Euler Hermes Economic Research

Weekly Export Risk Outlook

26 June 2019

FIGURE OF THE WEEK

97.4

Ifo business climate index for Germany in June 2019 (55-month low)

In the Headlines

Germany: Lower sentiment for longer

In June the ifo Business Climate Index fell by -0.5 points to 97.4 – its lowest level since November 2014. Firms' business expectations declined significantly (-1.0 points) to 94.2. Meanwhile companies' assessment of the current situation more or less stabilized at 100.8 (+0.1 points) following a sharp downward correction in the previous month. The June decline in sentiment was broad-based across all major economic sectors with the exception of trade. Going forward a swift improvement in the German economic outlook is not in the cards. With elevated political uncertainty related to trade, Italy and Brexit as well as clouds over the car sector likely to stay with us for much of H2 2019, the German industry will remain under pressure. Construction and private consumption will be the main pillars of the German economy in the coming quarters, albeit their strength will start to fade gradually. After all, the domestic economy is not immune to the industrial soft-patch. The longer the current weakness in the German industry persists, the more it will also start to affect investment and spending decisions. Overall, we expect GDP to grow by +0.8% in 2019.

UK: How prepared are companies to a no-deal?

In Q2, 57% of UK firms interviewed by the Bank of England between 23 April and 28 May reported that Brexit was part of their top three current sources of uncertainty, a record high number. About 40% of them reported uncertainty about supply chains and customs arrangements. More firms adjusted their expectations for Brexit to be resolved later (in 2020 instead of 2019). Moreover, 75% of companies are maintaining or increasing contingency planning (i.e. increasing resources to handle Brexit, stockpiling, building cash reserves, looking for alternative suppliers). Increases in inventories due to Brexit were concentrated in manufacturing (more than half in raw materials) while wholesale and retailers were most likely to have built up stocks of finished goods (around 40% reported this). We expect an extension of Article 50 from 31 October to mid or end-2020 (50% probability) while increased uncertainty will push companies to re-stock in Q3. A downside adjustment will then occur in Q4 2019 (we forecast a -0.2% q/q decline of GDP) and could be prolonged into Q1 2020.

France: Divided landscape

In France, business confidence surveys are pointing to a deterioration mainly driven by foreign demand. The manufacturing confidence index decreased to 102 points in June, taking the Q2 average to the lowest level since Q3 2016. Export orders deteriorated markedly in June, at the steepest pace since H1 2013, particularly in the automotive value added chain (carmakers, car suppliers, metals) and in highly cyclical sectors such as electronics and chemicals. At the same time, French corporates continue to feel inventory pressures as a result of lower demand, but the sectors impacted have evolved. Carmakers' inventories returned to a "normal" level, but car suppliers still have inventories above their long-term average; and electronics have joined this club. At the same time, the retail sector did not see any improvement in sentiment, with an overall confidence index below par (97) with the strongest deterioration in food retailers. Finally, services and construction still experience a good situation and will probably be the main winners from expected higher household spending resulting from fiscal stimulus, allowing GDP growth to reach +1.2% in 2019.

Ethiopia: Please don't stop the music

During the last decade, Ethiopia was among the fasted growing economies in the world. But growth seems to have faltered somewhat recently: goodbye +10% per year, hello +7.5% which should be the rate observed in the next fiscal year. Moreover, the country is not benefiting from rising exports despite the foreign direct investment made in its textile sector. Infrastructure spending was quite strong and construction made the main contribution to overall growth (about one third). However, difficulties to raise key infrastructure (such as access to power) fast enough to cope with public needs can create some discontent. Moreover, Ethiopia is still suffering from a USD shortage, with foreign reserves providing just two months of import cover. This is a key bottleneck since many goods still need to be imported (e.g. cars). Ethiopia surely needs more market-friendly reforms to engineer a new growth cycle, but in the short run poor rains are a more tremendous issue. It is a potential downside risk to growth and catalyst for discontent.

