Euler Hermes Economic Research

Weekly Export Risk Outlook

18 August 2016

FIGURE OF THE WEEK

-0.6%

Q2 2016 y/y GDP growth in Russia

In the Headlines

Russia: Recession continues to ease only gradually

A flash estimate by RosStat indicates that Q2 real GDP contracted by -0.6% y/y, following a -1.2% y/y decline in Q1. The further easing of the recession was expected but whether the economy has hit bottom and begun a recovery in Q3 is not clear. July activity data are not encouraging. Industrial production declined by -0.3% y/y in July after it had edged up in each of the three preceding months (and thus by an average +1% y/y in Q2). It was dragged down by a -1.5% y/y fall in manufacturing output which is consistent with the decline in the manufacturing PMI to 49.5 in July (from 51.5 in June) back again below the 50.0 mark which indicates activity in the sector is contracting. Negative trends in the sector include reduced inflows of new total and export orders. Moreover, retail trade turnover continued to contract markedly by -5% y/y in July, after an average -5.6% in Q2 and -5.8% in Q1, indicating that private consumption remains weak. For now, Euler Hermes continues to forecast full-year 2016 GDP to contract by -0.9%, followed by a modest recovery of +1% in 2017.

Central & Eastern Europe: Regional growth remains robust

First estimates indicate that real GDP growth in the group of 11 EU members in the CEE region regained momentum in Q2, picking up to around +3.2% y/y (from a five-quarter low of +2.9% in Q1). The key driver of this rebound was **Romania** which surprised once again on the upside with growth surging to +6% y/y in Q2, thanks to continued strong domestic demand that has been supported by fiscal stimulus measures. Growth in **Slovakia** accelerated as well, to +3.7% y/y, driven by rising net exports and household demand, especially domestic automotive sales were up by +23% y/y. In both **Poland** and **Bulgaria** growth remained nearly unchanged at around +3% y/y in Q2. In the **Czech Republic**, growth eased to +2.5% y/y as construction activity fell sharply, indicating a probable drop in investment. **Hungary** saw a rebound of growth to +2.6% y/y (from 0.9% in Q1). The decline in demand for Baltic exports in Russia continues to retard growth in **Latvia** (+2.1% y/y in Q2), **Lithuania** (+1.8) and **Estonia** (+0.6%). Euler Hermes expects regional full-year growth of the 11 EU members in the CEE will ease to around +3% in both 2016 and 2017 (+3.4% in 2015).

Japan: Strong yen affects GDP growth

Real GDP growth was flat in Q2, down from +0.5% q/q in Q1, according to preliminary estimates. Real exports declined (-1.5% q/q) as a result of the strong yen and subdued external demand. Net exports subtracted -0.3pps from growth. Domestic demand made a positive contribution, supported by modest growth in private consumption (+0.2% q/q) and public expenditures while private investment recovered from contraction as residential investment picked up. However, non-residential investment continued to contract. June activity indicators pointed to a small uptick, with industrial production (+2.3% m/m) and retail sales (+0.3% m/m) recovering from contraction while capacity utilization improved (+1.5% m/m). In July, consumer and business confidence recovered from the trough seen in Q2 (e.g. the manufacturing PMI was 49.3 compared to 47.7 in May). Looking ahead, uncertainties continue to weigh on the outlook. Rising wages and further fiscal support will support domestic demand in the short run. However, addressing the yen strength will be critical to boost exports and private investment.

Spain: The beat goes on

First official estimates by the National Statistics Institute from end-July have put Q2 real GDP growth at +0.7% q/q, slightly down from +0.8% q/q in Q1 but above market expectations. For now, Euler Hermes maintains its GDP growth forecast of +2.6% for 2016 (after +3.2% in 2015). Despite a loss of confidence, private consumption remains strong, supported by a decreasing unemployment rate (19.9% in June after 22.3% a year ago) and an acceleration of retail sales growth (+4.9% y/y in June after +3.2% in May). However, industrial production has slowed down from +2.5% in April to +0.8% in May and +0.9% in June and this trend is likely to continue as total order books keep decreasing. Ongoing political turmoil has led to a drop in portfolio inflows – net inflows of EUR122.4bn in October 2015 have shifted to net outflows of -EUR9.8bn in May 2016. As bond yields reached a new historic low, going below 1% in August, net portfolio inflows are unlikely to return to positive grounds any time soon.

