Euler Hermes Economic Research

Weekly Export Risk Outlook

22 August 2018

FIGURE OF THE WEEK

-37%

Depreciation of Turkish lira in 2018 YTD

In the Headlines

Turkey: Full-blown currency crisis. Recession to follow?

Since the start of August, the currency crisis has intensified and become full-blown. The value of the TRY vs the USD dropped rapidly from 4.89 at end-July and on 10 August it plunged by -14% in one day, hitting a record low of 7.24. The plunge was triggered by the introduction of U.S. sanctions against two Turkish ministers and the doubling of tariffs that the U.S. applies to metal imports from Turkey. However, the underlying reason for the crisis has been Turkey's longstanding high vulnerability to all kind of shocks owing to persistently large current account deficits (currently at -7% of GDP) and the huge level of short-term external debt (maturing within 12 months), currently estimated at USD180bn. This compares to FX reserves that have fallen to an 8-year low of USD76bn in June. The Central Bank of Turkey has refrained from interest rate hikes and instead taken measures to provide more liquidity to the markets and signed a USD3bn Swap agreement with the Qatar Central Bank. But these appear to be drops in the ocean, even though the TRY has recovered somewhat to 6.05 vs the USD at the time of writing (-19% in August; -37% YTD). The history of currency crises tells that decisive fiscal and monetary tightening is now needed to stabilize the economy. Otherwise a recession is highly likely.

U.S.: A host of strong data

Retail sales in July rose +0.5% m/m to a +6.4% y/y rate, exceeding the long-term average of +6.1%. After stripping out volatile components, core sales still rose +0.5% m/m to +4.8% y/y, again exceeding the long-term average of +4.2%. Sales in bars and restaurants are now growing +9.7% y/y. The highly discretionary nature of these sales indicates that the consumer is now more willing to spend. Manufacturing industrial production rose +0.3% m/m to +2.8% y/y in July, the fastest in six years. The increase in headline industrial production of only +0.1% m/m was dragged down by a -0.3% m/m loss in mining and a -0.5% loss in utilities, yet on a y/y basis, the headline grew at a six-year high of +4.2%. Small business optimism as measured by the NFIB survey rose to 107.9, just 0.1 point shy of its 45-year record high. Productivity in Q2 rose +2.9% q/q annualized, the most in three and a half years, but the y/y rate remains weak at only +1.3%. With an aging population, productivity will be the key driver of economic growth for years, perhaps decades to come.

UK: The economy should remain resilient

Q2 real GDP growth came in at +0.4% q/q, in line with our expectations, after +0.2% in Q1. Consumer spending accelerated slightly to +0.3% (from +0.2% in Q1) and business investment rebounded to +0.5% (-0.4% in Q1). Public spending grew at the same pace as in the previous two quarters (+0.4%) while inventories rebounded (+0.4pp to Q2 GDP growth) after four consecutive quarters of contraction. Net exports subtracted -0.8pp from GDP growth. We expect economic growth at +0.4% q/q on average over the next two quarters which will keep our full-year forecast of +1.4% in 2018 on track, followed by a slight slowdown to +1.3% in 2019. Brexit negotiations are expected to remain tough. However, we expect a last-minute agreement (70% probability) by the end of January 2019 which targets the Withdrawal Bill (currently 80% agreed) and the political declaration on the Future Relationship – which will pave the way for the transition period until the end of 2020.

China: Keeping the boat afloat

Q3 started on a disappointing note. Industrial production growth was stable at +6% y/y in July. But both retail sales (+8.8% y/y in July, down from +9% in June) and investment growth (+5.5% y/y in January-July, after +6% in January-June) slowed. Trade remained resilient despite fresh U.S. tariffs, with a surplus of USD28.1bn (after USD41.5bn in June). USD-denominated exports rose +12.2% y/y in July (+11.2% in June) while imports accelerated to +27.3% y/y (from +14.1%). Looking ahead, leading indicators are not particularly encouraging. Both the official Manufacturing (to 51.2 from 51.5 in June) and Non-manufacturing PMIs (to 54.0 from 55.0) edged down in July, with the new export orders' sub-component signaling a contraction of activity in the short run. And risks are elevated given that the U.S. considers a new wave of tariffs on USD200bn of imports from China. Supportive measures have already been announced to keep growth in check in the form of higher infrastructure spending and liquidity injections into the banking system. Against this background, we expect GDP growth to slow to +6.6% in 2018 (from +6.9%).

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Countries in Focus

Americas

Chile: A 2018 Grand Cru?

