

21 March 2019

FIGURE
OF THE WEEK

+4.0%

Chile's
GDP growth
in 2018

In the Headlines



U.S.: Federal Reserve is finished raising rates for 2019

As expected the Federal Reserve left interest rates unchanged at yesterday's meeting. And as Euler Hermes had expected, the Fed also indicated that it had finished raising rates for the year. We expect the Fed to start cutting rates in 2020. In support of its decision the Fed noted that "growth of economic activity has slowed from its solid rate in the fourth quarter" and that "Recent indicators point to slower growth of household spending and business fixed investment in the first quarter." Accordingly the Fed also downgraded its 2019 GDP forecast to +2.1% from its +2.3% estimate in December, and downgraded its unemployment rate forecast to 3.7% from 3.5%. Indeed consensus forecasts for Q1 GDP are less than +1% q/q annualized. In yet another dovish policy shift, the Fed indicated that it would end its balance sheet reduction program in September, meaning that it will stop putting upward pressure on long term rates at that point. As a result of yesterday's actions, the yield on the 10-year Treasury note dropped 8bp, driving the yield curve down to a mere 6bp.



China: Stimulus starting to bear fruit

China's stimulus is starting to have tangible impacts on the economy. Domestic demand shows some signs of improvement. First, nominal retail sales growth, a proxy of private consumption, stabilized in Jan-Feb (+8.2% y/y, similar to December), helped by tax cuts. Investment recorded a modest pick-up (+6.1% in Jan-Feb 2019 after +5.9% in 2018) supported by a rise in State Owned Enterprises and infrastructure investment. On the negative, industrial production disappointed (+5.3% y/y) held back by weaker external demand: USD denominated exports contracted by c.5% in the first two months of the year. We expect Chinese economic growth to get some traction within the year (after a low of +6.2% y/y in Q1). This improvement will be driven by (i) a generous fiscal package (5% GDP) and eased monetary conditions; (ii) reduced tensions with the US. Overall, real GDP is set to grow by +6.4% in 2019.



Africa: Shark in the water

What if Africa's growth story would suddenly be interrupted by a shortage of...water. Water supply is still a key input to the main growth contributor (agriculture) and tensions about access to water have already risen as a result of conflicting needs: agriculture, urbanization (water sanitation) and power generation (which is often about dams in Africa). E.g. the Green Morocco Plan allowed productivity gains, but the agricultural output remained volatile, which may have income consequences for producers, an issue that is also highly sensitive in other areas of the continent. In Kenya and Ethiopia, poor crops were a key contributor to social tensions in 2017-2018. In the context of constrained access to land and water resources, farmers and herders are increasingly opposing violently in West African countries. According to the United Nations, water use has risen by +1% a year since the 1980s and should increase further by +30% until 2050. However, water supply is likely to lag the needs since investment is not following the trend (institutional capabilities and financing are key bottlenecks).



Saudi Arabia: Oil continues to drive the economy

Recently released data by the General Authority for Statistics (GAS) show that real GDP grew by +2.2% in 2018 as a whole, following the -0.7% contraction in 2017. The rebound was driven by strong export expansion of +7.6% (-3.1% in 2017), thanks to much increased oil output. Imports rose more modestly by +2.6% (+0.4% in 2017) so that net exports contributed +2.4pp to 2018 growth (-1.1% in 2017). Domestic demand was weak last year, with consumer spending easing to +1.8% (from +3.2%), in part due to the 5% VAT introduction at the start of 2018; public spending declining by -1.8%, owing to fiscal consolidation measures, and investment being flat. For 2019 we expect another shift in the breakdown of GDP growth. As OPEC and allies agreed on new oil production cuts at the end of 2018 which shall last until at least mid-2019, we forecast overall exports to shrink this year. On the other hand, domestic demand should see a broad-based recovery, thanks to a record expansionary budget for 2019, with spending to be boosted by +7.3% vs. 2018, reflecting a prioritization of growth over deficit reduction. Overall, we forecast full-year GDP growth of +1.7% in 2019.

