Euler Hermes Economic Research

Weekly Export Risk Outlook

16 January 2019

FIGURE OF THE WEEK

+1.5%

Germany's 2018 GDP growth

In the Headlines

UK: A Shakespearean Brexit until the last minute

As expected the Brexit deal has been rejected by the UK Parliament: only 202 out of 650 MPs voted in favor. 118 Conservatives + 10 DUP voted against. This heavy defeat for PM May's government shows the high political division in the UK and raises the alarm bell for the EU which is likely to make more concessions in upcoming negotiations. May will work on a plan B for a new vote to be expected on 25 January. Even a third vote is possible as the effective deadline is mid-February in order to allow time for the EU Parliament ratification. Should the next attempts to ratify the deal in the UK Parliament be unsuccessful, an extension of Article 50 is highly likely. This would allow to avoid a disorderly UK exit. However, politically it would be complicated for May and she could decide to resign. In this case, either another Conservative leader takes over through a confidence vote in Parliament or general elections could be called. In the latter scenario another referendum, on the deal, cannot be ruled out (a 2/3 majority in Parliament has to agree). Expect economic uncertainty to continue, cutting 0.1-0.2pp from growth each quarter of uncertainty, raising downside risks to our +1.2% GDP growth forecast for 2019.

Germany: No economic downturn ahead

At +1.5%, the economy last year recorded its weakest GDP growth since 2013. Domestic demand was the main growth driver in 2018. Private consumption grew by a moderate +1% in real terms. Investment in machinery & equipment and construction meanwhile showed robust growth of +4.5% and +3%, respectively. The negative contribution from the external sector (-0.2pp) is evidence for the negative impact that the smoldering trade dispute with the U.S. as well as the economic slowdown in China and other important emerging markets have had on German exports. After a strong start to the year, the German economy initially stumbled in the second half of 2018. But even though the growth peak in the current economic cycle is most likely behind us, rising concerns about a looming economic slump have probably turned out to be exaggerated. There are some indications that a timid economic recovery has already been underway in late 2018, as we had anticipated. We expect this recovery to continue and, for the time being, we stick to our annual GDP growth forecast of +1.7% for 2019.

Nigeria: 36 shades of Nigeria

Imagine a country that is changing rapidly, where the young generation represents 51% of the voters in the next election. Imagine a country where growth is often hard to get in real time but is there. This is Nigeria. Remember that Nigeria's GDP grew by +89% overnight in April 2014 after data revisions. Informality and information gaps are difficult to substitute in such a fractionalized country. But, it seems that Nigeria has its own pockets of reforms and related growth. Overall, the growth take-off is not expected in 2019, as we forecast +2.2% after +1.8% in 2018. Elections on 16 February may reveal some divide between supporters of the two main candidates, M. Buhari (current President) and A. Abubakar (former Vice President), amid rising violence related to Boko Haram activity. Obviously, federal policymaking processes are often a nightmare. But, there is growing evidence that pro-business reforms were adopted at the state level. Some of these reforms improve corporate access to financing, as shown by the latest Doing Business survey which ranked Nigeria 12th worldwide on the ease of getting credit.

China: Red flags and policy reactions

In December, car sales contracted (-13% y/y), both USD-denominated exports (-4.4% y/y) and imports dropped (-7.6%), and producer prices growth slowed (+0.9% y/y from +2.7% in November). Looking ahead, it is firstly important to nuance trade results as they were heavily distorted by front-loading activity. Also, while Q4 disappointed, exports increased by +9.9% in 2018, the highest increase in seven years. Secondly, business surveys provide a more distinct picture with a declining momentum in manufacturing activity (PMI signals contraction) but a stronger performance of services. The exports and industrial production outlook, in particular, is weak for Q1 as corporates wait for the end of China-US trade negotiations. Thirdly, the authorities' latest policy moves signal improved domestic resilience going forward. In January, the Central Bank cut the RRR for the fifth time since 2018, and the government committed to support growth through tax cuts to households and SMEs. Credit conditions have already started to improve (loans up +13.5% y/y in December 2018). In that context, economic growth is set to slow but remain resilient at +6.3% in 2019 (after +6.6% in 2018).

