Euler Hermes Economic Research

Weekly Export Risk Outlook

5 September 2018

FIGURE OF THE WEEK

17.9%

Consumer price inflation in August in Turkey

In the Headlines

Argentina: Tightrope walking

Last week, poor activity data releases (the activity index contracted -3.9% q/q in Q2) following the harshest drought in decades, contagion from the Turkey crisis (the TRY sold off heavily in the first half of August) and communication errors of the government (asking for faster IMF disbursements without presenting a new fiscal plan) precipitated a massive sell-off of the ARS: its value against the USD has halved year-to-date. The subsequent interest rate shock (+15pp to 60% for the policy rate), a bad harvest, tight fiscal consolidation (from a -3.9% of GDP primary deficit in 2017 to 0% in 2019), runaway inflation (projected to end 2018 at 40%), less favorable global financial conditions and heightened political uncertainty should sink the country into recession. Restoring confidence requires: (i) detailing new austerity measures, (ii) the IMF to frontload funds over 2018 and 2019 or increase the overall envelope, (iii) strengthening communication with a unified economics and finance team in the government. So far, emergency austerity measures unveiled on Monday failed to convince markets, while the IMF has in principle agreed to speed up disbursements but negotiations are still ongoing. Finally, President Macri has halved the number of ministers but has not created an emergency economic task force yet.

Turkey: No respite for the TRY

In turn, the renewed currency slump in Argentina was not without impact on Turkey, the other key EM that has been heavily sanctioned by financial markets this year. The TRY depreciated by -8% vs. the USD in the last week of August, taking the full-month decline to -25% and the YTD fall to -43%. As a result, inflation continued to surge. Consumer prices increased by a near 15-year high of 17.9% y/y in August (up from 15.9% in July) and producer prices rose by 32.1% y/y (25% in July). We expect consumer price inflation to rise further in the next months. Moreover, as the Central Bank of Turkey refrained from interest rate hikes to counter the TRY sell-off in August and instead took measures to provide more foreign exchange (FX) liquidity to the markets (see also WERO 22 August 2018), its official FX reserves have fallen to USD73bn on 24 August 2018, the lowest level since June 2010, and down -USD6bn since end-July 2018 or -USD19bn y/y. As a result, import cover has fallen to just 3.4 months (from 4.1 at end-2017 and a peak of 5.9 in August 2016). Expect the currency crisis to persist and deepen as long as the authorities continue to refrain from decisive economic policy measures.

South Africa: Illusive recovery turns into technical recession

There were great expectations at the beginning of the year after the nomination of C. Ramaphosa as President, yielding to a surge in consumer confidence. However, 2018 has begun with a recession. Q2 GDP decreased by -0.2% q/q, after a -0.7% contraction in Q1. Overall, this recession is not broad-based. The negative figures were mainly driven by commodity outputs, particularly agriculture (-8.3% q/q) and metals (still -1% y/y, despite a slight recovery this quarter). The other sectors of the economy rather show a no growth picture than a broad-based recession. However, missed expectations on the GDP growth rate drove the ZAR to unexpected lows (-16% YTD). In conjunction with higher oil prices it should send inflation above 6%, and thus now posing a risk of monetary tightening. Overall, GDP growth is expected at +0.6% in 2018 and +1.3% in 2019. Lower growth and a weaker ZAR also point to an upside risk on debt ratios. External debt is revised up by +1pp to 52% of GDP in 2018.

Italy: Past the peak of the economic upswing

The economy grew at +0.2% q/q in Q2 2018 – down from +0.3% q/q in Q1 but in line with our expectations. Strong domestic demand driven by a buoyant performance of investment (+2.9% q/q) and a more modest contribution from consumption (+0.1% q/q) was largely offset by a marked negative contribution from net exports. Not only did imports post a gain of +1.8% q/q but also exports registered a further – albeit mild – correction of -0.2% q/q after a sharp decline in Q1. Looking forward, we expect economic momentum in Italy to remain relatively resilient for now, but a renewed pick-up in growth dynamics is not in the cards. While business and consumer confidence are still registering close to decade-highs, we expect elevated domestic policy uncertainty around the Italian budget debate in September/October to weigh increasingly on consumption, investment and hiring decisions. Meanwhile the lingering threat of an escalating global trade dispute appears to weigh already on Italian exports. For 2018 we expect Italian GDP growth to slow to +1.2% from +1.6% in 2017.