Countries in Focus

Americas

Chile: High cruise speed

In Q4 2018, GDP rebounded +1.3% q/q after slowing in Q3 (+0.2%), mainly driven by a strong growth in mining (+3.1%) as copper output rose to a historical high. On the demand side, both exports (+1.5% after -0.2% in Q3) and imports (+2.7% after -2.6%) rebounded. GDP grew +3.3% from Q4 2017, mainly driven by consumption, while investment positively contributed to growth for the fifth straight quarter. This puts 2018 annual GDP growth at +4%. Despite the acceleration, inflation went back below the 3% \pm 1pp target range (at +1.7% in February). This is consistent with the overall trend in Latin America. Hence the central bank could postpone its tightening cycle as the Fed's pressure to hike rates eases from 2018. Growth will stay strong in 2019 as copper prices stay resilient and progress on the tax reform sustains confidence. But it could slow to +3% given the Chinese mega-stimulus will benefit commodity exporters less than in 2016, and as the statistical carry-over is lower than in 2018.

Europe

Italy: Resurfacing budget tension to weigh on growth

In 2019 Italy is on course to raking in its worst GDP growth reading since 2014. After slipping into recession in H2 2018, we expect the economy to expand by a meagre +0.2% this year, down from +0.8% last year. While positive support from the external sector should strengthen going forward, thanks to the Chinese stimulus propping up export demand, Italian domestic demand should remain muted at best as heightened policy uncertainty and elevated borrowing costs will weigh on hiring and investment decisions. After all, we expect budget tensions to reemerge by fall at the latest when Italy is due to submit its 2020 budget draft. With the 2019 budget deficit nearing the -3% of GDP mark, fiscal tightening will be required to reign in public finances. As the Lega/M5S coalition will once again test the EU's patience, rising spreads and the lingering threat of a sovereign rating cut should act as key disciplining factors to bring about a fiscal policy rethink. However, given the expected inability of the Lega and the M5S to agree on unpopular fiscal saving measures we see a rising probability of fresh elections before year-end.

Africa & Middle East

Ghana: The importance of being earnest

The Ghanaian cedi (GHS) was hit by significant depreciation year-to-date (-12% as of 19 March), despite relatively low inflation (+9.2% y/y in January, compared to double-digit figures for most of the past decades). Given that weak inflation track record, a policy rate cut in February was considered as premature. Low FX liquidity is another weak track record, reflected in just three months of import cover for quite a long time. But it improved during the last two years and stood at five months as of end-2018. Yet, Ghana has to carefully manage its bond redemption calendar and match with convenient issuances in order to avoid liquidity drains. In recent weeks, some bonds matured while new bonds did not come timely. The issue should be solved with the issuance of a USD3bn Eurobond designed to finance infrastructure. However, the latest events show that currency volatility is likely to continue with a consequence on the cost of financing in GHS (has been consistently above 20%).

Asia Pacific

Japan: Hampered by trade

In Japan, industrial production gained some speed in January (+0.3% y.y). Yet February trade figures were disappointing. Nominal exports contracted by -1.2% y/y due to lower demand from Asia, especially South Korea (-13.8% y/y), Singapore (-18.2%) and Thailand (-2.7%). Exports to China rose +5.5%. The near term outlook is not encouraging as shown by the manufacturing PMI (48.9 in February due to low new orders). Looking ahead, we expect a modest +0.8% GDP growth this year in Japan, driven mainly by domestic demand. Private consumption fundamentals are still solid with low unemployment rate and rising wages. Financing conditions remain supportive and the BoJ will likely maintain its ultra-loose monetary policy stance considering that deflation fears have resurfaced and the growth outlook has weakened. In the remainder of the year, a de-escalation of trade tensions between China and the US, and a stabilization of growth in China, would allow a modest acceleration of exports.

What to watch

- March 21 (8pm) – Argentina Q4 2018 GDP
- March 22 – Lithuania February industrial production
- March 22 – Ukraine February industrial production
- March 22 – U.S. February existing home sales
- March 23 – Belarus Q4 2018 GDP
- March 25 – Mexico January economic activity index
- March 25 – Turkey March business confidence
- March 26 – Argentina February trade balance
- March 26 – France Q4 purchasing power
- March 26 – France March business confidence
- March 26 – Hungary Central Bank meeting
- March 26 – Mexico January retail sales
- March 26 – U.S. February housing starts
- March 26 – U.S. March consumer confidence
- March 27 – France March consumer confidence

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