In the Headlines

North America: NAFTA becomes USMCA
On September 30, Canada, Mexico and the US reached a last minute agreement on a vast revision of the NAFTA that President Trump had previously judged “the worst trade deal ever”. After one year of negotiations, the three trade partners eventually adopted the following changes:
- a higher share (from 62.5% to 75%) of North-American content to be imposed to auto manufacturers as a condition to benefit from duty free access to markets
- auto manufacturers will also have to make sure that two fifths of this content has been produced by workers being paid at least USD16 per hour
- the US secured better access to Canada’s dairy market
- dispute resolution mechanisms have been broadly maintained.
In our view, this agreement won’t really achieve its aims of helping the US reduce its trade deficit, but will insure Canada and Mexico against potential tariff attacks from the US, better protect manufacturing workers, increase costs for companies and set an example for future global trade agreements.

Italy: Budget battle begins
Italy is targeting a budget deficit of 2.4% of GDP for 2019 – notably above the level previously communicated by Finance Minister Tria, and at the higher end of market expectations. While the Italian government insists that it remains committed to reducing its debt burden, which currently stands at 132% of GDP, in our view the planned fiscal expansion would in fact trigger a rise in public debt. For one, nominal GDP growth would slow due to elevated political uncertainty and higher refinancing costs weighing on economic activity. Notably, our 2019 GDP forecast of +0.8% stands in sharp contrast with the government’s growth projection of +1.6%, which in the context of slowing eurozone GDP growth and tightening financial conditions, appears clearly out of reach. In addition, higher spending coupled with a weaker growth outlook would push Italy’s primary surplus below 1% of GDP. The prospect of deteriorating debt dynamics has financial markets worried: The yield on 10yr Italian debt has risen to 3.4% – the highest in four years. Unless the government rediscovers a fiscally more responsible path, a cut in Italy’s sovereign debt rating before year-end remains a key risk.

Morocco: Low-fi growth
Growth unexpectedly decelerated in Morocco in Q2 to +2.4% y/y from +3.2% in Q1, its slowest pace since 2016. Expectations were met in the agricultural sector where growth was +3% y/y in Q2. The non-agricultural GDP surprised on the downside with subpar growth (+2.3% y/y). Higher prices weighed on overall growth performance since prices grew by +1.8% y/y in Q2. Against a background of low inflation in Morocco, corporates were pressured on their margins. This price pressure, as well as the stagnation of the construction output (+0.9% y/y), weighed on investment and inventories (+0.1% together). Export growth also weakened, to +6.7%, cutting overall GDP growth performance by -0.5pp from what was seen one year ago. As a result, growth decelerated to +2.7% from +3.2% in Q1 in export driven processing industries. Lower utilities output growth (+3.1%) also suggests that this growth deceleration was quite broad-based and should have an impact also on Q3. Overall, we expect growth to land at +3% in 2018 (after +4.1% in 2017).

Europe: Stable, but rather soft optimism
Eurozone business confidence in September remained broadly stable. Composite PMI stood at 54.1 from 54.5 as the Services sector (54.7 from 54.4 in August) counterbalanced the fall in the Manufacturing PMI (-1.4 points to 53.2, the lowest level since Sept. 2016). The readings are in line with a +0.4%–0.5% q/q Eurozone GDP growth in Q3 against +0.4% in Q2. Country wise, Germany (55.3) and France (53.6) registered relatively robust rates of expansion in the Composite PMIs, Italy (52.4) remained broadly stable at low levels and Spain (52.5) reached its lowest level in almost five years. In the UK, stock building driven by rising Brexit uncertainty – but also stronger new orders – drove the Manufacturing PMI up by 1 point to 53.8. On the contrary, Services PMI softened to 53.9 from 54.3. Overall, business confidence suggests UK GDP growth to be at +0.3%–0.4% q/q in Q3 against +0.4% in Q2. This confirms a slowdown in activity in the coming quarters, mainly driven by less favorable external conditions such as lower global trade growth and rising vulnerabilities in the emerging markets.
Countries in Focus