Countries in Focus

Americas

Latin America: Wait and see

Even though inflation continued to ease in most Latin American countries in July, according to CPI figures published in August, inflation rates remain above Central Bank's targets for most countries. July consumer price inflation was reported at 8.7% y/y in Brazil (target 4.5%), 4% in Chile (target 3%) and 9% in Colombia (target range 3% +/-1pp) while in Peru it fell back to 3% y/y, now just within the Central Bank's target range (2% +/-1pp). In Mexico, the inflation rate (2.7% y/y) remained within Central Bank's target range (3% +/-1pp) as it has done over the past years, in contrast to most of the region. Nonetheless Mexico's Central Bank has tightened monetary policy recently to offset downside pressures on its currency stemming from several sources, including the Fed's rate hike at end-2015. Other Central Banks have also tightened in the past and are now in a wait-and-see mode since the Fed's monetary policy course remains uncertain for the months to come.

Europe

UK: More stimulus but still contained inflation

In order to support growth in an increasingly uncertain economic environment following the Brexit referendum, the BoE cut its key policy interest rate by 25bps to 0.25%, expanded its asset purchase program by +GBP60bn and launched a new plan of corporate bond purchases worth GBP10bn in early August. This caused renewed appetite for GBP-denominated corporate bonds which saw the strongest two weeks of issuance in almost three years following the announcement while yields fell to a record low of 2.06%. Meanwhile, consumer price inflation edged up (but only slightly) in July, to +0.6% y/y from +0.5% in June. On the producer side, GBP depreciation caused input producer prices to rise significantly by +4.3% y/y in July but the higher import costs were almost entirely absorbed by companies as the 'factory gate prices' only gained +0.3% y/y. For now, the GBP depreciation after the Brexit referendum has only slightly passed through to higher inflation.

Africa & Middle East

Egypt: Welcome back to the IMF

Last week, the IMF announced a staff-level agreement on a three-year USD12bn loan to Egypt. The agreement still needs to be approved by the Executive Board of the IMF, but this is already good news. The country was locked in a kind of blind run, as accelerating growth came along with rising fiscal and current account deficits. As a result, there were strong pressures on the EGP, particularly in March (see also **WERO 16 March 2016**), and foreign exchange reserves hit a floor in July, covering just 2.7 months of imports. The agreement reached with the IMF should help to secure more financing from other donors (World Bank, African Development Bank) and from financial markets. But the main challenge will remain fiscal consolidation, as public debt is approaching 98% of GDP. This will be a difficult task since the country is still exposed to high inflation (+14% y/y in June) and high unemployment (13%).

Asia Pacific

China: Slowing slowly

Economic activity moderated in July, hampered by bad weather conditions and weak demand growth. Both industrial production (+6% y/y) and retail sales growth (+10.2% y/y) slowed. USD-denominated exports declined by -4.4% y/y but imports (-12.5% y/y) contracted at a faster pace. Some goods news came from price developments, with producer price deflation in manufacturing easing to -1.7% y/y in July (from -2.6%). Going forward, business surveys point to growth stabilization in the near term. Services PMIs (both official and unofficial) continue to indicate strong growth. But manufacturing sentiment is still fragile due to weak new orders. The economic policy mix is still accommodative. However, signs of monetary policy fine-tuning are appearing, indicated by lower credit growth in July (new Yuan loans up by RMB464bn, after RMB1,380bn in June) in order to contain financial risks. Euler Hermes expects real GDP to expand by +6.5% in 2016.

What to watch

- August 19 – Indonesia interest rate decision
- August 19 – Taiwan Q2 GDP (second estimate)
- August 19 – Spain June Trade Balance
- August 22 – Mexico Q2 GDP (second estimate)
- August 22 – Ukraine July industrial production
- August 23 – Eurozone August PMIs (flash estimates)
- August 23 – Eurozone August Consumer Confidence
- August 23 – Japan August PMI Mfg (flash estimates)
- August 23 – Mexico June Retail Sales
- August 23 – Singapore July inflation
- August 23 – U.S. July new home sales
- August 23 – Hungary and Turkey interest rate decision
- August 24 – Brazil August Consumer Confidence
- August 24 – Germany Q2 GDP (second estimate/details)

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