the **U.S.**, the minutes from the Fed's June meeting had expressed concern over May's weak jobs report as one reason to keep the Fed Funds rate unchanged. Later in June, however, the labour market rebounded, gaining +287,000 jobs while the labour force rose +414,000. However wage growth remained tepid, rising only +0.1% m/m to a +2.6% y/y rate, and May still looks worrisome as job creation of only +38,000 was revised down to a mere +11,000, while the job openings rate fell from 3.9% to 3.7%. The ISM services index was strong in June, gaining +3.6 to 56.5, the highest since last November. Critical new orders rebounded +5.7 to 59.9, eight of the ten components rose, and nine are above 50. The trade gap widened from –USD37.4bn to –USD41.1bn in May as exports fell -0.2% m/m while imports rose +1.6% m/m. In **Canada**, job losses of -46,000 in the goods sector were the worst of the recovery, but were offset by a gain of +46,000 in services, putting the y/y job growth rate at a weak +0.6%.

Russia: Current account surplus narrows

Initial estimates indicate that the current account surplus narrowed to just +USD3.4bn in Q2, down from +USD12.6bn in Q1, despite somewhat strengthening oil prices. Indeed, exports of oil and oil products increased by +25% q/q to USD30bn in Q1, however, they were still below the USD33bn shipped in Q4 2015, the weakest quarter last year. The breakdown of the current account balance reveals that the decreased surplus in Q2 is largely due to a widening deficit on the incomes account (from -USD3bn to –USD11bn) while the trade surplus (+USD22bn) and the services deficit (–USD5bn) remained unchanged. For 2016 as a whole, Euler Hermes forecasts the current account surplus to narrow to about +3.4% of GDP from +5.3% in 2015. Meanwhile, net capital outflows by the private sector have normalised since mid-2015, partly because external debt repayments have moderated. In Q2, net capital outflows fell to just –USD2.4bn, taking the cumulative net outflows of the past four quarters to –USD17bn, well below the average four-quarter rolling cumulus of –USD55bn during 2010-2013 (the four years prior to Russia's current crisis).

Spain & Portugal: Sanctioned for insufficient fiscal effort

The Eurogroup concluded that neither **Spain** nor **Portugal** will be able to reduce their 2016 fiscal deficit to the targets set by European Commission (EC). Thus, they could be sanctioned with fines of up to 0.2% of GDP (EUR2.3bn for **Spain** and EUR0.4bn for **Portugal**) at the start of August. Both countries have 10 days to submit reasoned requests for a reduction. The Spanish fiscal deficit stood at -5% of GDP in 2015, above the -4.2% target set by the EC. Fiscal slippage has been driven by pre-elections tax cuts and higher public spending, notably for infrastructure. **Spain** is expected to fall short of the EC target of -2.8% in 2016 as official estimates point to a fiscal deficit of -3.6% (Euler Hermes forecasts -3.9%). In **Portugal**, the fiscal deficit was -4.4% of GDP in 2015, well above the -2.7% EC target. Fiscal slippage can be partially explained by Banif's restructuring, whose fiscal impact amounted to 1.4% of GDP. As for 2016, **Portugal** is also predicted to miss the -1.8% target set by the EC. Indeed, the Portuguese government forecasts a deficit of -2.2% of GDP (Euler Hermes forecasts -2.9%).

Countries in Focus

Americas

Latin America: Monetary policies remain tight

Monetary policies have been tightened in Latin America in an attempt to contain inflationary pressures and volatility on local currencies. **Mexico**'s Central Bank raised its key policy interest rate in late June by +50bps to 4.25% (+125bps since December 2015), despite moderate inflation (2.5% y/y in June, below the target of 3%). As expected, **Colombia**'s Central Bank hiked again its rate by +25bps to 7.5% (+275bps since October 2015) since inflation surged to 8.2% y/y in May 2016 (well above the target of 3%). Even though the central banks of **Brazil** (14.75%), **Peru** (4.25%), and **Chile** (3.5%) left interest rates unchanged at their last meetings, this followed recent tightening cycles: +700bps in **Brazil** in 28 months until July 2015, +100bps in **Peru** in the six months until February 2016 and +50 bps in **Chile** in the four months until January 2016. While easing, inflation remains above respective targets at 8.8% y/y in **Brazil** (target 4.5%), 3.2% in **Peru** (2%) and 4.2% in **Chile** (3%).

