Euler Hermes Economic Research

Weekly Export Risk Outlook

4 May 2016

FIGURE OF THE WEEK

+0.6%

Eurozone q/q Q1 2016 GDP growth

In the Headlines

Spain: Still solid GDP growth despite political uncertainty

The first quarter of 2016, a year that started without a government formation following the inconclusive elections in December 2015, still produced good economic results, with GDP expanding by +0.8% q/q, the same pace as in the previous quarter, and slightly above expectations. Retail sales expanded by +4.3% y/y in March, indicating that domestic demand continued to drive growth. Industrial production increased by +2.2% y/y in February. Bank interest rates for SME continued to fall (2.75% on average for loans between 1- 5 years, below current rates in Germany) while deflationary issues are progressively easing. Even though political uncertainty has not yet translated into economic disturbances, it has started to weigh on domestic business and consumer confidence which have deteriorated strongly in Q1. Foreign investor confidence has also been affected. Portfolio investment inflows fell sharply to EUR14bn in the 12 months ending in February 2016, down from a peak of EUR114bn in October 2015. After a last round of government formation talks failed again, the King of Spain dissolved Congress yesterday, calling new elections to be held on 26 June.

U.S.: Weak consumer hurts Q1 GDP, Fed on hold

Q1 GDP growth was only +0.5% q/q annualized, hurt by business investment which shaved -0.6pps from the headline while inventories and net exports both detracted -0.3pps. Consumption grew only +1.9% q/q annualized, and in March it was virtually unchanged at +0.05% m/m, despite a decent gain in real disposable income of +0.3% m/m to +3.1% y/y. The Fed's preferred inflation measure, the PCE core rate slipped from +1.7% to +1.6% y/y in March. As expected the Fed left interest rates unchanged but issued a dovish statement which virtually mirrored the GDP report, saying "economic activity appears to have slowed" and "household spending has moderated." The trade deficit in goods shrank from USD62.9bn in February to USD56.9bn in March, driven by a -1.7% m/m drop in exports while imports fell -4.4%. The April ISM manufacturing index fell from 51.8 to 50.8, barely above the 50 level signalling expansion, while the "new orders" component remained solid at 55.8 despite falling from 58.3. We believe the Fed will hike one time at most this year, probably in H2.

France: These boosts are made for working!

In France, growth surprised on the upside during the first quarter (+0.5% q/q). This growth acceleration was partly explained by cyclical factors. Private consumption was very weak during the fourth quarter of 2015 (-0.1% q/q) but recovered very quickly in the first quarter (+1.2% q/q) of 2016. This bumpy growth profile is related to shocks such as the terrorist attacks in November. The oil price evolution also helps explain the growth figures (the cycle and the trend). A weak oil price is favorable for household and corporate purchasing power, but when oil prices recover (such as in Q2 2015 and currently) economic growth often fades. However, at the end of the day, the trend in oil prices (low for longer) is growth-friendly. Corporate profit margins are rapidly recovering. At 31.4% at the end of 2015, margins were 2 points higher than at their 2014 lows and are expected to return rapidly to their long-term average (32.5%). Last but not least, business insolvencies decreased visibly during the first quarter (-4.5% y/y).

Emerging Markets: Unpleasant growth arithmetic

Some emerging markets are experiencing a new cyclical deterioration. An aggregate manufacturing PMI computed by Euler Hermes decreased to 49.3 in April (from 49.9 in March), but with strong regional divergences. Resilient growth engines, such as Asia or Central Europe remain stable. The weakness is mainly related to vulnerable economies (with fiscal and/or current account deficits). The so-called fragile five (Brazil, Turkey, Russia, South Africa, Indonesia) aggregate manufacturing PMI exhibited a record low of 46.9 in April. This weakness is driven by domestic factors, particularly in Latin America, where the negative shock led by "low for longer" commodity prices still has detrimental effects on confidence, which in addition has also been hit by social tensions (unemployment is increasing very fast) and rising political risks (situations in Brazil, Venezuela or Chile). The last update of global housing prices revealed a very strong deterioration in this set of fragile economies. Against the backdrop of such an unfavorable cyclical outlook, Euler Hermes forecasts global business insolvencies to increase by +2% in 2016, driven by emerging markets.

