Euler Hermes Economic Research

Weekly Export Risk Outlook

11 March 2015

FIGURE OF THE WEEK

-0.7%

EH forecast of Brazilian GDP growth in 2015

In the Headlines

Brazil: Recession ahead

The Central Bank again increased the key policy interest rate (SELIC) by 50bps, to 12.75%, the highest level since 2008. A similar increase is likely in April as inflationary pressures continue to strengthen. Indeed, growth in consumer prices in February reached a 12-year high of 7.7% y/y (driven, in particular, by a surge in regulated prices) and markedly above the inflation target range of 4.5% +/- 2pps. Moreover, fiscal consolidation is a key target of the government for 2015, with expenditure cuts and tax increases ahead. However, austerity measures are likely to be difficult to enact amid political tensions; last week, a presidential decree aiming to increase payroll taxes was rejected by legislative leaders from Roussef's coalition. Combined with restrictive economic policies, already weak economic activity will be heavily impacted by the fragile outlook for investment plans of Petrobras (which accounts for around 10% of total Brazilian investment) as well as by water and electricity cuts. After stagnating in 2014, Euler Hermes expects Brazil will be the first Latin American economy to fall into recession in 2015, with real GDP contracting by -0.7%, at least as risks are on the downside.

Eurozone: Industrial momentum improves gradually

German industrial production increased moderately in January, by +0.8% y/y. Manufacturing output increased by +1%, again falling short of its historic long-run average of +1.5%. The strongest growth came from durable consumer goods, with +2.4% y/y, after growing by +5% in December 2014. Construction decreased by -1.2% y/y but this was expected as the weather at end-2014 was exceptionally mild. **French** IP expanded by +0.4% m/m following +1.4% in December. On a quarterly basis, IP was up +0.2%, but still down -0.9% compared with January 2014. This slow rebound in industry appears coherent with the improvement of the overall economy around the turn of the year. In **Spain**, IP increased by +0.4% y/y, largely a result of positive output growth of capital and intermediate goods. In **Italy**, IP unexpectedly decreased by -0.7% m/m (-2.2% y/y), the first fall since October 2014, mainly driven by capital and durable consumer goods. Overall, this data confirm that the Eurozone has entered a moderate recovery path, although output remains markedly below pre-crisis levels.

China: Growth to moderate in 2015

Industrial production growth slowed in January-February, to +6.8% y/y, compared with +7.9% in December 2014. Growth in retail sales decelerated to +10.7% y/y in the same period (from 11.9%). Investment registered limited growth, with total fixed assets increasing by +13.9% y/y (from +15.7%). Deflationary pressures in the manufacturing sector remain evident. Consumer prices increased by +1.4% y/y in February but this resulted largely from seasonal effects relating to the Chinese New Year. Producer prices remained in negative territory for the 36th consecutive month; -4.8% y/y in February (-4.3% in January). Against this background, economic growth will decelerate further in Q1, to around +7.1% (+7.3% in Q4 2014). Going forward, we expect monetary policy will remain accommodative, with additional interest rate cuts in H1 (-25bps at least) and fiscal policy will be broadly supportive of growth, which is set to stabilise in H2 reflecting recovery in both domestic and global demand. EH expects overall growth will slow to +7.1% in 2015 and +7% in 2016, broadly in line with government targets.

Italy: Better days to come

Q4 2014 GDP stagnated and 2014 was the third consecutive year of recession (-0.4%). However, the Q4 breakdown provides some good news. Firstly, net exports contributed +0.4pps to GDP growth, the highest positive contribution since Q2 2013. Exports increased by +1.6% q/q, the strongest growth since Q4 2012. Secondly, investment increased by +0.2% q/q with equipment up by +1%, the first positive growth for three quarters and the strongest since Q4 2010, although construction remained in contraction (-0.6%). In contrast, private consumption growth remained weak at +0.1% q/q. Going forward, business confidence is improving, with the Manufacturing PMI in February above 50, for the first time in five months. Credit conditions are easing (and should do so further with ECB QE) but credit demand is still weak. From Q2 onwards there will be a boost to private consumption through lower oil prices and to export growth because of a lower EUR. We revised upwards by +0.1pps our GDP growth forecasts to +0.4% in 2015 and +0.9% in 2016, still below Eurozone averages of +1.3% and +1.5%.

