Euler Hermes Economic Research

Weekly Export Risk Outlook

5 December 2018

FIGURE OF THE WEEK

+0.8%

Q3 2018 q/q GDP growth in Brazil

In the Headlines

Eurozone: Progress towards reform of the ESM

As expected the Eurogroup presented their proposal for ESM reform ahead of the 13-14 December EU Summit. The ESM shall receive a larger role in designing, negotiating and monitoring financial assistance programs. In addition it shall act as a backstop for the Single Resolution Fund before 2024, provided that the banking sector shows sufficient risk reduction by 2020. The agreement moreover aims to improve the eligibility for precautionary credit lines extended by the ESM, but conditionality will remain strong. Countries will have to meet the quantitative benchmarks of the EU fiscal rules (i.e. a below 60% debt-to-GDP ratio and a deficit below 3% of GDP) and to comply with qualitative conditions related to the EU's surveillance of macroeconomic imbalances (i.e. not experiencing excessive imbalances or being subject to the Excessive Deficit Procedure). The sustainability of general government debt further remains a key prerequisite for eligibility. Next steps are the proposal's endorsement at the EU Summit and the necessary ESM Treaty amendments by June 2019. Meanwhile, no progress was made on the third pillar of the EU banking union, the European Deposit Insurance Scheme (EDIS). However, we expect a more concrete discussion after the EU Summit.

U.S.: Volatility from mixed signals

Economic news has been volatile. Real personal consumption expenditures rose +0.4% m/m in October to +2.9% y/y, and like holiday sales, it's solid but unexciting. Disposable personal income gained +0.3% m/m to a +2.8% y/y rate. The ISM manufacturing report came out stronger than expected, but a separate report showed construction spending was weak. Fed Chair Powell took a more dovish stance last week, saying that interest rates "remain just below" neutral as opposed to "a long way" from neutral previously. Over the weekend at the G-20, the USMCA was symbolically signed by the three countries, and the U.S. and China struck a temporary truce in their trade dispute. The next deadline is 90 days away when Trump may raise tariffs from 10% to 25% on USD200bn of Chinese goods. U.S. financial markets have been whipsawed over the past week, first by the dovish Fed news and relief on the trade front, but now by fears over slowing growth as the yield curve approaches inversion, where short term interest rates are higher than long term rates – a harbinger of a potential recession in 3-5 quarters.

Brazil: Back on the slow recovery track

Real GDP growth accelerated to +0.8% q/q in Q3, up from +0.2% in Q2. This was the fastest q/q pace since Q1 2017, the first recovery quarter after Brazil's worst recession. Compared to Q3 2017, GDP grew +1.3%. This confirms Q2's weak performance was a temporary dip due to the truckers' strike in May. Private consumption added +0.4pp to Q3 q/q growth as unemployment continued to decrease from 12.4% in June to 11.9% in September. Investment surprised on the upside (+1% q/q, up from +0.2% in Q2). Annual GDP growth could reach +1.3% in 2018 and accelerate to +2.3% next year, thanks to the gradual recovery of consumption as the job market improves and higher investment as electoral uncertainty partly dissipates. Yet, reforming pensions will prove difficult and we cannot exclude volatility in President Bolsonaro's policy choices due to his history of backing statist policies and the necessity to compromise to build a parliamentary coalition. Subdued growth remains our medium-term baseline, especially as monetary policy is expected to be tightened in 2019.

Emerging Markets: What a difference a year makes

In January 2018, Emerging Markets (EM) open to trade (from Asia, Eastern Europe and Latin America) recorded their highest aggregate Manufacturing PMI since March 2011, well in the growth territory. As President Trump began introducing protectionist rhetoric in February, this momentum faded and after the implementation of tariffs against China, the aggregate PMI of open economies went into negative territory in September (49.9 points). In November, this PMI decreased to a new low of 48.8, a level not observed since the great recession about ten years ago. This negative sentiment is broad-based, since 65% of the countries in the sample is now in negative territory. Along with Asian trade hubs, Mexico and Poland are now below 50. In Poland this is the first time since September 2014, with continued weak new export orders. At the same time, financially vulnerable EM took some relief, particularly Brazil and South Africa. However, Turkey remained the weakest in the loop as markedly higher inflation is now a drag on the economy.