Countries in Focus

Americas

Venezuela: Power crisis - the straw that broke the camel's back

Venezuela has been hard hit by "low for longer" oil prices (which account for 95% of exports). With a rapid depletion of foreign exchange reserves and a free fall of the bolivar on the parallel market, inflation is now skyrocketing, and risks to our forecast of 400% by the end of the year are more on the upside now. Moreover, the country is now facing a serious power crisis. To cope with it, President Maduro declared a two-day work week for public sector employees, who represent 20% of the country's labor force, for at least two weeks. This could be extended if El Guri dam, the country's main source of electricity, continues to face water shortage. The country is fighting many bottlenecks, partly a result of weak investment for many years. Political and social tensions are very high and the country could soon move to unchartered territories: a sovereign debt default and/or serious political turmoil cannot be ruled out anymore.

Europe

Hungary & Russia & Turkey: Monetary policies

The Monetary Council of **Hungary** reduced its key policy interest rate once again by 15bps to 1.05% last week (after an equal cut in March) citing unused capacity in the economy that has a deflationary impact. Indeed, after five months of moderate but positive inflation, consumer prices fell again by -0.2% y/y in March. The Central Bank of **Russia** kept its key policy rate unchanged at 11% last week, even though inflation fell to 7.3% y/y in March (from an average 15.6% in 2015), citing continued elevated inflation risks, including looser fiscal policy and exchange rate risks. EH expects gradual monetary easing in H2 2016. The Central Bank of **Turkey** continued its gradual monetary loosening in late April, lowering the overnight lending rate by 50bps to 10% (after a 25 bps cut in March) but it kept the overnight borrowing rate at 7.25% and the key one-week repo rate at 7.5%. Inflation fell to 6.6% y/y in April. Should the inflation outlook improve further, EH expects more rate cuts to come.

Africa & Middle East

Ghana: Working with the IMF

GDP growth in Q4 2015 was +1.3% q/q and +4.9% y/y (+4.5% y/y in Q4 2014). The first estimate for full-year 2015 puts growth at +3.9% (+4% in 2014), reflecting a decline in output in key export sectors, particularly gold following a large mine closure. In addition, low oil prices reduced the contribution from that sector, and electricity production fell. Non-oil GDP growth in 2015 was +4.1%. Meanwhile, the Central Bank re-affirmed that key policy considerations remain inflation control and a reduction in interest rates, although both will take time; inflation was 19.2% y/y in March (18.5% in February), the highest since August 2009. A three-year ECF was approved by the IMF in April 2015 (see also EH Country Report March 2016) and the Fund released a disbursement of USD115mn from this facility in January, noting that the reform agenda (including fiscal consolidation to reduce twin deficits) is on track, although debt levels remain a concern. EH expects GDP growth of +5% in 2016 and +7% in 2017.

Asia Pacific

China: Struggling economic activity

China's PMIs indicate weaker economic momentum in April. For manufacturing, the official PMI still points to meager expansion (50.1, after 50.2 in March) but the pace will likely be slower with lower growth in both output and new orders. The Markit/Caixin PMI (49.4, down from 49.7 in March) signals deepening contraction as the new export orders component declined further. Both surveys indicate a decrease in staffing numbers. For non-manufacturing activities, the official PMI edged down (53.5 in April from 53.8 in March) due to lower new orders and sales prices. Looking ahead, activity improvement will be very gradual. Room for indicators' volatility is elevated due to ongoing overcapacity, a high corporate debt overhang and weak export opportunities. Fiscal and monetary stimuli have already started to bear fruits with recovering real estate and higher growth in public investment. The pace is set to strengthen going forward. EH expects real GDP growth at a decent +6.5% in 2016.

What to watch

- May 05 – Romania interest rate decision
- May 06 – U.S. April employment report
- May 06 – Poland interest rate decision
- May 06 – Russia and Ukraine April CPI
- May 06 – Mexico April consumer confidence index
- May 08 – China April foreign trade balance
- May 09 – Eurogroup meeting on Greece
- May 09 – Turkey March industrial production
- May 09 – Germany March manufacturing orders
- May 10 – France, Germany and Italy March IP
- May 10 – Czech Rep. and Hungary April CPI
- May 10 – Germany March current account balance
- May 10 – Turkey March current account balance
- May 10 – U.S. March JOLTS survey
- May 10 – China April aggregate financing

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