Euler Hermes Economic Research

Weekly Export Risk Outlook

10 October 2018

In the Headlines

FIGURE OF THE WEEK

+5.4%

Egypt's GDP growth in FY 2017/18

Brazil: Pro-business stance prevails in election, for now

As expected, far-right candidate Jair Bolsonaro won the first round of the Brazilian presidential election last Sunday. Yet his comfortable lead surprised on the upside (46% of the votes, close to 17pp above runner-up Fernando Haddad) as it had been underestimated by polls. In addition, Bolsonaro increased his number of seats by +44 in the lower house of Congress and now holds 10% of total seats. Markets, who had already priced in his lead, still reacted positively to the unexpected Congress renewal rate and conservative breakthrough. On the day after the election, the Brazilian stock market index gained +4.6% and the BRL +1.6% against the USD, as Bolsonaro reaffirmed his pro-business policy platform. Providing he avoids making a series of mistakes in debates and TV interviews, he is best positioned to win the second round on 28 October against Haddad. The latter, former President Lula's designated candidate, plans to eliminate the fiscal spending cap and overturn the recent labor market reform, unnerving markets. He will struggle with his party to make moves towards the center. However, in case of a Bolsonaro victory, concerns about governability and stability of his policy platform remain.

Russia: De-dollarization plans

Against the background of deteriorated inter-bank lending conditions in the context of tightening global liquidity and intensified U.S. sanctions against Russia, the government is reportedly working on measures to reduce the Russian economy's dependence on the USD. The plans includes encouraging and facilitating the usage of alternative currencies in international trade. For example, transactions with the EU and China, Russia's main trading partners accounting for nearly 60% of its foreign trade, could be shifted into EUR and CHY while trade with CIS countries could be done in RUB. However, previous efforts to do so have had little success, highlighting that close cooperation with other countries is needed. This may be easier now in a world of rising U.S. protectionism. Other measures could be delisting of major Russian companies from foreign stock exchanges and increasing gold and EUR reserves. Russia has already reduced holdings of U.S. government debt by around USD80bn this year. Still, large-scale de-dollarization will take time – estimates range between 1.5 and five years.

Egypt: Back in time

In the fiscal year (FY) 2017/18 (ending June 2018), the economy grew by +5.4%, the highest growth rate in the last decade. And the economy rebalanced rapidly as the current account deficit decreased from -6.3% of GDP in FY 2016/17 to -2.5% in FY 2017/18. The overall political stabilization is still generating positive results; for example tourism receipts increased from USD4.4bn to USD9.8bn (about 4% of GDP). Moreover, the currency depreciation engineered in November 2016 (-50%) continues to benefit the economy through local production substituting imports; e.g. sales of locally assembled cars increased by +26% y/y in July. Further, gas output increases helped to end gas imports. Also, FDI inflows (USD7.7bn) fully covered the current account deficit last year. Along with foreign reserves still providing 8 months of import cover, it implies that the financial situation of the country is improving fast. Moreover, the unwinding of energy subsidies has helped to reduce the fiscal deficit (-7.9% of GDP) without causing too much inflation (14%). Growth should accelerate further to +6% in FY 2018/19.

Saudi Arabia: Gradually gaining momentum

Real GDP growth picked up to +1.6% y/y in Q2 from +1.2% in Q1. Both the oil sector (+1.3% y/y, after +0.6% in Q1) and the non-oil sector (+2.4% y/y, up from +1.6%) gathered momentum in Q2. Within the non-oil sector, non-oil private sector GDP expanded by +1.8% y/y (+1.1% in Q1) and non-oil public sector GDP rose by +4% y/y (+2.7% in Q1). The latter reflects fiscal stimulus measures implemented in Q2 to offset the blow to incomes from austerity measures at the beginning of the year. Looking ahead, we expect the recovery to gain further momentum in H2 2018, for several reasons. First, the non-oil private sector PMI, although easing to 53.4 points in September from 55.1 in August, posted an average 54.5 in Q3 which was stronger than in Q2 (53.2) and Q1 (53.0). Second, a large boost to growth is expected to come from the revised OPEC agreement from end-June which should result in an increase of Saudi oil output by up to +0.5 million barrels per day in H2. Third, increased oil output combined with higher oil prices provide some leeway for continued fiscal stimulus. Euler Hermes forecasts full-year GDP growth of about +2% in 2018 and +2.5% in 2019.