US: Consumption and manufacturing solid
Real personal consumption expenditures (PCE) gained +0.2% m/m in August, pushing the y/y rate up a notch to +3.0%, a significant improvement from +2.2% just six months ago. Real disposable income also gained +0.2% to +2.9% y/y. The personal savings rate held steady at +6.6%, indicating consumers were neither too frugal nor too lavish in their spending. On the inflation side, headline PCE prices slipped a notch to +2.2% y/y while the Fed’s favorite measure, the PCE core, remained at the Bank’s target of +2.0%. The September ISM manufacturing report remained at a very strong level of 59.8 despite falling -1.5 points. New orders declined -3.3 points but also stayed at a solid 61.9. Prices still remain high at 66.9 despite falling for the fourth straight month. Nine of the 10 components are above 50. Respondents to the survey continued to report strong demand, a shortage of labor, and ever increasing concerns from tariffs.

Ukraine: Robust GDP growth in Q2 but consumer spending slows
Real GDP growth accelerated to +3.8% y/y in Q2 2018 from +3.1% y/y in Q1. Fixed investment was the main growth driver in Q2, rising by +14.2% y/y (though this was down from +17% in Q1). A surprisingly strong rebound in public spending growth to +11% y/y (from -1.4% in Q1) also contributed significantly to the performance in Q2. Household spending slowed down to +4.2% y/y in Q2 from +5.6% y/y in Q1. A closer look shows that consumers increased their spending the most on furnishing and household maintenance (+12.6% y/y), health (+10.1%), clothing (+6.3%) and energy and utilities (+6% y/y) in Q2. In contrast, spending on communication (+1.1% y/y) and on transport (+3.4%) increased more moderately, while spending on education shrank by -5.5%. External trade activity recovered somewhat from the weakening in Q1, with exports up by +0.1% y/y (after contracting by -9.9% y/y in Q1) and imports up by +5% (+5.4% in Q1). We forecast full-year GDP growth of +3.4% in 2018.

Kenya: The come-back
Kenya registered growth acceleration in Q2 to +6.3% y/y from +5.7% in Q1 (and +4.9% in 2017). Farming (23% of the economy) was weak last year and was the first growth contributor in H1. In Q2, it grew by +5.6% y/y in Q2 as a result of better crops (growth was about +1.5% in 2017). This growth acceleration is also broad-based, since the manufacturing output grew by +3.1% in Q2 (after stalling in 2017), driven by a recovery of business confidence. The manufacturing PMI was above 54 on average during the first nine months of the year (its trough was in October 2017 at 34). Moreover, the electricity and water output (+8.6% y/y in Q2) shows that this recovery should not be short-lived. Overall, our 2018 growth forecast is at +6.6%. Downside risks can be triggered by higher inflation (it was +4.4% y/y on average year-to-date) and tax hikes, since the government is trying to rein in its fiscal deficit (-8% of GDP in 2018).

China: Waning momentum
The latest indicators continue to suggest that growth momentum is waning in China. Both industrial profits (+16.2% YTD y/y in Jan-August after +17.1% in Jan-July) and revenue growth (+9.8% after +9.9%) have slowed. Business surveys in the manufacturing sector point to further deceleration in September. The official manufacturing PMI decreased to 50.8 in September (from 51.3 in August), while the Caixin (private survey) manufacturing index declined to 50.0 (from 50.6). The main component of both indicators decreased. In particular, new export orders continued to fall, suggesting that US protectionist measures are starting to bite. We expect the previously announced stimulus (for example, higher infrastructure spending and tax cuts) to begin having an impact from Q4 2018 onwards. This will help keep growth in a decent range of +6.6% in 2018 and +6.3% in 2019.

What to watch
- October 05 – France August trade balance
- October 05 – US September employment report
- October 05 – Canada September employment report
- October 05 – US August international trade
- October 05 – Brazil September inflation
- October 08 – China September Caixin services PMI
- October 09 – Mexico September inflation
- October 09 – Argentina central bank meeting
- October 09 – Spain August Industrial Production
- October 10 – France, August industrial production
- October 10 – UK August Trade Balance
- October 10 – UK August GDP
- October 11 – Bank of England Credit Conditions and Bank Lending Survey

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