Euler Hermes Economic Research

Weekly Export Risk Outlook

24 August 2016

In the Headlines

FIGURE OF THE WEEK

-40%

Depreciation of Nigerian naira since 20 June

Germany: Robust Q2 GDP growth, driven by net exports

Q2 real GDP growth was confirmed at +0.4% q/q, down from the very strong +0.7% in Q1. The GDP breakdown reveals that external demand replaced domestic demand as the key growth driver, even though export expansion slowed to +1.2% q/q (+1.6% in Q1). But since imports declined by -0.1% q/q (+1.3% in Q1) net exports contributed +0.6pps to Q2 growth (+0.3pps in Q1). Private consumption was a little disappointing, up by just +0.2% q/q (+0.3% in Q1), while government consumption slowed to a still solid +0.6% q/q (+1.3% in Q1). Capital spending dragged down Q2 growth, with fixed investment declining by -1.5% q/q (after a strong +1.7% in Q1), pulled down by both construction investment (-1.6% q/q) and investment in equipment (-2.4% q/q). Inventories subtracted -0.1pps from Q2 growth (-0.3pps in Q1). However, the annual comparison shows a more benign picture for fixed investment which rose by +4.4% y/y, driven by strong increases in both construction investment (+5.1% y/y) and investment in equipment (+4.4%). Euler Hermes forecasts full-year GDP growth of around +1.8% in 2016 and +1.7% in 2017, up from +1.5% in 2015 (revised upwards from +1.4% previously).

Nigeria: Fear of floating of the naira erases credibility

The economy is in stagflation. GDP growth was negative in Q1 (-0.4% y/y) and inflation is soaring (+16.5% y/y in June). The monetary authorities kept a fixed exchange rate for too long. Last year, a black market premium appeared and a late exchange rate reform on 20 June 2016 – replacing the peg with a managed float – did not solve the problem despite a one-day depreciation of the naira by -30% (and a cumulative -40% to date). The black market premium is approaching 20%. Nigeria does neither have a public debt (15% of GDP) nor an external debt problem (6% of GDP). However, as fear of floating is weakening the naira, foreign exchange (FX) reserves have fallen to about USD25bn (about four months of import cover) from USD28bn at end-2015. The Nigerian authorities have announced a set of emergency measures, including some banks being banned from doing FX transactions. More measures are likely, including additional capital controls, however, the appropriate one would perhaps be a free floating of the naira, despite a possible knee-jerk reaction in the short term.

Philippines: Strong growth performance in Q2

Real GDP growth accelerated to +7% y/y in Q2 (+6.8% in Q1) supported by strong domestic demand. Public spending rose rapidly with public expenditures in construction increasing by +27.9% y/y and government consumption by +13.5%. Private consumption remained solid (+7.3% y/y) supported by election-related spending and increased remittances from overseas Filipinos. Net external trade was the main drag on Q2 growth. Export growth decelerated to +6.6% y/y (+7.3% in Q1) while imports continued to surge (+20.9% y/y). On the production side, growth was driven by services (+8.4% y/y) and industry (+6.9%). Agriculture continued to struggle (-2.1% y/y) hampered by disturbed weather conditions (El Niño). On the price front, inflation remained relatively low (1.9% y/y in July) compared to the Central Bank's target range of 3% ± 1pp. Going forward, a growth slowdown is expected in H2 due to (i) the withdrawal of election-related spending, (ii) modest global demand and (iii) continued weather-related weakness in agriculture, but full-year growth should still post a robust +6.5% in 2016.

Mexico: GDP contraction in Q2

Seasonally adjusted real GDP fell by -0.5% q/q in Q2, after expanding by +0.8% in Q1. The primary sector contracted by -0.3% q/q, while the services sector stagnated. The industrial sector shrank by -1.5% q/q, dragged down by still mild industrial activity in the U.S. (-0.5% y/y in July, the 11th consecutive month of contraction) which absorbs 80% of Mexican industrial exports. The economy is also being affected by tight fiscal and monetary policies. Despite moderate inflation (+2.7% y/y in July), the Central Bank has raised its key policy interest rate by +125bps to 4.25% since December 2015 in order to smoothen the impact of external shocks on the currency (notably Fed rate hike risk). Alongside, the government has announced several cuts in the budget due to still low oil revenues and investors' concerns about public finances. Overall, 1pp of GDP of spending cuts have been decided since the start of the year. Against this gloomy background, Euler Hermes has revised downwards its forecast of economic growth to +2% in 2016, at best.

