Euler Hermes Economic Research

Weekly Export Risk Outlook

20 September 2018

FIGURE OF THE WEEK

17.9%

Consumer price inflation in August in Turkey

In the Headlines

Protectionism: Global trade enters a dangerous path

Early this week, President Trump imposed 10% tariffs on USD200bn of Chinese imports (effective from September 24th) set to rise to 25% by the year-end if no deal is reached. As a consequence, the US average import tariff would increase from 5.2%, equivalent to levels seen in the ‘80s, to 6.7% by year end. As a reminder it stood at 3.5% in the beginning of this year. China has announced retaliatory measures on USD60bn imports from the US in addition to the previous USD50bn previously implemented. Overall, global trade growth is expected to slow to +3.8% in 2018 and +3.6% in 2019 (after +4.8% in 2017). Yet, further US tariffs put global trade growth on a dangerous path. We are now close to a Trade Feud scenario (40% probability) which would cut global growth by -2pp in the two coming years. China could lose -0.3pp of GDP growth. The US administration announced that it could go further with tariffs on USD267bn of additional imports, which would mean that all imports from China are taxed higher. This would translate into around 9% US average import tariff. In this environment, we would be closer to the Trade War scenario (5% probability) in which global trade growth could be cut by -6pp, China’s economic growth would be cut by -1pp.

Argentina: Free fall

Argentina’s GDP fell -4.03% q/q (in seasonally-adjusted terms) in Q2, which was broadly aligned with expectations, after a +0.8% growth in Q1. Compared to the same quarter last year, the economy contracted -4.2% y/y after growing +3.9% in Q1 (in non-seasonally-adjusted terms). Private consumption declined -1.1% q/q while exports were the hardest hit (-14.2%) due to the exceptionally bad crop harvest after the worst drought in several decades. The drop in investment (-6.9% q/q) follows high economic policy uncertainty starting early May. Going forward, while the effect of the draught should dissipate, private consumption will continue to weaken as the ARS depreciated further in Q3 so far (-37% vs. the USD) and as inflation is expected to end the year close to +40% (against +25% in January), hurting purchasing power. We expect a contraction of activity of -3% this year, which is a bit more pessimistic than the consensus (-2.4%). Indeed, we expect tighter fiscal consolidation, the huge interest rate shock and policy uncertainty to add to the inflation and currency depreciation plagues.

Turkey: Monetary tightening and foreign exchange controls

Last week, the Monetary Policy Committee (MPC) raised its key policy one-week repo rate by 625bp to 24% at its regularly scheduled meeting on 13 September, defying President Erdogan’s calls for lower rates. The hike was larger than most analysts had expected and the TRY initially gained about +4% vs. the USD. Meanwhile, however, those gains have largely disappeared again. In order to regain investor sentiment on a sustained basis and stop the ongoing currency crisis from further deepening, monetary tightening needs to be accompanied by decisive fiscal tightening, at least. Also last week, President Erdogan issued a decree curtailing the use of foreign currencies in domestic transactions. Contracts will have to be converted to TRY within 30 days. Details have to be revealed yet, but the decree has caused confusion and will likely adversely affect thousands of companies whose contracts are currently priced in USD or EUR, including many government contracts in construction activities. Especially domestic market-oriented firms which have large-scale FX-denominated debt will face difficulties.

France: Look on the bright side of life

It is now obvious that France experienced in 2018 a visible deceleration from the 2017 economic performance. Our growth forecast for France is revised down to +1.5% (+2.3% in 2017). The missing consumer is not the entire story, since residential investment was the other big disappointment. Both household consumption and investment stalled during H1. Purchasing power issues were a drag on performance, along with policy moves (scarcer support to residential investment). However, there are reasons to expect for a recovery soon, since those burdensome factors should fade. Moreover, corporate and public investments have not shown any signs of faltering this year. In the corporate sector, high capacity utilization rates bode well for a good momentum (+3.7% in 2018). Public works also show good performance. Here, catch-up effects are pervasive since the output of the sector decreased by -11% in real terms from 2011 to 2016.

