Euler Hermes Economic Research

Weekly Export Risk Outlook

11 July 2019

FIGURE OF THE WEEK

+1.7%

Q1 2019 y/y GDP growth in Saudi Arabia

In the Headlines

Germany: H2 2018 déjà-vu fuels recession fears

Thanks to gains in the production of capital and consumer goods, seasonally adjusted industrial production in May rose by +0.9% compared with the previous month. This rather encouraging development, however, is unlikely to be enough to pull the cart out of the ditch and compensate for the sharp decline in industrial production in the previous month. Following a stabilization in the first quarter of 2019, we expect industrial production to have declined overall in the second quarter at a rate observed in the second half of 2018 bringing back memories of the near-recession. Although industrial production is not in free fall, there is unlikely to be more than a timid stabilization in the cards for the remainder of the year. Persistent trade uncertainties and elevated inventory levels are keeping a lid on recovery prospects. So far, German domestic demand is still holding up relatively well, but it is only a matter of time before the weakness in industry will also affect investment activity and private consumption. Overall, we expect GDP to grow by only +0.8% in 2019.

France: Meet me halfway

French exports grew by +EUR5.5bn in May and export gains reached about +EUR14.2bn in the first five months, roughly what we expect for the whole year. The sectors with the largest gains were aeronautics (+EUR4.8bn), followed by luxury (+EUR2.8bn), electronics (+EUR1.8bn) and pharmaceuticals (+EUR1.3bn). In terms of destinations, the U.S. surprised with the strongest gains so far this year (+EUR2.2bn) mainly explained by increasing aeronautics exports (+EUR2bn), followed by China and the UK (+EUR1.7bn each). However, the increase towards the UK was achieved in Q1 but has leveled off in Q2, before an expected reversal during fall due to renewed inventory building ahead of the next Brexit deadline. Eurozone destinations remain below average, with stagnating export growth to Germany, which is the main explanation for the overall decrease in car suppliers' exports (-EUR0.5bn). Pharmaceuticals are an exception since 85% of the export gains were made in the Eurozone. Overall, we expect export gains to come to a sudden stop in H2 as a result of trade tensions: export orders plummeted suddenly in June for carmakers, chemicals, electronics and plastics.

Saudi Arabia: Oil output cuts pull down overall growth

Recently released data show that real GDP growth decelerated to +1.7% y/y in Q1 from +4.3% in Q4 2018. The latter figure was revised upwards from an earlier estimate of +3.6% y/y, which also led to an upward revision of full-year 2018 growth to +2.4% from +2.2% previously. The deceleration in Q1 is almost entirely due to a sharp slowdown of growth in the oil sector to just +1% y/y from +7.1% in Q4. This high volatility mirrors the seesaw changes with regard to oil output cuts by OPEC, Russia and other major oil producers. Those cuts were cancelled in June 2018, leading to sharp output increases thereafter until their re-imposition at end-2018. Meanwhile, growth in the Saudi non-oil sector edged down only marginally to +2.1% y/y in Q1 from +2.2% in Q4. Looking ahead, we expect the non-oil sector to remain broadly stable while continued oil output cuts (extended until March 2020) will continue to weigh on growth which we forecast at +1.6% in 2019 as a whole. Downside risks to this forecast include the uncertain global economic outlook as well as increased geopolitical risks in the region.

Africa: Just can't get enough

One free trade area in Africa will become a reality as even Nigeria has decided to join in, but a shortage of dollars may well limit its effectiveness. Intra-African trade is accounting for only 15% of total African trade, the lowest intra-regional ratio in the World (16% in Latin America, but 46% in Asia and 70% in Europe). This is a direct consequence of an export concentration towards commodities often traded by wholesalers in advanced economies. A free trade area will not be achieved tomorrow and is not only about trade tariffs cuts, since non-tariffs barriers are numerous (e.g. subsidies, quotas, rules of origin, red tape). The agreement will also need to leapfrog in order to be fully operational: ecommerce and mobile payment will be on the agenda. Dollar scarcity is another issue: More openness to trade would mean a larger part of foreign currency denominated flows in economies where dollar access is often limited. According to our calculations, dollar cash shortages entail a USD40bn cost per year (1.7% of GDP) through missed opportunities.