Countries in Focus

Americas

U.S.: Labour market continues to strengthen

The economy added +295,000 jobs in February, above consensus, as unemployment ticked down -0.2pps to 5.5%. Both hourly and weekly earnings increased +0.1% m/m, but on a y/y basis after inflation increased by only +0.3% and +0.9%, respectively. The JOLTS survey also showed strength as the number of job openings reached its highest level since 2001. The February ISM non-manufacturing survey showed even further progress as the employment component gained a sharp +4.8 to 56.4, markedly above the 50 level indicating expansion. The total index gained +0.2 to a healthy 56.9 and the new orders component, although it fell, remained at a robust 56.7. Meanwhile, the January goods and services balance improved to -USD41.8 bn from -USD45.6 bn in December 2014, driven to a large extent by the petroleum deficit, which declined to -USD10.7 bn from -USD14.6 bn. The only disappointing data this week came from Q4 2014 productivity, which fell an annualised -2.2% q/q.

Europe

Poland: Further monetary easing as deflation persists

The Monetary Policy Council (MPC) last week lowered its key policy interest rate by 50bps to 1.5%. This was only the second rate cut since mid-2013 (after a 50bps reduction in October 2014), even though consumer price inflation has been below the MPC's inflation target range of 2.5%±1pps since February 2013 and has been in deflation territory since July 2014, reaching a record low -1.3% y/y in January 2015. The latest monetary easing was explained by an expectation of prolonged deflation as a result of moderate wage growth, the fall in global prices for oil and other commodities and the lack of demand pressures. Private sector credit growth has gradually picked up from +4.5% y/y at end-2013 to +7.7% y/y a year later but remains markedly below the long-term average for emerging markets (+13.5%). Euler Hermes expects further monetary easing in the near term as deflation is set to continue in H1, before possibly giving way to moderate inflation in H2 and 2016.

Africa & Middle East

Lesotho: Successful elections, but political fragility

There was no outright winner in legislative elections on 28 February and a multi-party coalition government under PM Pakalitha Mosisili will take office on 17 March. The country has a recent history of coalitions, which tend to limit the potential for reforms and do little to consolidate political stability. The seven-party coalition currently being formed appears unwieldy and EH expects internal power struggles for ministerial, parastatal and NGO official positions. Although the elections were peaceful and democratic, the political environment remains fragile, with competing power bases in the army and the police force adding to the mix. An alleged coup attempt in August 2014 may have resulted from branches of the security forces aligning with different political factions. Lesotho is landlocked within South Africa and the latter is likely to intercede, as it did in 1998, if any dispute looks as though it will lead to severe instability. Commercial prospects are limited.

Asia Pacific

Thailand: Early 2015 data prompt a cut in interest rates

Today, the Bank of Thailand reduced its key interest rate (by -0.25bps) to 1.75% in a policy move aimed at boosting market confidence and supporting economic growth. The latter was only +0.7% in 2014 and the latest short-term indicators point to weak growth in Q1. Credit to the private sector continues to decelerate (+3.8% y/y in January, +6.4% in July 2014). Manufacturing production deteriorated in January (-1.3% m/m) and consumer confidence remained on a downward trend (79.1 in February from 80.4 in January). Price pressures remain weak, with headline inflation in negative territory for the second consecutive month in February (-0.5% y/y after -0.4% in January) reflecting lower energy prices. Trade data this year are disappointing, with exports contracting in January (-3.5% y/y). Against this background, the cut in the policy rate will probably have a modest effect. GDP is set to recover in 2015 but only moderately (+2.2%) supported by improving global demand.

What to watch

- March 12 – Eurozone January industrial production
- March 12 – France & Germany February CPI
- March 12 – India February CPI
- March 12 – India January industrial production
- March 12 – South Africa January mining output
- March 12 – U.S. February retail sales
- March 13 – Russia monetary policy meeting
- March 13 – Canada February unemployment
- March 13 – Japan January industrial production
- March 16 – U.S. February industrial production
- March 17 – Israel elections
- March 17 – Russia February industrial production
- March 17 – Turkey monetary policy meeting
- March 17 – U.S. February housing starts & permits
- March 17 – South Africa Q4 2014 current account
- March 18 – Ukraine February industrial production
- March 18 – U.S. Fed meeting announcement

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