Euler Hermes Economic Research

Weekly Export Risk Outlook

31 January 2019

FIGURE OF THE WEEK

+1.8%

Eurozone GDP growth in 2018

In the Headlines

U.S.: Federal Reserve gets even more dovish

As expected the Fed left interest rates untouched, but the policy statement and press conference continued a remarkable streak of increasingly dovish communications. The Fed dropped the language about making "further gradual increases" and instead said it "will be patient as it determines what future adjustments to the… federal funds rate may be appropriate." Chairman Powell also said in the press conference that "The case for raising rates has weakened somewhat". The Fed also addressed the balance sheet reduction program, saying it "is prepared to adjust any of the details for completing balance sheet normalization in light of economic and financial developments," and said the Fed "would be prepared to alter(ing) the size and composition of its balance sheet, if future economic conditions were to warrant a more accommodative monetary policy." The market probability of a rate hike this year dropped after the meeting from 20% to 10%. In other news, consumer confidence fell for the third consecutive month to the lowest level in 18 months. The declines have been driven by steep losses in the expectations component of the survey which is now at the lowest level in two years.

Eurozone: A weak ending to 2018

Real GDP in the Eurozone grew by +0.2% q/q in Q4. For 2018 as a whole GDP growth came in at +1.8%, above the potential rate for the fourth consecutive year. We expect the slowdown from +2.5% in 2017 to have been broad-based. Consumer spending growth should have slowed to +1.3% or so in 2018 – the slowest pace since 2014. And uncertainty related to the US-China trade dispute has started to weigh more notably on Eurozone exports which we estimate to have grown by +2.7% in real terms in 2018, about half of the pace registered in 2017. The weakness of consumer and external demand in addition to the crisis in the automotive sector in some countries, notably in Germany, are likely to have held back corporate investment. Our concerns about Italy slipping into recession have been confirmed with GDP contracting for the second quarter in a row (-0.2% q/q in Q4) as elevated uncertainty around Italy's fiscal policy is likely to have taken its toll on domestic demand. Meanwhile, Spain defied again its peers and grew +0.7% q/q, with a rebound of net exports and still solid domestic demand.

World Trade: Correction?

The CPB Netherlands Bureau for Economic Policy Analysis estimated that global trade growth decelerated to +0.7% y/y in November from +5.1% y/y in October. The institution assumed a m/m standstill of both imports and exports in the U.S. – as data were not available because of the government shutdown – taking the y/y growth of imports and exports to +4.6% (from +6.4% in October) and +2.8% (from +4.8%) respectively. Looking at other major economic blocs, import growth in November contracted in Europe and slowed rapidly in Emerging Asia (+2.3% y/y, down from +11.9%). Export growth decreased in both the Eurozone (-2.5% y/y) and Emerging Europe (-1.5%) and decelerated in Emerging Asia (+0.8% y/y, after +9.3%). Advanced indicators point to a weak momentum going forward. The first trade figures available for December (e.g. China, South Korea) were generally disappointing while business surveys (PMIs) point to lower new export orders. The near-term outlook is still clouded by U.S.-China trade related uncertainties. Global trade growth is expected to slow further to +3.6% this year, after +3.8% in 2018.

World FDI: Decade low

According to Unctad, world foreign direct investment (FDI) inflows decreased by -19% in 2018 to the lowest level in a decade, after already falling by about -20% in 2017. This data is aligned with evidence that global liquidity has been decreasing as a result of monetary policy tightening in the U.S. (reducing M&A activity, amongst others). Moreover, increasing digitalization, more trade openness (China, India) and renewed protectionism (U.S. trade policy, Brexit) acted as triggers of a more structural reversion to exports instead of investment in strategic internationalization choices. The FDI downtrend was magnified in Europe (-73% to USD100bn) as a result of the expected tightening by the ECB in 2019 and political uncertainties related to Brexit and Italy. FDI inflows to Africa, excluding South Africa, decreased again, by -11% to USD33bn after a -20% decline in 2017. It supports the view that debt is now the main financing scheme of deficit economies and may lead to credit events in the years to come (see our publication on Africa financing).

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Countries in Focus

Americas

Mexico: Q4 2018, a preview for 2019?

