Euler Hermes Economic Research

# Weekly Export Risk Outlook

5 June 2019

## In the Headlines

FIGURE OF THE WEEK

+0.2%

**Q1 2019 q/q GDP growth in Greece**

### Greece: Economy moving in the right direction

The Greek economy returned on a positive growth trajectory in Q1 2019 with GDP expanding by +0.2% q/q – driven by impulses from the domestic economy – after a contraction of -0.1% q/q in the previous quarter. Undoubtedly Greece has made a lot of progress in recent years and short-term growth prospects have brightened notably. Nevertheless this is just the beginning of a still timid economic recovery after a decade-long downturn. To ensure that Greece's economic recovery is sustainable beyond the short-term, investment – which remains close to levels recorded in the 1960s – will have to pick up notably. This requires above all policy consistency and a favorable business environment. Sticking to the reform course therefore remains absolutely essential and the government's recent backtracking is a major concern in that context. The July general election provides an upside risk with the New Democracy party which is leading the polls promising to pursue a more business-friendly policy mix including lower taxes. Overall, we stick to our 2019 GDP growth forecast of +2%.

### Turkey: Sentiment falls again

Real GDP grew by a seasonally adjusted +1.3% q/q in Q1, following three consecutive quarters of decline. Yet, in y/y terms GDP shrank again by -2.6% in Q1, after -3% in Q4. Consumer spending (-4.7% y/y), fixed investment (-13%) and inventories (-8.8pp) continued to nosedive, still heavily impacted by the currency crisis (the average TRY per USD rate in Q1 was down -41% y/y). Imports dropped by -28.8% y/y in line with domestic demand while exports rose by +9.5% as firms gained competitiveness due to the sharp TRY depreciation. Strong public spending expansion (+7.2% y/y) ahead of the March local elections mitigated the overall economic decline in Q1, however, we do not expect that pace to continue for the rest of the year. Meanwhile, the political and financial market turmoil in the aftermath of the local elections (see WERO 9 May 2019) has led to a renewed drop in sentiment. In May, the manufacturing PMI fell to a four-month low of 45.3 points and Turkstat's Consumer Confidence Index plunged to an all-time low of 55.3 points, suggesting ongoing economic contraction in Q2. For 2019 as a whole, we forecast real GDP to decline by -0.9%.

### France: Made in heaven?

French corporate margins were hit by a roller coaster during the last quarters, reaching a four-year low in Q2 2018 (30.9%) and back to a decade-high in Q1 2019 (32.6%). The 2018 weakness was mainly driven by higher oil prices in sectors unable to adapt their selling prices (mainly agrifood, retail, transportation), and by cash pressures in consumer-related sectors (retail, consumer goods). In Q1 2019, overall margins increased by +1.1pp from Q4 2018, fully driven by lower social contributions. The end of the CICE (a tax credit) is backed by the reduced social contributions and should be neutral overall for corporates' balance sheets, but other tax cuts (lower corporate tax, lower taxes on production as a result of the law Pacte) should decrease the total tax to profits ratio to 58% in 2019 (62.6% in 2017). Considering margins, the construction sector went in reverse to 35.2% in Q1 (-0.9pp), a situation fully explained by a higher wage bill (+3.4%) but quite risky in a sector where 28% of the corporates have observed an increasing correlation between late and non-payment.

### Emerging Markets: Under pressure

The economic cycle of Emerging Markets (EM) is currently deteriorating fast, indicated by our aggregate EM manufacturing PMI falling to 49.6 points in May, back below 50 (recession area) for the first time since August 2016. The May figure is -1.1 points below the March one. Hopes raised from Chinese stimulus measures are no longer supportive as even China's official PMI fell back below 50 (49.4). As trade barriers have increased – U.S. tariffs on China, Mexico and India as well as retaliatory measures – the PMI of open EM is the weakest sub-index at 48.6, below 50 for the ninth straight month. But the difficulties are now broadening to other EM as well: The Fragile-4 markets (South Africa, Turkey, Brazil and Mexico) are also back below 50 (48.9) as a result of renewed exchange rate pressures. Moreover, the difference with past downturns is that oil price pressures did not abate yet (the benchmark Brent price has averaged USD65 per bbl year-to-date, well above the USD45 from August 2016) which means there is no particular relief for oil importing EM that posted a PMI sub-index of 49.8 in May (50.7 in August 2016).

