Euler Hermes Economic Research

Weekly Export Risk Outlook

7 September 2016

In the Headlines

FIGURE OF THE WEEK

+3.3%

GDP growth in South Africa (annualized, Q2 data)

Brazil: The end of the drama?

After more than 6 months of political turmoil, the Brazilian Senate voted last week to remove president Dilma Rousseff, who had been re-elected in late 2014. We do not expect new elections to take place. Interim President Michel Temer should remain in office until the end of the term in 2018, despite approval ratings below 15%. This might mark the end of the political drama.
Yet Brazil's economic woes are far from over. Real GDP was down -0.6% q/q in Q2, a deeper contraction than in Q1 (-0.4%). Private (-0.7%) and public (-0.5%) consumption continued to fall. Infrastructure projects related to the Olympics led to modest growth in investment (+0.4% after 10 consecutive quarters of contraction) and to a rebound in imports (+4.5%). Exports grew by a modest +0.4%, thus net exports shaved growth by -0.5pp. We expect the recession to moderate in the coming quarters while GDP should return to growth by Q1 2017. The Brazilian economy could contract by -3.5% in 2016, and grow moderately in 2017 (by +0.2%).

Italy: Ma il cielo è sempre più grigio*

Q2 data shows GDP at 0% q/q, below expectations (+0.3%). Domestic demand contributed -0.2pp to growth this quarter: (i) consumer spending growth slowed to +0.1% q/q, the lowest level since mid-2014; (ii) public spending fell by -0.3% q/q; (iii) investment in machinery and equipment fell by -0.6% q/q; (iv) investment in construction stalled; (v) stocks contributed -0.1pp to growth. Good news comes from exports, which rebounded by +1.9% q/q, the highest quarterly growth since 2011.
The manufacturing Price Managers Index (PMI) continued to drop in August and reached 49.8, the first time below the 50 threshold since Jan. 2015. Services PMI remained stable at 52.3. Consumer confidence deteriorated further.
We expect +0.8% growth in 2016 (previous forecast was +1.0%) and +0.9% in 2017. Risks could arise after the constitutional referendum in November. Banks remain in focus with the ongoing restructuring of Monte dei Paschi di Siena and merger of the two biggest regional banks - Banco Popolare and Banca Popolare di Milano.
** But the sky is increasingly gray*

South Africa: A sigh of relief, but will it last?

South Africa avoided recession, as GDP rose by an annualized +3.3% q/q in Q2, up from a -1.2% contraction in Q1. This growth was particularly driven by the mining sector which rebounded with +8.1%, up from - 18.1% in Q1, and manufacturing, which increased by +8.1% in Q2. Household and government consumption increased by +1% and +1.3% respectively, while investment dropped -4.6%. Despite positive signals, South Africa's twin deficits (current account deficit at -4.1% of GDP, fiscal deficit at -3.5% of GDP), rand volatility caused by political uncertainty, and the associated risk of a rating downgrade (see also WERO 24 August 2016), could pose serious future challenges.
South Africa's current account financing heavily relies on investment from abroad. Despite resilient FDI inflows - Beijing Automotive International just announced an $819 million automobiles investment - South Africa's external financing relies more on short-term portfolio inflows. These are sensitive to political risk, credit rating changes, and rand volatility.

Emerging Markets: Stuck in the middle with you

Our aggregate manufacturing Emerging Markets' PMI edged up to 49.8 in August (from 49.5 in July). This improvement sent the index almost to its April high. It is the best performance since February 2015, the last time the Index stood above 50. Conclusion: the trend decline is over, but there's no clear acceleration in manufacturing sectors. The growth cycle is somewhere in the middle.
This holds also for the Fragile-5 economies: Indonesia, Turkey, Brazil, Russia, and South Africa. Recession in the latter three is not over. Yet the private sector has made big efforts and the rebalancing has progressed. Major improvements in the level of private savings and private sector confidence have their effect. While this cannot yet be described as a growth cycle, green shoots are evident. Should the dovish Fed and China hold the line for a while more, no big hurdles await down the road.