Countries in Focus

Americas

U.S.: Jobs report better than it looks. Yields jump.

The economy created +134k jobs in September compared to +180k expected, but there were two mitigating factors. Hurricane Florence kept some people off the payrolls, and the prior two months were revised up a sharp +87k. The unemployment rate dropped from 3.9% to 3.7%, the lowest since December 1969. Wage growth slipped to +2.8% y/y from last month's +2.9%, which was the highest in nine years. However, weekly wages are growing faster at +3.4% y/y. The ISM non-manufacturing index posted a blistering 61.6 points, just shy of the record 62.0 set 21 years ago. New orders rose +4.5 points to 65.2, and the employment component rose to a record high 62.4. Fed Chair Powell reiterated the need for more interest rate hikes in two speeches. The combination of low unemployment, strong ISM, and a stiff Powell caused the yield on the 10-year Treasury to jump +18bp on the week to 3.23%, the highest in seven years.

Europe

UK: Summer is over

Real GDP growth remained stable in August (0% m/m) after a rebound in July (+0.4% m/m) driven by the summer pick-up in services and construction. Looking at the details in August, activity in services grew by a meager +0.1% m/m while it contracted in manufacturing (-0.2% m/m) and construction (-0.7% m/m). Taking into account the rise in uncertainty since August we expect a slight contraction in the September GDP which would bring Q3 GDP growth to +0.5% q/q after +0.4% in Q2. Going forward, we pencil in GDP growth of +0.2% q/q in Q4 supported by contingency stockpiling and moderate consumer spending. Company investment is expected to have been delayed by the rising Brexit-related uncertainty. However, while companies do not invest to increase production capacity, they seem to invest in digitalization: activity in ITC grew stronger than the whole services sector over the past year. A "last-minute" Brexit deal is expected by mid-January which should bring some temporary relief. Overall, we expect GDP growth to reach +1.3% in 2018 and +1.2% in 2019.

Africa & Middle East

South Africa: Seven

South Africa experienced many disruptions during the last summer. The last one was the resignation of Nhlanhla Nene. He will be replaced by Tito Mboweni who will become the seventh Finance Minister in the last five years. The first nine months of President Ramaphosa were not exactly the honeymoon that had been expected and the resignation of Nene over corruption allegations is just one more proof that the bottlenecks inhibiting the growth potential will be hard to overcome. However, it seems that some of the additional burden that was put on growth in H1 is set to end. The business confidence index recovered from the low experienced in August (90 points) to 93 in September. Strikes in the mining sector as well as in key public enterprises (such as Eskom) were the result of a confrontational wage bargaining process. Since the unions have agreed on new wage deals, output should now recover somewhat. However, it should be just enough to meet our 2018 growth forecast (+0.7%).

Asia Pacific

China: Stimulus tap open

China revealed a new set of policies to boost growth. The Central Bank announced a reduction of 100bp in the Reserve Requirement Ratio, effective from 15 October. This move is expected to release RMB1.2tn in liquidity of which RMB450bn will be used to pay off maturing medium-term lending facility loans. Moreover, the government announced a rise in export tax rebates to support corporates in the context of rising protectionist policies from the U.S. These announcements came with no surprise as the economic data flow has been broadly negative recently: industrial activity was weak in July and August; the manufacturing PMI pointed to slower growth in September; and Chinese stock markets and the RMB remain stuck at low levels. Looking ahead, we expect monetary authorities to maintain their accommodative stance and another RRR cut (by -25bp to -50bp) could be possible if activity indicators remain weak in Q4. We maintain our full-year growth forecast of +6.6% this year and +6.3% in 2019.

What to watch

- October 11 – Turkey August balance of payments
- October 11 – U.S. September consumer prices
- October 12 – Canada Teranet housing prices
- October 12 – Eurozone August industrial production
- October 12 – Mexico August industrial production
- October 15 – Canada September home sales
- October 15 – U.S. September retail sales
- October 16 – China September inflation
- October 16 – Eurozone August foreign trade
- October 16 – U.S. September industrial production
- October 16 – Hungary Central Bank meeting
- October 17 – Eurozone September CPI
- October 17 – EU Summit
- October 17 – Ghana Q2 GDP
- October 17 – UK September CPI

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