Euler Hermes Economic Research

Weekly Export Risk Outlook

7 November 2018

FIGURE OF THE WEEK

+2.3%

Q3 2018 y/y GDP growth in Taiwan

In the Headlines

U.S.: Democratic House, Republican Senate to provide legislative stagnation, more investigations

The Democratic Party took control of the House of Representatives last night, while the Republicans maintained their majority in the Senate. The divided Congress is likely to produce another two years of political turmoil and legislative gridlock. Democrats have threatened to use their majority in the House to launch new investigations into President Trump's affairs, perhaps including another Russian collusion probe, and a look into Trump's personal taxes and international business dealings. Democrats could also begin impeachment proceedings although a removal from office is unlikely since that would require 67 votes in the Senate. It is doubtful that there will be any major legislative accomplishments over the next years as the Republicans in the Senate will defy the Democrats in the House, and vice versa. There are a few possible areas for bi-partisan action, however, including approval of the USMCA agreement and other trade measures, infrastructure spending, immigration reform, and drug pricing. President Trump will likely intensify his use of Executive Orders as his only way to govern effectively and implement his agenda.

China and U.S.: Trade war – a glimmer of hope?

Last week, President Trump hinted at a trade deal with China. He said that there has been some progress in resolving trade tensions between the two nations and China was ready to make concessions. Then, he reportedly asked officials to draft the terms of a potential trade deal ahead of the next G20 summit in Buenos Aires later this month. In China, the tone was not as positive. In his keynote speech at the Shanghai Trade Fair, President Xi did not mention any concessions that China could make to respond to President Trump's demand; he indirectly criticized the current U.S. trade policy while casting China as a globalization champion. Looking ahead, we believe that it is too early to foresee a trade deal by the end of this month but progress and more detail on a bilateral agreement could be announced at the G20 summit. This could imply for now: a pause in tariff escalation with no increase of tariffs to 25% for USD200bn of imports from China (currently at 10%); no further tariffs on the remaining imports from China. The average U.S. tariff rate would remain below 6%, a level not too disruptive for global trade growth. The latter would slow but remain resilient at +3.6% in 2019 (after +3.8% in 2018).

Germany: Growth likely to have paused in the third quarter

Seasonally adjusted industrial production rose by only +0.2% m/m in September. On average in Q3, production was thus -0.9% below the level in Q2. This disappointing development can be explained to a considerable extent by a specific factor. The automotive sector faced major problems with the certification of vehicles according to a new emission test procedure, which led to a very sharp drop in auto production. There is no doubt that the prospects for the German economy have deteriorated in recent months. This can be seen both in sentiment indicators and in "hard" economic data such as production, incoming orders and retail sales. In our view the main reasons for this are the continuing uncertainty over the outcome of the trade dispute with the U.S. and sluggish progress in the Brexit negotiations. The further development in these problem fields will play a decisive role in determining whether the German economy will noticeably regain momentum or not following a likely stagnation in Q3.

UK: More rate hikes post Brexit deal?

At the Bank of England (BoE) meeting last Thursday, there was a unanimous vote to keep interest rates unchanged at 0.75% and maintain the stock of gilt and corporate bond purchases at GBP435bn and GBP10bn, respectively. The BoE signaled a faster pace of interest rate hikes should a Brexit deal be signed by March 2019. The pound registered its biggest rally in around 18 months as expectations for two rate hikes started to be priced in by markets. While we assign a 70% probability for a last-minute Brexit agreement by January 2019, we doubt the economy will accelerate as expected by policymakers. The remaining uncertainty regarding the trade deal after the 21-month transition period will weigh on corporate investment and be a drag on the GBP. This coupled with the global slowdown is expected to bring UK GDP growth to +1.2% in 2019 (from +1.3% in 2018) against +1.7% expected by the BoE and +1.6% by the Office for Budget Responsibility. Hence, the state of the economy is likely to be conducive for only one +25bp rate hike in Q2 2019.