Countries in Focus

Americas

Canada: GDP improves in Q2

Q2 GDP grew +2.9% q/q annualized as expected – a significant improvement over Q1 at +1.4% and +1.7% in both Q4 and Q3 2017. Personal consumption expenditures rose +2.6% in Q2 vs. only +1.1% in Q1. Business investment grew +1.9% but that was after five straight quarters of strong growth which put it at +6.7% y/y, making it the biggest contributor to GDP over the past year. Residential investment rebounded to +1.1% after -10.5% in Q1, which was preceded by +13.5% in Q4 2017, demonstrating the housing market's violent swings over the past year. Exports grew a very strong +12.3% due to the robust U.S. economy. However, they were muted by imports which subtracted -2.1pp from the headline, largely because of four refinery shutdowns which caused a +45% increase in petroleum imports. Trade remains a worry, and the Bank of Canada is likely to raise rates once more this year, but we maintain our GDP growth forecast of +2.1% in 2018, cooling to +1.9% in 2019.

Europe

Poland: Rapid Q2 growth but gradual slowdown ahead

Real GDP growth slowed down to +0.9% in q/q seasonally adjusted terms in Q2 (from +1.6% in Q1) but maintained a strong pace of +5.1% in y/y terms (only marginally down from +5.2% in Q2). The demand-side breakdown reveals that growth in Q2 was broad-based, in contrast to Q1 when it was entirely driven by domestic demand. Private consumption rose by +4.9% y/y and government consumption by +4.4% in Q2. Capital formation moderated in Q2, with fixed investment up by +4.5% y/y (+8.1% in Q1) and inventories contributing +0.2pp to y/y growth (+1.5pp in Q1). Meanwhile, external trade activity rebounded in Q2, with exports up +6.9% y/y (+1.1% in Q1) and imports up by +6.5% (+3.5% in Q1) so that net exports added +0.5pp to Q2 growth (-1.2pp in Q1). Industrial production and retail data were still strong in July, but the Manufacturing PMI fell to a 22-month low of 51.4 points in August, indicating weakening activity in the months to come. We also expect investment activity to ease somewhat from H2 due to base effects and forecast full-year growth of +4.6% in 2018 and +3.5% in 2019.

Africa & Middle East

Africa: China will hold on

Financing in Africa is changing its pattern, with a declining share of FDI inflows (down -20% in 2017, to USD42bn). Debt is set to become the main source of inflows in 2018. Eurobond issuance was about USD22bn YTD, well above all past year-end figures. More debt and less FDI is not exactly seen as the right financing mix to fund basic infrastructure needs. Moreover, some countries (e.g. Congo Rep. or Angola) are currently trapped in high debt ratios (with a high share of bilateral loans) which is detrimental for growth. China has just pledged loans of USD60bn within the next three years, exactly the same amount of financial support pledged in 2015. However, the nature of support is likely to change, with less concessional (or interest-free) loans (USD15bn instead of USD40bn) and more funds for development and trade finance (USD15bn instead of USD5bn). But these official declarations are not the full story. Overall, we calculated that the Belt and Road Initiative drove about USD280bn to the Middle East and Africa in the past five years.

Asia Pacific

Japan: Feeling the pinch of a U.S. trade war

In Japan, nominal export growth slowed to +3.9% y/y in July from +6.7% in June. Demand was mainly driven by Asia, notably by sound export increases to China (+11.9% y/y) and Hong Kong (+6.1%), and by the EU (+6.4% y/y). Exports to the U.S. decreased by -5.2% y/y. This news was followed by disappointing domestic activity data. Industrial production contracted further (-0.1% m/m after -1.8% in June) and retail sales growth slowed to +0.1% m/m (from +1.5%). Looking ahead, advanced indicators suggest an improvement. The Manufacturing PMI rose to 52.5 points in August (from 52.3 in July) as firms reported a rise in production, in employment and new domestic orders. Note that new export orders decreased on the back of rising trade tensions between the U.S. and its trade partners. Against this background, we expect economic growth to slow to +1% in 2018 (after +1.7% in 2017).

What to watch

- September 6 – Brazil August inflation (official; IBGE)
- September 6 – Germany July factory orders
- September 6 – South Africa Q2 current account bal.
- September 6 – Ukraine Central Bank meeting
- September 6 – U.S. July factory orders
- September 6 – U.S. August ISM non-manufact. index
- September 7 – Canada August employment report
- September 7 – France July industrial production
- September 7 – France July trade balance
- September 7 – Germany July industrial production
- September 7 – Mexico August inflation
- September 7 – U.S. August employment report
- September 8 – China August foreign trade
- September 10 – China August CPI and PPI
- September 10 – Turkey Q2 GDP

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