Countries in Focus

Americas

U.S.: Positive signals?

New home sales surged by +12.4% m/m in July to a steep +31% y/y rate. The increase was driven in part by a drop in prices of -5.1% m/m, putting the y/y rate at -0.5%. At July's sales pace it would take 4.3 months to clear the supply of houses on the market, the least since June 2013, and down from 4.9 months in June. The index of leading economic indicators gained +0.4% in July, the third increase in four months, suggesting continued economic growth. Similarly, the minutes of the Fed's July meeting gave an upbeat assessment of the economy, describing household spending as "growing strongly." But there appeared to be a lack of urgency to hike interest rates, as some members were content to wait for more data which would indicate more progress towards policy objectives. An interest rate hike in September appears unlikely, but it is still possible in December.

Europe

Eurozone: Economic activity is resilient post-Brexit

Markit PMI surveys of economic activity reveal that the Eurozone private sector held firm in August. The Services PMI stood at 53.1 against 52.9 in July and the Manufacturing Output Index suggested a faster output increase than in the previous month (54.0 against 53.9). Meanwhile, French private sector activity rose at the fastest rate in ten months, with the Composite PMI standing at 51.6 against 50.1 in July on the back of services performing well (52.0 against 50.5 in July) thanks to renewed activity after the terrorist attacks. On the contrary, Germany registered a small decline to 54.4 from 55.3 in July for the Composite PMI, mainly because of a deteriorating Services PMI (to 53.3 from 54.4). Overall the data show that Eurozone firms have for now shrugged off the Brexit impact. It may also indicate stronger growth momentum in Q3 after a soft Q2 with +0.3% q/q GDP expansion for the Eurozone and no growth in France.

Africa & Middle East

South Africa: Low growth to fuel more insolvencies

Following South African local government elections, the ruling African National Congress (ANC) had its worst showing since it took over power in 1994. The ANC has not only lost in Cape Town, an opposition stronghold, but has also lost Pretoria and Johannesburg, South Africa's largest city, to the Democratic Alliance. This signals a reaction, especially among the urban youth, to subdued economic performance following a real GDP contraction of -1.2% annualized q/q in Q1. Euler Hermes expects the economy to grow by a mere +0.5% in 2016. High unemployment of 26.6% in Q2 further compounds economic challenges while an expected structural current account deficit of -4% of GDP in 2016 constraints fiscal measures to boost growth. The ongoing threat of a downgrade by international rating agencies (see also WERO 8 June 2016) and the associated volatility of the ZAR could further worsen economic challenges. We forecast business insolvencies to rise by +5% this year and next.

Asia Pacific

Taiwan: Growing better?

Real GDP rose by +0.7% y/y in Q2 while Q1 GDP figures were revised upward to -0.3%y/y (from -0.7%). On a sequential basis, the data indicate a less favorable picture with growth almost stable in Q2 (+0.1% q/q). The breakdown of the latter shows that domestic expenditures were the main driver. Private consumption has paused (0% q/q) but investment recovered (+2.5% q/q) after three quarters of contraction, benefitting from a relaxed monetary policy. This improvement was associated with a pickup in exports (+1.1% q/q). Looking ahead, high frequency demand indicators suggest a mixed outlook. Regarding external demand, USD-denominated exports recovered in July (+1.2% y/y) from contraction previously, however, prolonged weakness in new export orders indicate the trend is not solid yet. Domestically, retail sales increased in July (+2.8% y/y) but fundamentals (modest labor markets, low wage growth) remain weak.

What to watch

- August 25 – Austria June industrial production
- August 25 – France August business confidence
- August 25 – Germany August Ifo business climate
- August 25 – Spain Q2 GDP (second estimate)
- August 26 – France August consumer confidence
- August 26 – Germany August GfK consumer confidence
- August 26 – France and U.S. Q2 GDP (second estimate)
- August 26 – Japan July inflation
- August 26 – Spain July retail sales
- August 27 – China July industrial profits
- August 29 – Germany July retail sales
- August 29 – Greece Q2 GDP
- August 30 – Germany August inflation
- August 30 – Poland Q2 GDP (second estimate)
- August 30 – U.S. August consumer confidence
- August 31 – Croatia and Slovenia Q2 GDP
- August 31 – Poland August inflation