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Countries in Focus

Americas

Mexico: Lower regime of growth, persisting risks

The monthly activity index barely rose by +0.1% m/m after a -0.5% drop in March in seasonally adjusted terms, helped by the secondary sector (+1.5%) but dragged down by agriculture (-2.6%). Services grew +0.3% m/m. Compared to April 2018, economic activity expanded by +0.3% y/y after contracting by -0.6% in March. We are in a lower regime of growth: the 12-month average growth pace fell to +1.4% from +2% last November. The carry-over for 2019 is now slightly negative (-0.03%), which comforts our GDP growth forecast of +1% in 2019 and +1.5% in 2020 after +2.1% last year. Besides, the threat of U.S. tariffs on exports remains. The U.S. and Mexico administrations will review the result of Mexico's ramped up migration policy on 22 July and then on 5 September. A failure to reach the goals agreed could then trigger the imposition of tariffs, which could subtract -0.6pp from Mexican GDP growth (with tariffs up to 10% held until November) or would sink the country into recession (with 25% tariffs).

Europe

Turkey: Opposition win in Istanbul reconfirmed

The Istanbul local election rerun, held last Sunday (23 June), resulted in a clearer victory for Ekrem Imamoglu, the opposition mayoral candidate, who beat Binali Yıldırım from the ruling AKP with 54% vs. 45% of the vote, thereby widening his winning margin to about 775,000 from 14,000 votes in the March election. Yildirim, as well as President Erdogan on behalf of the AKP, conceded defeat and congratulated Imamoglu on the victory. Markets initially rallied after the outcome, perhaps hoping the government will now shift its attention to much needed economic reforms as Turkey has a rare four-year window of opportunity to do so before the next elections are scheduled. However, there is also a risk of early elections in the next two years. One trigger could be that Sunday's outcome might trigger an AKP splinter movement as apparently some AKP heavyweights were against the Istanbul election rerun. Another reason could be that the AKP loses parliamentary support from the MHP, its junior coalition partner. In any event, expect Turkish politics to remain turbulent.

Africa & Middle East

Egypt: Preparing for the morning after

Egypt has registered a quite steady growth dynamics in Q1, as unemployment went down to 8.1% from 10.6% a year ago. Growth was +5.6% y/y in Q1 but, as subsidies are progressively cut and inflation is still quite high (+14% y/y in June), private consumption is no longer the main contributor. Investment is likely to have grown at a strong pace during fiscal year (FY, July to June) 2018/19 (+13% YTD). Import substitution is the other key growth contributor since net trade is currently improving mainly as a result of decreasing imports (-6.7% YTD in FY 2018/19). Overall, Egypt should be able to live without IMF support, since the government does not want to ask for new financing after the end of the current program (November 2019). The import cover of foreign reserves is still quite high (about 9 months) and the country has recently benefited from falling yields (the 10-year local currency yield was 16% in June, -200bps below the February level). We expect growth to accelerate to +5.7% during the next fiscal year.

Asia Pacific

Malaysia: Growth slows gradually but remains robust overall

Real GDP growth eased to +4.5% y/y in Q1 from +4.7% in Q4 2018. The slowdown was mainly due to a -3.5% drop in fixed investment in Q1, after an already tepid increase of +0.6% in Q4. Consumer spending growth slowed to a still strong +7.6% in Q1 (+8.4% in Q4) but this was counterbalanced by a faster expansion of public spending (+6.3% in Q1 after +4% in Q4). External trade activity lost momentum in Q1, impacted by the U.S.-China trade tensions, with real exports increasing by a mere +0.1% in Q1 (down from +3.1% in Q4) while imports decreased by -1.4% (+1.8% in Q4). However, industrial production growth accelerated to +4% y/y in April, up from an average +2.7% in Q1, driven by a rebound in exports of goods, which expanded by +1.1% in nominal terms, after a -0.9% decline in Q1. We expect full-year GDP to grow +4.6% in 2019 (after +4.7% in 2018) and +4.1% in 2020.

What to watch

- June 27 – China May industrial profits
- June 27 – Germany June inflation (preliminary)
- June 27 – Japan May retail sales
- June 28 – France May consumer spending
- June 28 – Kenya Q1 GDP
- June 28 – Thailand May balance of payments
- June 28 – Turkey May trade balance
- July 1 – Eurozone June manufacturing PMI
- July 1 – Brazil, Mexico June manufacturing PMI
- July 1 – China June Caixin manufacturing PMI
- July 1 – Japan June manufacturing PMI
- July 1 – Russia, Turkey June manufacturing PMI
- July 2 – Brazil May industrial production
- July 2 – Germany May retail sales
- July 3 – Turkey June inflation