Euler Hermes Economic Research

Weekly Export Risk Outlook

27 September 2018

FIGURE OF THE WEEK

USD57bn

Total, enhanced IMF loan to Argentina

In the Headlines

U.S.: Fed hikes, with more coming; sees stronger economy

As expected the Federal Reserve raised the Fed Funds rate by 25bp to a range of 2.0%-2.25%, and strongly implied that it would hike again in December of this year and three times in 2019, although Euler Hermes anticipates only two hikes. Importantly, the accompanying statement dropped the language "The stance of monetary policy remains accommodative…" suggesting that interest rates would no longer be so low as to stimulate the economy. The Fed sharply upgraded its 2018 GDP forecast from +2.8% to +3.1%. The increase in the Fed Funds rate has significantly driven up rates for mortgages, credit cards, and other types of loans, and has also flattened the yield curve. However the curve remains positive, strongly suggesting that a recession in 2019 is unlikely. There was no mention in the statement of concerns over trade, but Chairman Powell did say in the press conference that "We've been hearing a rising chorus of concerns from businesses all over the country about disruption of supply chains, materials cost increases… widespread tariffs… that's going to be bad for the United States economy…. It's a concern. It's a risk. You could see prices moving up…".

France: Being misunderstood?

The French government just announced its budget for 2019. After a year spent to control public spending and postpone some tax cuts in order to limit the fiscal deficit, the government announced new tax cuts for 2019. The corporates should benefit from the wider cuts (about EUR20bn). The end of a tax credit (CICE) will be backed by a -6pp social contribution decrease, and the corporate tax will be lowered to 31% from 33% (after a cut to 28% for SMEs only in 2018). The last quarter was not favorable for corporate margins which decreased to an average 31.5% in Q2 (-0.5pp from Q1) burdened by higher input costs. As a result, French corporates had to increase their debt exposure (72.3% of GDP in Q2) in order to finance their investment efforts (+3.7% in 2018) as well as for some of them their working capital requirement. Against this background, tax cuts are more than welcome.

However, French growth cannot walk on one leg for too long. In the first half of 2018, households did not contribute to growth since their consumption and investment stalled. Purchasing power issues and a scarcening of policy support (to tense areas) for residential investment were the main burdens. Households have the perception that their financial situation worsened to the same levels as in 2014. The announcement of the government that taxes will decrease by -EUR6bn in 2019 was not sufficient to drive a recovery in household confidence, also because EUR4bn are explained by a calendar effect (social contribution cuts were postponed from January 2018 to October 2018) and EUR1bn from measures perceived to benefit high incomes. This could be one explanation for the disconnection between household perception and government decisions. In Q2, household incomes (+1.1% q/q) were driven mainly by lower capital taxation (impact of flat tax and lower wealth tax). It helped household savings to recover (to 14.3% of their disposable income), but our forecasts for household consumption growth are still quite subdued (+0.3% q/q in Q3, after -0.1% in Q2).

Argentina: The IMF to the rescue – part 2

One month after President Macri asked the IMF a second time for help, the Fund's staff agreed to grant an additional USD7.1bn to Argentina, increasing the overall envelope to USD57.1bn. More importantly and as we expected, it allowed the frontloading of an additional USD19bn until the end of 2019. It provides immediate relief to the administration and to the country's external financing needs (accepting the new fiscal targets and delaying the need to go to markets for financing to 2020). One key condition is adopting a "floating exchange rate regime without intervention," a condition that led Central Bank governor Luis Caputo to resign earlier this week. Under Caputo, the Central Bank burned USD10.2bn in reserves between July and September, i.e. two thirds of the first USD15bn IMF disbursement. The new governor adopted a no-intervention zone (a range of ARS34 to ARS44 per USD). This makes the ARS more flexible, but not freely floating. For the real economy, a recession is underway, and as IMF Managing Director Christine Lagarde put it, for the administration the "effort is just beginning." What to watch next: the IMF Executive Board approval process and in particular the IMF staff report, an updated assessment on the Argentine economy and its financing needs under the updated program.