After strong Q1 growth (+1.2% q/q), economic activity remained dynamic in Q2, posting +0.7% q/q. Q2 growth was driven by internal demand, while exports were a drag so that external demand subtracted -1.2pp q/q. On a y/y basis, investment contributed positively to growth for the third straight quarter (+1.6pp) after having subtracted on average -0.4pp from growth in 2014-2017. Especially investment in machinery and equipment grew strongly by +12.5% y/y. In all, this helped to achieve an impressive +5% y/y growth in Q2 after +5.1% in Q1, the highest rates since 2012. On the supply side, growth was broad-based with manufacturing activity as the main driver. In July, business confidence receded to its lowest level since last December while inflation accelerated to its fastest pace in more than a year (+2.7%). Along with the drop in copper prices (to their lowest level in a year) we thus see factors for slower growth in H2. We expect annual growth of close to +4% this year, up from +1.5% in 2017.

Europe

Russia: Growth set to remain modest

Real GDP grew by +1.8% y/y in Q2 2018. Although up from +1.3% in Q1 and +0.9% in Q4 2017, the outcome in Q2 was lower than expected as rising oil prices and the FIFA World Cup had suggested somewhat higher growth. Real retail sales expanded by +2.6% y/y in Q2, up from +2.2% in Q1, indicating that private consumption remained the key growth driver in Q2. The increase in industrial production picked up to +3.3% y/y in Q2 from +2.8% in Q1. However, the weakened Manufacturing PMI – at 48.1 points in July, the third consecutive month below the 50.0 mark and thus indicating contraction – points to slower industrial output growth in the coming months. However, this should be offset to some extent by higher oil output. Meanwhile, new U.S. sanctions against Russia announced on 8 August and the threat of further sanctions to come have hit Russian financial markets, with the RUB down by about -7% vs the USD, and could impact medium-term growth. Overall, we have revised our real GDP growth forecasts to +1.6% in 2018 and +1.5% in 2019 (both down from +1.8% previously).

Africa & Middle East

Israel: Strong growth in H1

Seasonally adjusted real GDP growth decelerated to +0.5% q/q in Q2 from +1.2% in Q1. In unadjusted y/y terms, GDP growth slowed down to a still strong +4% in Q2 from +4.2% in Q1. Domestic demand eased somewhat but remained firm in Q2, with private consumption rising by +5.3% y/y (+6% in Q1), government consumption by +4.6% (+5.5% in Q1) and gross capital formation by +7.6% (+10.2% in Q1), including inventories which added +0.6pp to y/y growth. Exports of goods and services grew by +5.8% y/y (up from +4.3% in Q1) but was outpaced by imports which rose by +11.8% (+13.4% in Q1), reflecting the firm domestic demand, notably the build-up in inventories. Hence net exports subtracted -1.8pp from Q2 growth (-2.7pp in Q1). High consumer confidence and low unemployment should continue to support consumption in the near term while the build-up in inventories is likely to reverse. We forecast full-year GDP growth of +3.8% in 2018 and +3.6% in 2019.

Asia Pacific

Malaysia: Q2 GDP – bad omen?

Real GDP growth slowed down markedly to +4.5% y/y in Q2 from +5.4% y/y in Q1, reflecting supply disruptions in the mining sector (-2.2% y/y in Q2) as well as supply constraints and adverse weather conditions in agriculture (-2.5% y/y). Domestic demand was strong, led by the private sector. Both private consumption and investment accelerated, to +8% y/y (from +6.9% in Q1) and +6.1% (+0.5% in Q1) respectively. Public expenditures were weak (-1.4% y/y). Net exports contributed less to growth (+0.1pp) than in the previous quarter (+4pp) due to weaker export and higher import expansion. Looking ahead, external risks stem from elevated trade-related tensions between China and the U.S. and tighter U.S. monetary policy. At home, a tight fiscal stance may act as a drag on growth. Against this background, we expect monetary tightening to pause for the remainder of the year with the key rate at 3.25% and real GDP to grow by +5% in 2018 as a whole (after +5.9% in 2017).

What to watch

- August 23 – Japan August Nikkei Manufacturing PMI
- August 23 – Spain June trade balance
- August 23 – U.S. July new home sales
- August 24 – Germany Q2 GDP (with details)
- August 24 – Japan July CPI inflation
- August 24 – Mexico Q2 GDP (with details)
- August 24 – U.S. July durable goods orders
- August 24 – Fed Chair Powell speaks at Jackson Hole
- August 27 – Brazil July balance of payments
- August 27 – Germany August Ifo business climate
- August 27 – Nigeria Q2 GDP growth
- August 27 – Russia July industrial production
- August 27 – Turkey August business confidence
- August 28 – U.S. July international trade
- August 28 – U.S. August consumer confidence

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