Euler Hermes Economic Research

# Weekly Export Risk Outlook

16 November 2016

## In the Headlines

FIGURE OF THE WEEK

+4.3%

U.S. retail sales growth rate in October (y/y)

### U.S.: Markets overreact to Trump, but retail sales are impressive

Financial markets have reacted strongly to Trump's election. The stock market has risen sharply because it sees an agenda of tax cuts, increased spending, and deregulation as good for economic growth. Yet the bond market has tumbled as it sees those plans, and proposed tariffs, as inflationary.

Both may have over-reacted. The cabinet is just forming with a mix of controversial and traditional picks. The president-elect is already softening campaign promises, and won't be able to implement his entire agenda.

What is not speculation, however, is that October retail sales were impressive with +0.8% m/m gain. September sales were revised up +0.4% to a strong +1.0% m/m. The back-to-back gains drove the y/y rate up to +4.3%, almost twice as high as the +2.2% recorded in August. Excluding volatile components, "core" sales (which feed into GDP calculations), gained +0.8% m/m to reach a +4.0% y/y rate. October's gains were widespread across most categories. E-commerce retailers continued to outpace all other categories, gaining 1.5% m/m to a blistering 12.9% y/y rate. The results bode well for both holiday sales and Q4 GDP.

### Eurozone : Stuck in moderate growth, risks on the upside

Eurozone GDP growth preliminary estimates confirmed that the region grew at a steady but moderate pace of +0.3% q/q. Several advanced indicators suggest that domestic demand has been a positive contributor to growth contrary to net trade. The biggest positive surprises came from Spain (+0.7% q/q), Portugal (+0.8%) and Finland (+0.5%), and to a lesser extent the Netherlands (+0.7%) and Austria (+0.5%). Unlike in recent quarters, Italy has at least not disappointed (+0.3% q/q). Germany, France, and Belgium grew in sync with an anemic +0.2% q/q.

Overall these figures suggest that the eurozone growth in 2016 will reach +1.6%, as expected. We do not expect to see a major improvement next year. The region should remain resilient, but risks abound. The Italian referendum on Dec 4th and key elections in the Netherlands, France, and Germany could be the source of surprises in 2017. Brexit remains a nagging worry; US economic policy is a new one.

### Japan: Doing better but…

Real GDP growth rose by a strong +0.5% q/q in Q3 (from +0.2% in Q2) supported by strong net exports. After a strong contraction in Q2, exports rebounded to +2% q/q (up from -1.5%), while imports contracted further (-0.6% q/q). On the other hand, domestic demand growth weakened. Private consumption increased by a limited +0.1% q/q and investment slowed to +0.2% q/q (from 1.1% q/q). Public support increased: government consumption was up by +0.4% q/q (from -0.3% q/q in Q2).

Looking ahead, three risks are looming. First, exports may suffer from a relatively strong yen, modest demand overseas and risk of further protectionist measures. Second, domestic drivers struggle to recover and stabilize. While wages gradually rise, private consumption does not show signs of picking up. Crucially, companies are in a defensive mode due to modest growth in aggregate new orders and rising uncertainties. GDP growth is expected to grow by a modest +1% in 2017.

### The Global Economy: Hush-hush, reflation?

There is growing expectation that inflation in the world economy may bounce back. Many economies are at the end of a deflationary period. Producer prices ended a 5-year lull in China (Emerging Markets: big is beautiful) and US profit recession (earnings per share) was over in Q3. Add to that market perception after the US presidential election. Long-term inflation expectations rose from 1.9% before the poll to more than 2% and are up from 1.5% to 1.6% in Europe.

Three consequences arise. First, mounting expectations for a Fed rate hike. Second, long-term interest rates rose worldwide. USD9.6trn are currently traded at negative yields, a sharp decline from 13.4, registered in August. Third, the USD's effective nominal exchange rate climbed to its past peaks. However, this is more the end of "noflation" than inflation.

