Euler Hermes Economic Research

Weekly Export Risk Outlook

31 August 2016

FIGURE OF THE WEEK

+1.1%

Q2 2016 q/q annualized GDP growth in the U.S.

In the Headlines

U.S.: Strong consumption supports case for rate hike

Fed Chair Yellen gave her Jackson Hole speech, saying “I believe the case for an increase in the federal funds rate has strengthened” but she gave no indication as to the timing of potential hikes stating “that gradual increases … will be appropriate over time.” EH believes a September rate hike is unlikely but one in December is possible. Financial markets concur, putting the odds of a September hike at 20%-25%, and the odds of a December hike around 55%. Q2 GDP grew at a weak annualized +1.1% q/q, but details show a split economy. Investment shrank at a -9.7% annualized rate in Q2, the third consecutive drop and the worst quarter of the recovery. Residential investment, which had been a good contributor to the economy before, came in at a disappointing -7.7%. Business investment fell -0.9%, the third consecutive drop. However there was a major positive which supports Yellen’s case: Q2 consumption was revised up to a strong +4.4% annualized rate (long term average +3.3%). Robust consumption continued into Q3 with a +0.3% gain m/m in July, while disposable income grew +0.4%. Further boosting the case, consumer confidence rose sharply in August from 96.7 to 101.1 points.

UK: Resilience post Brexit vote is fading

Ahead of the Brexit vote, the economy showed resilience. Q2 real GDP was up by +0.6% q/q, mainly thanks to strong consumers. However, data post the vote show a deteriorated business confidence in the manufacturing and services sectors in July. Consumers continue to show pessimism in terms of economic expectations in the next 12 months and of future major purchases (incl. housing) in August, even if to a lesser extent than in July. Given the GBP depreciation, inflation has increased to 0.6% y/y in July and is expected to be above 2% within six months. The housing market has been further damaged: both housing demand and sales dropped in July while lenders’ mortgage approvals were down by -12% y/y to 60,900 (after -5% in June). Although the negative Brexit shock could prove less severe than initially expected, recession remains a risk in H2. The high uncertainty over the EU exit is reinforced by the later-than-previously expected article 50 notification (recent official statements indicate this to happen not before 2017) and GDP growth in 2017 may turn out lower than +1%.

Spain: New elections likely

Mariano Rajoy, acting Prime Minister and People’s Party (PP) leader, is facing a confidence vote in parliament today as he has failed to form a coalition government after the PP won most of the votes (137 out of 350 seats) in the second inconclusive general elections held in June. The support given by the Ciudadanos party (32 seats) to Rajoy is not enough to reach the absolute majority needed for an investiture (176 seats needed). Despite multiple negotiations, the Socialist party (85 seats) refuses to back Rajoy. The confidence vote is likely to loom today. In this case, a new vote will take place on Friday and a simple majority would suffice to invest Rajoy. Although only 11 abstentions would be needed, another failed vote is likely as the Socialist leader, Pedro Sanchez, has asserted they will not abstain. Against this background, a call for new elections (perhaps to be held in December) appears increasingly likely. The political deadlock that began in December 2015, when general elections did not lead to a clear majority first, is far from being over.

Kenya: Cap on banks’ interest rates

In the context of electoral competition with general elections looming in 2017, Kenyan President Uhuru Kenyatta last week signed into law a popular bill that places a limit on the interest rate commercial banks may charge for loans. These rates will be pegged at 400 basis points above the benchmark central bank rate (currently 10.5%), while deposit rates are required to be at least 70% of the benchmark rate. Kenya suffered, as many, from deteriorating funding conditions as foreign banks increased their interest rates to Emerging & Frontier Markets. Last year, there was some pressure on the exchange rate and official foreign exchange reserves and the Central Bank decided to hike its key policy interest rate by +300 basis points to 11.5%. More recently, as the exchange rate stabilized, the Central Bank eased by -100 bps. The cap on banks’ rates is intended to increase the pass-through to lower banks rates. Another plausible issue is a foreclosure effect, as banks may well deliver less credit if their credit margins tighten.