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Countries in Focus

Americas

Mexico: Policy fluctuation is the new norm

Since the election of President Andrés Manuel Lopez Obrador (AMLO) we have maintained our cautious stance on his policy fluctuations between business-friendly commitments to austerity and more controversial decisions (see airport project cancellation). In the last thirty days, Congress adopted a fiscally prudent budget, promising a +1% of GDP primary surplus. Then AMLO implemented a quick fix to solve fuel theft – shutting or better guarding pipelines – that is causing gas shortages and is unsustainable. Such fluctuations harm investor confidence; growth could be subdued (~ +2%) for the next two years. Boosting private credit would help lift the cap on growth. Credit to Non-Financial Corporations only accounts for 26% of GDP in Mexico, against 40% in Brazil and 95% in Chile. Yet monetary policy should remain tight this year, constraining access to credit as policy risks and inflation pressures remain; the Central Bank hiked the policy rate last month to 8.25%, the highest in ten years.

Europe

Spain: A cloudier start of the year for corporates

Corporates are more pessimistic than optimistic about their performance as 2019 kicks in. Business confidence fell again, by -1% q/q after -1.7% in Q4 2018. For the first time in two years, the expectations balance for Q1 (difference between pessimistic and optimistic responses) is negative. This is in line with the latest weak “hard data” in Spain and Eurozone trade partners. In November, Spanish industrial production fell -2.6% y/y in seasonally-adjusted terms, its largest drop in five years. Over the past years, Spanish companies have enjoyed high margins (>43% of gross value added); but unit labor cost has reached again its 2012 level (before the decentralization of collective bargaining) and wages could moderately rise. The capacity utilization rate has dropped closer to its long-term average. Amid more challenging domestic and external environments, insolvencies could rise +2% in 2019.

Africa & Middle East

Morocco: Insolvencies’ and jobs’ unpleasant arithmetic

In Morocco, GDP growth disappointed again in Q4 (+2.7% y/y). Overall, the growth profile observed in 2018 appears relatively bumpy as Q2 was already quite weak. The non-agricultural sector was affected in Q2 and Q4 by an increasing oil price that affected household perception. The unemployment rate remained quite high at 10% in Q3 2018 with a particular weakness among the urban young population (about 40% are unemployed) that reveals some difficulty to create enough jobs in net terms. It shows the human cost of business insolvencies. In 2018 as a whole, overall GDP grew by +2.9% and the non-agricultural sector +2.8%. In the current environment, this is below the level where insolvencies stop to increase. As a result, business insolvencies have been on the rise again since Q2 2018 and should increase further in 2019 (+4%), weighing on the job market. This evidence of a mild deterioration will have an impact on GDP growth, which is expected at +2.7% in 2019.

Asia Pacific

Taiwan & South Korea: “Trade, we have a problem”

December’s trade figures were weak for Asian trade bellwethers. USD-denominated exports decreased by -1.2% y/y in South Korea and -3% in Taiwan. Lower demand for electronic products and weaker demand growth from China were among the reasons. Manufacturing PMIs signal a contraction of activity in the short term (with South Korea’s PMI at 49.8 and Taiwan’s at 47.7 in December) on the back of weaker new orders. In the near term, we see limited reasons for improvement. First, because corporates will not make major moves before the end of US-China trade talks. Second, because demand growth in China will likely be subdued in the near term. A gradual improvement could be expected from Q2, after the talks and when China’s stimulus effects start to kick in. Overall, we expect economic growth to be more moderate in both countries this year, at +2.5% in South Korea (after +2.7% in 2018) and at +2% in Taiwan (down from +2.6%).

What to watch

- January 17 – Brazil November economic activity index
- January 17 – Eurozone December inflation
- January 18 – UK: Brexit deal plan B to be presented by PM May to the Parliament
- January 18 – UK December retail sales
- January 18 – Poland December industrial production
- January 21 – China Q4 and 2018 GDP growth
- January 22 – Brazil December balance of payments
- January 22 – Poland December retail sales
- January 22 – Ukraine December industrial production
- January 22 – UK December wage growth
- January 23 – France January business confidence
- January 23 – Turkey January consumer confidence
- January 24 – Eurozone ECB meeting
- January 24 – UK BoE meeting

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