

FIGURE
OF THE WEEK

+6.9%

Q1 y/y GDP
growth in
Philippines

In the Headlines



Greece: Disbursement of funds & debt relief approved

The first review of the bailout programme should now be completed as all parties reached agreement on Tuesday. Reforms are deemed sufficient to reach the primary surplus target of 3.5% of GDP by 2018. Their implementation will allow disbursement of the second tranche of EUR10.3bn, starting with a transfer in June of EUR7.5bn, which will contribute towards covering debt servicing needs and clearing some arrears. The remainder will be disbursed in the summer. Meanwhile, an agreement was reached on debt relief measures that could bring in the IMF by the end of 2016, subject to agreement by the Fund's board. This will facilitate market access and encourage economic activity, although the economy will remain in recession in 2016 (EH forecasts -0.6%). In the short term, the repayment profile will be smoothed, with longer maturities and lower interest rates. However, the bulk of the measures will only be applied on completion of the programme (2018) and pending further assessment of debt sustainability. This is likely to include further interest rate reductions and extension of loan maturities.



Germany: Strong Q1 GDP growth, robust outlook

Q1 real GDP growth was confirmed at +0.7% q/q, a strong performance after +0.3% q/q in each of the two preceding quarters. Domestic demand was once again the key growth driver, particularly fixed investment, which increased by +1.8% q/q (+1.4% in Q4 2015), with both investment in equipment (+1.9% q/q) and construction (+2.3%) performing well, the latter as a result of continued mild weather in Q1. Private consumption expanded by +0.4% q/q and government consumption by +0.5% q/q. Export growth recovered to +1% q/q in Q1 (-0.6% in Q4 2015) while import growth also picked up, to +1.4% q/q (+0.5% in Q4). As a result, the negative contribution from net exports to q/q GDP growth moderated to -0.1pps in Q1 (from -0.5pps in Q4). Euler Hermes continues to forecast robust but unspectacular full-year growth of +1.7% in 2016 and +1.8% in 2017 (up from +1.4% in 2015). The outlook is supported by the Ifo Business Climate Index, which picked up to 107.7 points in May (106.7 in April) and the GfK Consumer Climate Indicator, which is up to 9.7 in May (from 9.4) and is forecast at 9.8 in June.



U.S.: Fed surprises with possibility of a June hike

Minutes from the Fed's April meeting surprised analysts and financial markets by suggesting that an interest rate hike in June is now a distinct possibility. The minutes specifically referred to the June meeting five times, stating that if conditions continue to improve "it likely would be appropriate for the Committee to increase the target range for the federal funds rate in June". Financial markets had put the probability of a June hike at less than 5% but now that probability is 38% and by July the probability of a hike is 60%. The Fed may be getting the inflation outlook it is looking for as oil prices were up 13% m/m in May and by 49% since February, while gasoline prices were up 6.5% m/m in May and 28% since February. We now expect two rate hikes this year. Housing data, although volatile, also suggest strength. New home sales increased by +16.6% m/m in April, with prices rising 9.7% y/y, while new home sales gained +1.7% m/m, with prices increasing by 6.3% y/y. However, manufacturing remains weak as the Philadelphia Fed survey indicated contraction for the second consecutive month.



Eurozone: Soft but resilient business confidence

The Composite PMI unexpectedly fell to 52.9 in May from 53.0 in April. This softness mainly reflected findings in the manufacturing sector, for which business confidence decreased to 51.5 from 51.7. Companies reported that domestic markets remain soft and that new export business growth was the weakest in more than a year. Average selling prices continued to fall, but the rate of decrease was the lowest since the start of the year. In services, confidence remained stable, at 53.1. In **Germany**, the Composite PMI increased to 54.7 in May from 53.6 in April, the first increase since the start of the year and with positive reports in both manufacturing and the services sectors. The **French** PMI showed a small improvement, particularly in services (51.8 in May from 50.6 in April) while the manufacturing sector softened slightly (48.3, the same as in April). In the rest of the Eurozone, preliminary estimates suggest deterioration in business confidence indicators in May. Overall, the second reading of the business confidence in Q2 suggests that Eurozone GDP growth will slow to +0.3% q/q.