Countries in Focus

Americas

Colombia: Peace deal will support economy only in medium-term

After two years of negotiations, the government and the FARC signed a peace deal on 25 June, ending 50 years of conflict that have generated much violence, drug trafficking and at least 200,000 deaths. The deal is likely to support economic activity in the medium-term thanks to a better business environment. However, in the short-term the economic outlook remains challenging. Real GDP expanded by +0.2% q/q (+2% y/y) in Q2, unchanged from Q1 and far below the 1% q/q average over 2013-2015. The contraction of the primary sector (-1.3% q/q) was the main drag on activity. Agriculture output stagnated, while the mining sector fell by -2.5% q/q, completing four quarters of contraction. The industrial sector proved resilient (+0.6% q/q), driven by manufacturing (+2.3% q/q). Services grew by +0.3% q/q, thanks to dynamic financial (+1.3%) and personal (+1%) services and despite a fall in transport (-2.7%) and retail (-0.5%) activities. EH expects full-year growth of +2.3% in 2016 (+3.1% in 2015).

Europe

Slovenia: Robust growth continues

Unadjusted Q2 real GDP growth accelerated to +2.7% y/y from +2.3% in Q1. The breakdown reveals that all demand components contributed positively except for fixed investment which continued to decline by -3.6% y/y, albeit down from -7.8% in Q1. However, inventories added +0.8pps to Q2 growth. Private consumption picked up to +2.6% y/y in Q2 (+1.2 in Q1) while government consumption slowed to +2.1% y/y (+3.5% in Q1). Real exports expanded by +7.5% y/y (+5.9% in Q1) outpacing imports at +7.2% y/y (+4.9% in Q1) so that net exports contributed +0.9pps to Q2 growth. However, the acceleration in Q2 2016 was in part due to calendar effects (more working days than in Q2 2015). In seasonally and calendar adjusted terms, Q2 real GDP expanded by +1.9% y/y (+2.1% in Q1) and by +0.5% q/q (unchanged from Q1). Euler Hermes forecasts full-year GDP growth of +2.2% in 2016, following +2.3% in 2015 which was markedly downwards revised from +2.9% previously.

Africa & Middle East

Israel: Gaining momentum

Real GDP growth accelerated to an annualized +3.7% q/q in Q2, up from +2.2% q/q in Q1 that was revised upwards from 0.8% initially and 1.7% in July. Strong domestic demand was the key growth driver. Private consumption surged by +9.5% q/q in Q2 (+6.2% in Q1), benefitting from low interest rates, still low oil prices, tepid inflation (+0.4% m/m and -0.5% y/y in July), near-full employment and strong wage growth that has picked up to almost +3% over the last year. Government consumption soared as well by +8.7% q/q in Q2 (-1.8% in Q1) while fixed investment grew by a still healthy +4.1% q/q in Q2, though down from a very strong rise of +17.4% in Q1. Exports expanded by +3.8% q/q in Q2 (+6.6% in Q1) but were outpaced by imports which surged by +22.1% q/q in Q2 (+2.9% in Q1) on the back of the strong domestic demand. Euler Hermes forecasts full-year GDP growth to pick up from +2.5% in 2015 to +3% in 2016 and +3.5% in 2017.

Asia Pacific

China: Less deflation = better profits?

Industrial profits increased by +6.9% y/y in July YTD , a significant upturn compared to the full-year performance in 2015 (-2.3%). The improvement was led by better results from the private sector (+8.7% y/y YTD). State holding companies continued to underperform (-6.1% y/y YTD). Regarding sectors, mining and quarrying remained the main weak point with a drop of -77% y/y YTD. In contrast, manufacturing registered an increase of +12.8% y/y YTD with a strong rise in industries related to the new growth model (e.g. vehicles, electronics and chemicals). Overall, the increase was supported by a pick-up in sales and a decrease of costs. Looking ahead, it is perhaps too early to declare victory. From a sales perspective, the current improvement has been mainly driven by lower deflationary pressures: the producer price index (PPI) was down -1.7% y/y in July, after -2.6% in June. Otherwise, demand indicators continue to point to a weak growth momentum.

What to watch

- September 1 – EU August Manufacturing PMIs
- September 1 – Brazil August Manufacturing PMI
- September 1 – U.S. August ISM manufacturing index
- September 1 – China official August PMIs
- September 2 – Czech Republic Q2 GDP (2nd estimate)
- September 2 – South Korea Q2 GDP (2nd estimate)
- September 2 – U.S. August employment report
- September 5 – EU August Services & Composite PMIs
- September 5 – Russia and Turkey August inflation
- September 6 – Hungary Q2 GDP (2nd estimate)
- September 6 – Philippines August inflation
- September 6 – Mexico August consumer confidence
- September 6 – Germany July factory orders
- September 6 – U.S. August ISM non-manufact. index
- September 7 – Germany July industrial production
- September 7 – Poland interest rate decision
- September 8 – Eurozone ECB monetary policy meeting

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