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Countries in Focus

Americas

Canada: GDP in line, oil prices to stabilize on cuts

Q3 GDP grew +2% q/q annualized as expected, to a +2.1% y/y rate, but the details were mixed. On the plus side, inventories were responsible for dragging down the headline by -1.3pp. But consumption was weak, growing only +1.2% q/q annualized to a slow +1.8% y/y, and investment was especially disappointing, shrinking -5% q/q. And the biggest contributor to growth by far was a sharp decrease in imports of -7.8% q/q due to a surge in domestic petroleum production. We expect GDP growth for all of 2018 to be +2.1% and +2% for 2019. Western Canadian Select (WCS) crude has been trading at a massive discount to WTI due to the inability to transport WCS, but that discount, which had been close to USD50 per barrel, has narrowed to around USD35 and is expected to shrink to USD20 after an 8.7% production cut ordered by Alberta. The symbolic signing of the USMCA may help stabilize some trade concerns, although the metals tariffs still remain in place.

Europe

Greece: Recovery remains on track, for now

In contrast to its Eurozone peers the Greek economy saw economic growth accelerate in Q3 2018 with GDP expanding by +1% q/q after +0.4% q/q in the previous quarter. On an annual basis GDP growth rose to +2.2% y/y, up from +1.7% y/y in Q2 2018 with stronger private consumption and an increase in inventories more than offsetting a sharp drop in gross fixed capital formation. Meanwhile, net exports made a negative contribution with import growth exceeding that of exports in a sign that domestic demand is strengthening. Recent economic data as well as sentiment indicators – including consumer confidence and the Manufacturing PMI – point to a further strengthening of momentum in the quarters ahead. All in all we stick to our forecast that the Greek economy will grow by +2.5% in 2019 after +2.3% in 2018. Nevertheless, to ensure that Greek growth prospects remain dynamic beyond the short-term, key challenges still need to be tackled including banking sector risk and regaining the trust of long-term investors by sticking to the reform path.

Africa & Middle East

South Africa: Painful growth

Growth edged up to +0.6% q/q (+2.2% annualized) in Q3, after a recession in H1 (-0.7% in Q1 and -0.1% in Q2). Combined this means that Q3 GDP was still below the level observed at end-2017. The Q3 recovery was driven by the agricultural sector (+1.2% q/q after -6.9% in Q2) as well as the manufacturing sector. However, mining output remained in negative territory (-3.5%) as well as construction output (-1.9%, the fifth consecutive quarterly deterioration). In our view, the recession in H1 was not broadly based as key manufacturing and services sectors still showed growth. However, the difficult situation in the labor market, low confidence in the private sector and the consequence of the wage bargaining process weigh on the investment outlook. Low growth also means that debt is likely to rise. The debt due next year is already at 87% of foreign reserves. The growth outlook for Q4 is not vibrant since power blackouts are likely. We expect growth of +0.7% in 2018 as a whole and +1% in 2019.

Asia Pacific

India: Slower growth masks domestic resilience

Economic growth slowed to +7.1% y/y in Q3 (after +8.2% in Q2) due to a lower contribution of net export and a slower expansion of private consumption. Exports edged up to +13.4% y/y (after +12.7% in Q2) but the performance was offset by a surge in imports (+25.6% y/y). On the domestic side, private consumption slowed but remained resilient at +7% (after +8.2% in Q2). Growth of investment (+12.5% in Q3 after +10% in Q2) and government consumption (+12.7% after +7.6%) accelerated. Meanwhile, short-term indicators suggest stronger growth in Q4. Infrastructure output rose by +4.8% y/y in October (up from +4.3% in September). Bank credit growth is above +14% in November despite a tightening of monetary policy. And business surveys are well oriented: both the Manufacturing (54.0 in November) and Services PMIs (53.7 in November) are well above 50 and increasing. In that context, we expect economic growth to rise by a solid +7.4% in FY2018-19 (from +6.7% in FY2017-18).

What to watch

- December 6 – U.S. October trade
- December 6 – U.S. November factory orders
- December 6 – U.S. ISM non-manufacturing index
- December 7 – Canada November employment report
- December 7 – Eurozone Q3 GDP (with breakdown)
- December 7 – France October industrial production
- December 7 – France October trade balance
- December 7 – U.S. November employment report
- December 10 – Japan Q3 GDP (second estimate)
- December 10 – Nigeria, Turkey Q3 GDP
- December 11 – Turkey October BOP
- December 11 – UK planned Parliament vote on the Brexit deal
- December 11 – U.S. November producer prices
- December 12 – Brazil interest rate decision

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