Countries in Focus

Americas

Mexico: Towards a better Q3

Leading indicators point to an acceleration of the economy in Q3 after a weak Q2; activity grew +0.4% m/m in July after contracting -0.1% in June, posting the highest yearly growth in more than a year (+2.8% y/y). We have seen a jump in consumer confidence to a ten-year high in July, mainly owing to the election of president Andrés Manuel Lopez Obrador (AMLO). Retail sales accelerated to +4.2% y/y in July, also reflecting the solid fundamentals of the economy, with record low unemployment (3.3%) and wages growing at their fastest rate since 2008. Inflation shows signs of stabilizing (4.9% y/y in the first half of September, similar to August). On the corporate side, business confidence is high and industrial production accelerated to +1.2% y/y in July. While the outlook for trade improved, some uncertainty still surrounds AMLO’s future policy direction after his inauguration in December.

Europe

Germany: Solid growth despite foreign trade headwinds

In September, the ifo business climate index fell slightly by -0.2 points. The surveyed companies assessed both their business situation and their business expectations somewhat less positively than in August. However, this decline is not surprising, as the ifo index rose very strongly in August against the backdrop of at least a temporary easing in the trade dispute with the U.S. The development in the manufacturing sector is particularly interesting. Due to a less positive assessment of the current business situation, the index continued to fall. However, the manufacturing sector is much more confident about the future. Companies are planning to expand their production in the coming months – good news for the industrial production in Germany, which showed signs of weakness in recent months. Thanks to sustained robust domestic demand, we expect the German economy to continue to grow solidly in the second half of the year. However, foreign trade headwinds have intensified further in recent months as a result of the crises in some emerging market economies.

Africa & Middle East

GCC: Overall, inflation will remain in check in the region

Consumer price inflation has remained subdued to moderate in the GCC region YTD. Both **Saudi Arabia** and the **UAE** have seen an increase in annual inflation rates after they imposed a 5% VAT at the start of this year. Inflation in the **UAE** rose to just below 4% (3.8% y/y in July as well as on average in January-July), as expected. In **Saudi Arabia**, the increase has been more modest, with inflation posting 2.3% y/y in August, taking the average consumer price growth to 2.5% YTD. Inflation varied across sectors, with transportation (10.3% y/y YTD) and foodstuff (6.1%) recording strong rises, while it was subdued in household equipment (0.4%) and utilities (0%), and negative in clothing (-8.1%). In **Bahrain**, annual inflation has picked up to 2.7% on average YTD due to the implementation of excise taxes on tobacco, energy drinks and soft drinks at the end of 2017. Elsewhere in the region, in **Qatar**, **Kuwait** and **Oman**, inflation has remained below 1% on average YTD. But these countries along with **Bahrain** are expected to impose a 5% VAT in 2019 which should result in higher inflation.

Asia Pacific

Singapore and Taiwan: Headwinds

In **Taiwan**, USD-denominated exports rose by +1.9% y/y in August after +4.7% in July. Industrial production slowed to +1.3% y/y from +4.7% in July. Slowing growth in new export orders (+7.1% y/y in August from +8% in July) suggest further deceleration in the near term. In **Singapore**, the story is similar with slower growth in exports (NODX growth at +5% y/y, down from +11%) and industrial production (+3.3% y/y after +6.7%). The Manufacturing PMI also revealed a deterioration of new export orders. Overall, such a deceleration was expected. The beginning of the year was exceptionally strong in Asia with solid growth of exports despite the rise of trade tensions between China and the U.S. And now, as tariffs start to bite, the region is converging to a slower pace of growth. Against that background, we pencil in more moderate GDP growth for **Singapore** at +2.9% in 2018 (down from +3.6% in 2017) and **Taiwan** at +2.6% (after +2.9% in 2017).

What to watch

- September 28 – China Sept. NBS Manufacturing PMI
- September 28 – Croatia August industrial production
- September 28 – France August consumer spending
- September 28 – France September CPI
- September 28 – Ghana Q2 GDP
- September 28 – Serbia August industrial production
- September 28 – Spain, Portugal September inflation
- September 28 – U.S. Aug. personal income and outlays
- September 28 – Vietnam Q3 GDP growth
- October 1 – Czechia, Poland Sept. Manufacturing PMI
- October 1 – Germany, Spain August retail sales
- October 1 – Russia, Turkey Sept. Manufacturing PMI
- October 1 – U.S. September ISM manufacturing index
- October 2 – Brazil August industrial production
- October 3 – Turkey September CPI and PPI

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