Europe

Ireland: Corporate focused tax regime boosts growth

On 13 July, Ireland's GDP figures revealed that the economy grew by +26% in 2015, revised from a previous official estimate of +7.8%. This huge figure is mostly explained by one-off factors related to corporate reallocations, through acquisitions, seeking to take advantage from the accommodative corporate taxation. In Q1 2016, GDP fell by -2.1% q/q due to sluggish domestic demand (-3.5% q/q) impacted by the significant decrease in investment (-16.1% q/q). Exports and imports both declined but with the import decline of -9.8% outpacing the decline in exports of -5.0%. Value added increased for all service sectors with distribution, transport, software and communications sectors being the best performers. Industry registered an overall decrease of -9.2%, within which manufacturing recorded a decline of -11.1% while building and construction recorded a small increase of +0.1% in real terms. Euler Hermes expects annual real GDP growth to be above +4% for 2016.

Africa & Middle East

Zimbabwe: In from the cold?

Drought and land seizures have curtailed agricultural output and weak commodity prices and a virtual absence of capital inflows are now further depleting FX generation. The country and its people – some state employees have not been paid for several weeks and tensions are rising – are in need of external assistance. However, the IMF and other major donors will only provide support if arrears (approximately USD1.8bn) are settled and the Zimbabwean authorities are therefore attempting to negotiate a deal to raise USD1bn through Afreximbank to help pay off such obligations. New lending will be conditional on reform measures including rationalisation of the public sector, privatisation, pro-business policies (including in agriculture and banking) and greater accountability and transparency of governance. With a post-Mugabe future looming, political manoeuvring is intensifying. Against this economic and political background, expect commercial opportunities to remain limited, even if a deal is struck.

Asia Pacific

China: Low trade, lowflation, low growth?

Chinese figures continue to provide a mixed picture. On activity, trade indicators in USD terms deteriorated in June. Both exports (-4.8% y/y after -4.1% in May) and imports (-8.4% y/y after -0.4%) contracted, and the trade surplus weakened slightly to +USD48bn. In RMB terms, the figures showed a more positive evolution with exports increasing by +1.3% y/y and imports decreasing slightly (-2.3% y/y). External demand is low and the weaker RMB helps ease the pressure on the economy. On the price front, manufacturing price deflation continued to ease (-2.6% y/y in June after -2.8% in May) while consumer price inflation was broadly stable (1.9%). The outlook appears challenging. Domestic demand growth is improving, supported by a large fiscal and monetary stimulus, but at a slow pace. External demand has been sluggish and the authorities let the currency depreciate to support exporters. Against this backdrop, Euler Hermes sees weaker growth of +6.5% in 2016 (+6.9% in 2015).

What to watch

- July 14 – UK BoE meeting
- July 14 – U.S. June producer prices
- July 14 – Turkey May IP and current account balance
- July 15 – Eurozone June CPI
- July 15 – U.S. June consumer prices
- July 15 – U.S. June retail sales
- July 15 – U.S. June industrial production
- July 15 – Russia June industrial production
- July 15 – Canada May manufacturing shipments
- July 17 – Israel Q1 GDP
- July 18 – Ghana interest rate decision
- July 19 – U.S. June housing starts and permits
- July 19 – Turkey interest rate decision
- July 19 – Poland and Russia June retail sales
- July 19 – UK June CPI
- July 19 – Germany June ZEW survey
- July 20 – South Africa June CPI