EULER HERMES
A company of Allianz

Countries in Focus

Americas

U.S.: Fed cut almost certain, jobs up in June but trending down

In Congressional testimony, Fed Chair Powell signaled an almost certain rate cut at the end of July. Powell noted that ".... the case for a somewhat more accommodative monetary policy had strengthened. …based on incoming data and other developments… uncertainties around trade tensions and concerns about the strength of the global economy continue to weigh on the U.S. economic outlook." Despite the darkening outlook, the economy did add +224k jobs in June, beating expectations of +165k. The unemployment rate backed up +0.1% to 3.7%, largely as a result of a +335k increase in the labor force. There were some negatives in the report as the prior two months were revised down -11k jobs, and wages disappointed slightly at +3.1% y/y vs. expectations of +3.2%. Despite the strength of the report, the 6 and 12 months trends are downward, supporting the Fed's deteriorating outlook. We expect a cut in July and October and two more cuts in 2020.

Europe

Turkey: Got me under pressure

On Saturday, 6 July, Turkish President Erdogan removed Central Bank governor Murat Cetinkaya from his job one year before the end of his four-year term. He was replaced by his deputy Murat Uysal. Financial markets reacted negatively – the stock market has lost -3% since and the TRY -2%. Further weakness and volatility is likely at least until the next monetary policy meeting scheduled for 25 July. Markets were already expecting a small rate cut, but now there is a risk that President Erdogan will seek to impose a much sharper cut. Should that happen, it will almost certainly lead to another marked slide of the TRY. Investors have already been concerned over reports saying that the delivery of a controversial Russian air defense system to Turkey could take place this week or next – a move that is likely to trigger U.S. sanctions on Turkey. Expect the TRY to remain under pressure from time to time, with further rounds of significant losses (and partial recoveries) likely.

Africa & Middle East

Algeria: Likely stagnation

GDP growth has likely remained muted in H1, indicated by some contracting advanced indicators such as imports (-3.4% y/y in January-April). Moreover, the government announced the end of the unconventional monetary policy implemented between November 2017 and January 2019. Total Central Bank financing has reached 30% of GDP (government figures). Half of it was injected into the economy and drove strong credit growth. Yet, the impact on the economy was muted as Algeria experienced about 0% GDP per capita growth during that period. A recent revision of debt ratios showed that Central Bank financing has driven up the public debt to GDP ratio to 37% in 2018 (from 9% in 2015), and a new high of 47% is expected in 2019. Moreover, a decrease in oil-related fiscal revenues (-20% y/y in Q1 2019) is the main reason for a new drop in public investment (-28%). Hence, the gas output depletion should not recede. In 2019, we expect the slowest GDP growth (+1.2%) since 1997.

Asia Pacific

Georgia: Impacted by Russian sanctions

Following the violent unrest in Tbilisi after a Russian MP had appeared in the Georgian parliament on 20 June, Russia has banned flights to and imposed trade sanctions on Georgia. More punitive measures may follow. Since then the Georgian lari (GEL) has lost -4% in value against the USD (-8% since the start of the year). Russia's move will reduce Georgian export growth though it should not lead to a balance of payments crisis in the short term. The current account deficit narrowed from -7.9% of GDP in 2018 as a whole to -6.2% in Q1 2019, and the latter was fully covered by net FDI inflows (average coverage in 2014-2018 was a comfortable 82%). Yet, the sanctions are expected to have an impact on GDP growth (forecast at +4.5% in full-year 2019, after +4.7% in 2018 and +4.9% y/y in Q1 2019) and inflation (up to 4.3% y/y in June from 1.5% in December 2018). The current account deficit should widen again to -8.4% of GDP in full-year 2019 while public and external debt ratios (48% and 84% of GDP, respectively) will remain large, reflecting continued high country risk.

What to watch

- July 12 – Hungary May industrial production
- July 12 – Romania May industrial production
- July 12 – Turkey May industrial production
- July 12 – US June producer prices
- July 15 – Bulgaria June inflation
- July 15 – Poland June inflation
- July 15 – Kazakhstan Central Bank meeting
- July 15 – Kazakhstan June industrial production
- July 15 – Russia June industrial production
- July 16 – US June retail sales
- July 16 – US June industrial production
- July 16 – Croatia June inflation
- July 17 – Estonia, Latvia June inflation

View all Euler Hermes Economic Research online
https://www.eulerhermes.com/en_global/economic-research.html

Contact Euler Hermes Economic Research Team
research@eulerhermes.com

Publication Director
Ludovic Subran, Chief Economist
ludovic.subran@eulerhermes.com