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Countries in Focus

Americas

Mexico: AMLO’s first confidence shock

In October, we argued that Mexico was not yet out of the woods, due to a still sizable probability of policy mistake. And this despite its rather favorable economic environment and a cycle driven by strong U.S. activity. Yet once again, policy choices weighed significantly on financial conditions. The cancellation of a USD13.3bn airport project – which had started three years ago and had already issued bonds – after a hasty referendum with very low participation was a blow to market confidence. Since a recent high in mid-October, the Mexican peso (MXN) has depreciated by -6% and crossed USD1=MXN20 for the first time since July while the stock market has lost -4%. The political decision decreases further the likelihood of the implementation of president AMLO’s social spending agenda as public finances should bear the brunt of the cancellation. Should AMLO’s nationalistic stance on the oil sector lead to restrictions on future investment, markets could definitely turn their back on his administration’s policies, curbing growth prospects.

Europe

Central Europe: Monetary policy

The National Bank of the **Czech Republic** (CNB) raised its key monetary policy interest rate by 25bp to 1.75% last week, continuing its gradual tightening cycle (seven hikes by a cumulative 170bp since August 2017). Inflation eased to 2.3% y/y in September but remained slightly above the CNB’s 2% target. In contrast, the National Bank of **Romania** (NBR) decided yesterday to hold its key monetary policy interest rate unchanged at 2.5%, even though inflation (5.0% y/y in September) remained well above the NBR’s 2.5% ± 1pp target range and nominal wages continued to surge by over +13% y/y in Q3. The NBR argued that core inflation continued to fall to 2.7% in September. Today, the Monetary Policy Council (MPC) of **Poland** kept its key policy rate at 1.5%, unchanged since March 2015. Inflation fell to 1.7% in October, well below the MPC’s 2.5% target. The three countries’ currencies have shown resilience to global EM turbulences (Argentina, Turkey), having fallen only marginally by less than -1% against the EUR since end-July. We expect gradual monetary tightening in these countries in 2019.

Africa & Middle East

Kuwait: Recovery is on the way

Real GDP growth rebounded to +1.9% y/y in Q2 from a contraction by -0.5% in Q1 (the latter was sharply revised downwards from a previous estimate of +1.6%). The rebound in Q2 was mainly due to a recovery in the non-hydrocarbon sector. In particular, the manufacturing sector surged by +11.4% in Q2 after declining by -13.1% in Q1. However, the construction sector continued to decline by -5.4% in Q2, albeit at a slower pace than in Q1 (-8.3%). Meanwhile, the oil and gas mining sector remained broadly flat in Q2 (-0.1% y/y, unchanged from Q1) as Kuwait kept oil output at a steady 2.7mn bbl/day in 2017 and H1 2018. Following the revised OPEC agreement from end-June, oil production has been raised by +3.7% to 2.8mn bbl/day since July. This should contribute to stronger GDP expansion in H2 and take the full-year 2018 growth rate to +1.8% (after a -3.5% contraction in 2017). We expect oil output to be increased further next year and forecast growth of +2.8% in 2019.

Asia Pacific

Taiwan: All bet on domestic demand

GDP growth slowed to +2.3% y/y in Q3 from +3.3% y/y in Q2 on the back of slower export growth. Domestic demand was the main driver this time, driven by a surge in investment (+17.5% y/y after -2.6% y/y in Q2). Private consumption rose moderately (+1.9% y/y). Looking ahead, downside risks are elevated. The Manufacturing PMI decreased to 48.7 points in October (from 50.8 in September) with a drop in output and new orders. Corporate sentiment is weak due to ongoing trade tensions and a slowdown in global demand growth. In that context, growth will mainly rely on domestic demand and macroeconomic policies. We expect the Central Bank to maintain its easing stance in the short run (policy rate at 1.375%) and fiscal policy to turn accommodative. Economic growth is expected to slow to +2.3% in full-year 2019 (from +2.6% in 2018).

What to watch

- November 8 – Hungary October inflation
- November 8 – Mexico October inflation
- November 8 – U.S. Fed policy announcement
- November 9 – Mexico Sept. industrial production
- November 9 – UK Q3 GDP (preliminary estimate)
- November 9 – UK September trade balance
- November 9 – U.S. October producer prices
- November 12 – Poland, Romania October inflation
- November 13 – Brazil September retail sales
- November 14 – China October activity indicators
- November 14 – EU Q3 GDP (second estimate)
- November 14 – EU countries (several) Q3 GDP (flash estimates)
- November 14 – Ukraine Q3 GDP (flash estimate)
- November 14 – U.S. October consumer prices