Countries in Focus

Americas



Mexico: Q1 GDP growth below expectations

Preliminary estimates indicate that GDP in Q1 increased by +0.8% q/q (+2.8% y/y), a more rapid rate than in the previous quarter (+0.5% q/q in Q4 2015) although below expectations. The carry-over for 2015 stands at +2.5%. The primary sector (+3.5% q/q) recorded more dynamism than the industrial sector (+1.2%) and services (+0.8%), which are highly correlated with the U.S. economic cycle. Euler Hermes expects growth of +2.6% this year, but risks are on the downside. At +2.5% y/y in April, inflation remains within the target range of 3% +/-1pps, even though there has been a sharp depreciation of the MXN (-19% y/y against the USD, -6.7% since the beginning of the year). Despite this background, the Central Bank is likely to continue tightening monetary policy as it intends to synchronise key interest rates with movements in the U.S. Fed's rate; the Central Bank has already increased its key rate by +75bps since November 2015, to 3.75%.

Europe



Turkey: Policies and politics

The Central Bank continued its gradual monetary easing this week, lowering the overnight lending rate by -50bps to 9.5% (after a cumulative -75bps cut in March-April) but it kept the overnight borrowing rate at 7.25% and the key one-week repo rate at 7.5%. The move was facilitated by reduced inflation (6.6% y/y in April) as a result of lower food prices, still cheap oil and currency stability in March-April. However, the latter has waned since early May because of renewed political uncertainty. Following a seemingly growing rift with President Erdoğan, former PM Davutoğlu resigned from his posts as AKP leader and prime minister and was replaced by Binali Yıldırım, a close ally of Erdoğan. Moreover, concerns were raised by parliament's vote to lift MP's immunity from prosecution, a move that paves the way for trials of pro-Kurdish and other opposition legislators. The TRY is currently down by -6% since early May and by -13% y/y against the USD.

Africa & Middle East



Israel: Net effect?

As expected, the Bol this week maintained an accommodative monetary stance and left its key policy interest rate unchanged at 0.1%, citing low inflationary pressures, weak exports and a positive labour market. The decision followed the release of the latest GDP data, which showed that economic growth in Q1 slowed to +0.8% q/q and annualised (+3.1% in Q4 2015). GDP growth in the full-year 2015 was +2.5% y/y and we still expect a rebound in H2, partly reflecting strong private consumption (low unemployment, inflation and interest rates). However, our earlier forecast of overall growth of around +3% in 2016 is now potentially subject to downward revision. Meanwhile, PM Binyamin Netanyahu changed the composition of his coalition government, bringing in Yisrael Beiteinu (YB) and thereby extending his parliamentary majority by six seats (now 67 out of 120 Knesset seats). Avigdor Liberman of YB is now Defence Minister, perhaps signalling a more confrontational foreign policy stance.

Asia Pacific



Philippines: Overperforming?

GDP growth of +6.9% y/y in Q1 was driven by domestic demand. Private consumption accelerated by +7% y/y (+6.5% in Q4 2015) benefiting from low prices of goods and strong inward worker remittances. In addition, government expenditure ahead of May elections and investment in durable equipment were both strong. However, external trade exerted a drag, with lower growth in exports of goods and services. In terms of production, agriculture remained in contraction (-4.4% y/y) reflecting the impact of El Niño. Going forward, fundamentals are broadly positive. Firstly, strong growth in remittances, low inflation and a robust labour market will support private consumption in the short term. Secondly, credit conditions remain positive, with growth in FDI inflows and solid domestic credit growth. Thirdly, buffers (including FX reserves) are high and public finances are sound. Against this backdrop and barring a fall in investor confidence in H2, GDP will increase by +6.3% in 2016.



What to watch

- May 26 – UK Q1 GDP (second estimate)
- May 26 – U.S. April durable goods orders
- May 26 – Spain Q1 GDP (final estimate)
- May 26 – Italy March retail sales
- May 27 – U.S. Q1 GDP (second estimate)
- May 27 – Mexico April unemployment
- May 30 – Germany May inflation
- May 30 – France & Greece Q1 GDP
- May 30 – Serbia Q1 GDP (with breakdown)
- May 30 – Switzerland Q1 GDP (with breakdown)
- May 30 – Greece May business & consumer confidence
- May 31 – Brazil April unemployment
- May 31 – U.S. April personal income and outlays
- May 31 – U.S. May consumer confidence
- May 31 – Belgium, Croatia & Italy Q1 GDP
- May 31 – Germany April retail sales
- May 31 – France & Italy May inflation
- June 01 – China May official PMI
- June 01 – Brazil Q1 GDP
- June 01 – Brazil & Mexico May manufacturing PMI

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