# Countries in Focus

Americas

## Latin America: Commodities slump or jump? Better ask China

When it comes to the export of commodities from Latin America, China is a critical trade partner. The Asian powerhouse is the most important market for Brazil (19%) and Chile (25%) and the second export destination for Argentina (10%), Colombia (10%) and Peru (19%). Argentina and Brazil shipped three-quarters of their seeds and grains to China in 2015, compared to 52% and 15%, respectively, in 2000. China was the largest market for Chilean copper exports last year, with 47%, almost triple the figure scored 10 years ago. Is the only way up? Not necessarily. Colombia exported 59% of its copper to China last year, down from 68% in 2013.

While the growing reliance on China has brought benefits in buoyant times but could signal vulnerabilities in case China's slowdown takes a more abrupt pace. This calls for export diversification by economies heavily dependent on commodities, which has triggered strong imbalances from changes in prices in the past.

Europe

## The Netherlands: GDP growth steady and above eurozone average

Beating expectations, GDP growth was up +0.7% in Q3 (q/q), maintaining a solid, constant pace since the start of the year. The main driver for growth has been domestic demand. Consumer spending rebounded strongly with a +0.7% rise q/q, the highest increase since Q4 2014. Consumers spent more on services but also splurged on cars and electrical appliances. Investment growth has also been positive: +0.5% q/q. The sole driver, however, was the construction sector (+1.9% q/q), now up for the 4th consecutive quarter. Machinery and equipment fell -3.2% q/q.

Exports rebounded with +1.2% q/q and so did import growth, +1.1% q/q. Thus, net exports contributed by +0.2pp to GDP growth. Re-exports grew around twice as fast as exports while pharmaceuticals, products, basic metals, and machinery were the main winners. The economic momentum should stay positive in Q4. We expect annual 2016 GDP growth to be higher than previously expected, at +2.1%, up from +2.0% in 2015.

Africa & Middle East

## South Africa: Still lost in stagflation

South Africa's cyclical performance continues to be anemic. Depressed by weak domestic demand, the manufacturing PMI fell to 45.9 in October, its lowest level this year. Inflation rose to 6.1% y/y in September, outside the Central Bank's target range. Exchange rate volatility and structural bottlenecks were the main culprits. As long-term interest rate increased by 40 basis points to 9% on the back of US electoral results, the monetary policy decision of November 24th bears new significance.

The meeting comes at a time of contradicting pressures on the exchange rate. Local currency rallied after the finance minister was cleared of controversial charges and metal prices jumped as a result of China demand. But it tumbled following the US elections. The rand remains highly volatile due to political uncertainty. Public debt adds pressure on the country's rating: its investment grade is at risk.

Asia Pacific

## Malaysia : Resilient growth

GDP growth rose by +4.3% y/y in Q3 (after +4.0% in Q2) driven by a firm growth in private expenditures. Private consumption increased rapidly (+6.4% y/y from +6.3%). It was supported by lower inflation, improved wages, and solid employment growth. Private investment proved resilient (+4.7% y/y from +5.6% in Q2). On the other hand, both government consumption and investment growth slowed. Exports deteriorated (-1.3% y/y from +1% in Q2). On the supply side, services (+6.1% y/y) were the main driver, followed by the manufacturing sector (+4.2% y/y).

Looking ahead, domestic demand growth will remain the main growth driver. Exports growth will be limited by weak new orders and added protectionist measures are a risk. GDP growth should grow at about +4.4% in 2017.


# What to watch

- November 16 – US October industrial production
- November 16 – US October producer prices
- November 16 – US October consumer prices
- November 17 – UK October Retail Sales ex Auto Fuel
- November 17 – Eurozone October CPI
- November 21 – Nigeria Q3 GDP growth
- November 22 – US October existing home sales
- November 22 – Canada September retail sales
- November 22 – Eurozone November Consumer Confidence
- November 23 – Mexico Q3 GDP
- November 23 – Eurozone, France and Germany PMI
- November 23 – South Africa October CPI



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