Countries in Focus

Americas

U.S.: Consumption, manufacturing firm; prices soft

Retail sales rose +0.1% m/m, but an upward revision to June kept the y/y rate at a strong +6.6%. Restaurant sales rose for the fourth straight month to +10.1% y/y, a good sign of discretionary spending. Gasoline sales rose to +20.3% y/y, but autos fell for the third straight month to +4.0% y/y. The core rate is still strong at +5.2% y/y. Similar patterns emerged in consumer prices, which despite a +20.3% y/y gain in gasoline, fell from +2.9% y/y to +2.7%. The decline was led by weak auto sales of +0.3% y/y, declines in medical care and the fourth straight drop in apparel prices; core prices fell from +2.4% y/y to +2.2%. Producer prices were driven down by trade services to +2.8% y/y from +3.3% despite price increases from tariffs; core prices fell to +2.3% y/y from +2.7%. Manufacturing industrial production rose to +3.6% y/y, the highest in over six years, but a separate report showed homebuilder sentiment at the lowest in a year.

Europe

Russia: Cautious monetary tightening

The Central Bank of Russia (CBR) raised its key policy interest rate by 25bp to 7.50% last week, bringing an end to the monetary easing cycle that began in February 2015. The latest move reflects that the CBR expects annual inflation to return to its 4% target faster than initially thought, after consumer prices rose by +3.1% y/y in August, up from +2.5% in July, mainly driven by food price inflation and the weakened RUB. The currency lost -8% vs. the USD in August alone after the announcement of new, tougher U.S. sanctions against Russia at the start of that month. The CBR also expects advanced price increases by some companies later this year ahead of the VAT hike from 18% to 20% at the start of 2019. Euler Hermes expects annual consumer price inflation to reach about +3.8% at end-2018 and to average +4.4% in 2019. The CBR forecasts somewhat higher inflation next year; hence we expect further monetary tightening, especially in H1 2019.

Africa & Middle East

Africa: The resource curse

Africa's growth was supposed to accelerate in 2018. It will not, as growth should stall at +3.3%. The disappointment is concentrated in some commodity exporters, those where weak institutions and business environment prevented appropriate investment in the past. As a result, higher commodity prices are not the bonanza that they were supposed to be. Output goals were missed and growth is disappointing. South Africa is a case in point (+0.7% growth in 2018), but this example is not isolated. Algeria (+1.8%), Angola (+0%) and Nigeria's (+2%) outlooks also had to be revised on the downside due to weaker than expected performances in H1 in their commodity exporting sector. Debt and liquidity are aggravating factors in some cases, weighing on day to day business operations. This issue is now pervasive in some southern African economies, where past debt financing of the current account deficits is proving to be bad cholesterol. Zambia is a case in point, as foreign reserves dropped to about 2 months of import cover.

Asia Pacific

Japan: BoJ to maintain accomodative stance for longer

The trade deficit deteriorated further in August (-JPY445bn after -232bn in July). Nominal exports increased moderately by +6.6% y/y in August after +3.9% in July. Demand from China (+12.1% y/y) was strong but was moderate from the US (+5.3% y/y). Imports growth was strong (+15.4% y/y) reflecting higher cost of energy. Looking ahead, the economy is faced with rising risks. The trade outlook is hindered by rising protectionist measures from the US and elevated energy costs. Domestically, lower industrial activity over the two past months and weaker corporate confidence call for slower momentum in the near term. In that context, we expect monetary policy to remain accommodative with a policy rate at -0.1% at least until 2020. The fiscal policy will likely remain neutral as PM Abe calls for the implementation of the sales tax after his re-election as the leader of the LDP.

What to watch

- September 21 – Poland August retail sales
- September 24 – Turkey Sept. business confidence
- September 24 – Germany Sept. IFO business climate
- September 25 – US September consumer confidence
- September 25 – France Sept. business confidence
- September 25 – Mexico July economic activity index
- September 26 – US Fed policy decision
- September 26 – Czechia Central Bank meeting
- September 26 – Russia August industrial production
- September 26 – Ukraine August industrial production
- September 26 – US August new home sales
- September 26 – Argentina July economic activity index
- September 27 – China August Industrial Profits

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