The Q4 preliminary real GDP growth estimate came in at +0.3% q/q (+1.9% y/y), slowing down from the +0.8% q/q in Q3. It takes the annual 2018 figure to +2%, a slight deceleration from 2017 (+2.1%) and a little below our expectations. While services (accounting for 63% of GDP) were the main driver of growth, adding +0.5pp to the overall q/q figure, industry subtracted -0.3pp. The demand breakdown of GDP figures is not available yet, but it appears likely that private investment lagged behind. Indeed, the capacity utilization rate has fallen to its lowest level since early 2017 while business confidence returned to pre-election lows due to AMLO's policy fluctuations. The additional monetary tightening (an interest rate hike to 8.25%) resulting from heightened domestic risks could also continue to hinder activity. We start 2019 with the same carry-over as in 2018 (+0.6%). Private investment is likely to disappoint, and companies will also be affected by the slowdown in both U.S. growth and global trade.

Europe

France: Double dip

GDP growth came in at +0.25% q/q in Q4 2018, fully driven by net exports. Full-year 2018 GDP growth declined from +2.3% in 2017 to +1.5% in 2018. Two thirds of the latter was driven by a high carryover at the start of the year. In Q4, household spending decreased by -0.1% q/q. This weakness was the result of several factors, such as the second oil price spike (in October, after May), difficulties in the automotive sector (partly driven by new homologation rules and their impact on German carmakers) and the yellow vest blockades. The missing household spending was pervasive in Q4, since residential investment deteriorated to +0% y/y (+5.1% in Q4 2017) and private consumption to +0.6% y/y (+1% y/y). As a result, manufacturers had to stabilize their output in Q4 2018 (+0.1% q/q) and construction output posted a double dip decline (-0.1% in Q4 after -0.2% in Q1). In 2019, current spending is expected to recover (purchasing power should increase by +2%) and push GDP growth to +1.2%, but increased unemployment (9.2%) will weigh on residential and durable goods spending of households.

Africa & Middle East

Lebanon: Rising risks to financial stability

Nine months after the parliamentary elections in May 2018 – the first ones held since 2009 – Lebanon still has not been able to form a government. The ongoing political uncertainty has raised concerns among foreign investors and depositors. The country is highly reliant on deposit and remittance inflows from the large diaspora (USD8bn or 15% of GDP in 2017) in order to finance its huge twin deficits (annual fiscal deficits close to -10% of GDP; external deficits over -20% of GDP). But recently deposit growth has slowed and deposit dollarization has risen, despite higher interest rates. Moreover, funding costs for the government have gone up. Investors are alarmed by rumors about plans of a restructuring of the large public debt stock (approx. 150% of GDP). Against this backdrop, we agree with caretaker PM Hariri who is cited to have said that this week will be decisive in efforts to form a government. The longer the cabinet formation will be delayed, the higher the risk of stepped-up capital outflows and reduced remittances, which could be followed by the implementation of currency and capital controls.

Asia Pacific

China: Headwinds

Industrial profits grew by +10.3% in 2018. State-holding enterprise's profits rose by +12.6% while private enterprises recorded growth of +11.9%. Revenues were a key growth driver, rising by around +8.5%. However, the latest monthly data is less encouraging than the annual figures, with industrial profits decreasing by -1.9% y/y in December (after -1.8% in November). Going forward, the short term outlook is also not promising. First, both external and domestic demand will grow at a slower pace in Q1 as global uncertainties weigh on private demand. Second, the price momentum that has supported revenue growth last year is fading (+0.9% y/y in December, down from +2.7% in November). On a positive note, both monetary and fiscal policies are becoming more supportive. This should help keep economic growth at a decent level of +6.3% this year (after +6.6% in 2018).

What to watch

- February 1 – Brazil, Czechia, Poland, Russia, Turkey January Manufacturing PMI
- February 1 – Eurozone and member states January Manufacturing PMI
- February 1 – U.S. January employment report
- February 1 – U.S. January ISM manufacturing index
- February 4 – Turkey January CPI and PPI
- February 4 – U.S. November factory orders
- February 5 – Russia January Services PMI
- February 5 – U.S. Jan. ISM non-manufacturing index
- February 6 – Brazil Central Bank meeting
- February 6 – Germany December factory orders
- February 6 – Portugal Q4 unemployment rate
- February 6 – U.S. November international trade
- February 7 – France December trade balance