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# Countries in Focus

Americas

## U.S.: Rate cut on the cards

Fed officials are now hinting at a rate cut this year, citing concerns over trade and the inverted yield curve. St. Louis Fed President Bullard: “A downward policy rate adjustment may be warranted soon”. Vice Chair Clarida: “If… growth is lower than we expect… we’re going to put in place appropriate policy.” Chairman Powell: “we will act as appropriate to sustain the expansion”. Financial markets now imply a 90% chance of a cut in September and an 80% chance of another in December, and the yield curve has been inverted for nine straight days. Recent data supports their concerns. Real personal consumption fell for the third time in five months, pushing the y/y rate down from +3.1% to +2.7%. Real personal income is running at a tepid +2.2% y/y. The ISM manufacturing index fell from 52.8 to 52.1 points, the slowest in almost three years. Corporate profits after tax fell for the second consecutive quarter in Q1, shoving the y/y rate down from +11.1% to only +1.6%.

Europe

## Sweden: Positive surprise in growth masks vulnerabilities

Q1 GDP growth surprised on the upside, at +0.6% q/q. But the headline figure masks rising fragilities. Consumer spending fell -0.2%, public spending growth moderated to +0.1% while investment contracted by -0.4%. Overall, domestic demand subtracted -0.1pp from Q1 GDP growth while net exports contributed a strong +0.7pp. But the latter came mainly from a sharp import decline (-0.7%) while exports grew moderately (+0.8%). Going forward, rising trade uncertainty but also Brexit will continue to weigh on Sweden’s export performance as Germany, the U.S. and the UK are among its five biggest export markets. Domestic demand should remain weak as real wage growth has stalled even though unemployment reached its lowest level since 2007. Risks prevail in the housing market where building permits and prices have been tilted to the downside since mid-2018. Household debt remains a concern. Hence, the Central Bank is expected to keep interest rates unchanged until end-2020 while implementing macroprudential measures. Overall we expect GDP to grow by +1.9% in 2019 and +1.4% in 2020.

Africa & Middle East

## South Africa: Down the road

South Africa was heavily hit by increasing power shortages in Q1 (-2.3% y/y), with a key impact on GDP growth (-0.8% q/q) and the fiscal balance that is on the trajectory to reach -5.5% of GDP in 2019. The growth observed in Q1 was the worst since the Global Recession ten years ago and South Africa is now expected to experience stagnation in 2019. This weak momentum has put public debt on a higher path, we expect it to reach 62.5% of GDP by 2020. Cash constraints in SOEs mean also a need for fresh money that could have an impact on the overall public debt ratio (+12pp, considering current existing state guarantees). Looking forward, the debt problem in SOEs should continue to deter investment which contracted in the last five quarters. The outlook for private consumption is also meager, given that Q1 2019 (-0.2% q/q) marked the first contraction since Q1 2016 and the renewed decline of car registrations in May (-5.7% y/y).

Asia Pacific

## Indonesia: Growth set to remain robust despite external headwinds

Q1 real GDP growth edged down to +5.1% y/y from +5.2% in Q4 2018. Fixed investment slowed down to a still robust +5% y/y (+6% in Q4) mainly as spending on transportation equipment shrank by -7%, likely because the government tried to rein in capital goods imports (and thus the current account deficit which widened in 2018). However, rising public consumption (+5.1% y/y, up from +4.6% in Q4) partly compensated for that while steady private consumption growth (+5.2%) was a stabilizing factor. External trade activity made a positive contribution to Q1 growth, but that is a deceptive signal as a disappointing export performance (-2.1% y/y) was outpaced by an even stronger drop in imports (-7.8%). Meanwhile, S&P has upgrade Indonesia’s long-term sovereign rating to BBB (with a stable outlook) from BBB-, citing the expected policy continuity and stability after President Widodo’s reelection and the resulting ongoing strong growth prospects as well as favorable public finances. Euler Hermes forecasts annual GDP to grow by just over +5% in 2019-2020.


# What to watch

- June 6 – Eurozone Q1 GDP (with breakdown)
- June 6 – Germany April factory orders
- June 6 – Ukraine Central Bank meeting
- June 7 – Canada May employment report
- June 7 – France April industrial production
- June 7 – France April trade balance
- June 7 – Germany April industrial production
- June 7 – Hungary May inflation
- June 7 – U.S. May employment report
- June 10 – UK April GDP
- June 10 – Ukraine May inflation
- June 11 – Czechia May inflation
- June 12 – Romania May inflation
- June 12 – Turkey Central Bank meeting
- June 13 – Eurogroup meeting



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