Countries in Focus

Americas

U.S.: Weak data to keep Fed on hold in September

The economy created 151,000 jobs in August, less than expectations of 175,000. The unemployment rate and the labor force participation rate remained unchanged at 4.9% and 62.8%. Most importantly, average hourly earnings grew only +0.1% m/m, resulting in a fall in the y/y rate from +2.7% to +2.4%. Average weekly hours dropped -0.3% to -0.9% y/y. Falling hours and slowing wage growth are likely to keep the Fed on hold in September. The ISM manufacturing index fell -3.2 points to 49.4, the first dip below 50 in seven months. Nine of the ten components fell, putting seven into contractionary territory, including new orders which fell -7.8 points to 49.1. The ISM non-services index dropped from 55.5 to 51.4, the weakest since February of 2010. Eight of ten components fell including a -7.8 point drop in new orders to 51.4. Construction spending was flat in July, putting the y/y rate at only +1.5%; six months ago it was +10.5%.

Europe

Switzerland: Gaining momentum

Q2 real GDP growth accelerated to +0.6% q/q (from an upwards revised +0.3% in Q1). However, this was in part due to a sharp +35% q/q rise in exports of non-monetary gold which accounts for about 20% of exports and is subject to highly volatile trade activity (in Q1 it dropped by -32%). Still, excluding non-monetary gold and other valuables, exports increased by +0.5% q/q while imports fell by -0.1% q/q so that net exports contributed +0.3pps to Q2 growth. Private consumption came to a standstill in Q2 while government consumption surged by +1.7% q/q. Fixed investment fell by -0.7 q/q in Q2 after the strong performance in Q1, however, inventories added +0.7pps to Q2 growth. In y/y terms, Q2 real GDP grew by +2% (up from +1.1% in Q1), signaling that the negative impact of the sharp CHF appreciation in January 2015 is gradually fading. Euler Hermes forecasts full-year growth of +1.5% in 2016 (upwards revised from +1.2% previously) and +1.6% in 2017.

Africa & Middle East

Nigeria: Lost in stagflation

Nigeria published grim growth and inflation data last week. During Q2, GDP fell by -2.2% (y/y). Growth was severely affected by an oil output slump due to attacks on oilfields, a government spending delay amid protracted negotiations on the fiscal program, a steady rise in inflation (+17.1% y/y in august) which hampered private consumption, and capital flows coming to a sudden stop. Stagflation pushed the unemployment rate up from 12.1% in Q1 to 13.3% in Q2. The exchange rate reform implemented in June failed to stabilize the Naira since the Central Bank still manages the official exchange rate. The black market premium remains at a 20 to 30% range. Evidence of mounting supply bottlenecks (gas, infrastructure) is also noteworthy and the import of machine parts is an increasing challenge. Under the current conditions, we revise our growth forecast from +1% to -2.5% in 2016 and from +2.5% to -0.5% in 2017.

Asia Pacific

India: Temporary or long-term slowdown in GDP growth?

GDP growth slowed to +7.1% y/y in Q2 2016, down from a strong +7.9% in Q1. The decline was driven by technical factors, namely lower net indirect taxes due to higher subsidies expenditures. Excluding this component, gross value added growth was broadly stable at +7.3%, supported by solid growth in services and manufacturing. The mining and quarrying sector was the main laggard. Demand wise, solid private consumption and high public consumption growth were the main drivers. On the contrary, investment continued to contract (-3.1% y/y) despite several policy rates cut. In the short run, higher domestic consumption would help to maintain overall GDP growth above 7%. However, an improvement in investment would be pivotal to ignite a solid and sustainable growth cycle in the medium term.

What to watch

- September 8 – Trade figures for China (August)
- September 8 – China consumer prices (August)
- September 8 – ECB Meeting
- September 8 – Brazil, Colombia and Mexico CPI
- September 9 – Turkey Q2 GDP
- September 9 – Eurogroup meeting on Greece
- September 9 – UK Construction Output (July)
- September 9 – Spain industrial production
- September 9 – France Industrial and Manufacturing Production
- September 13 – Germany, France, Italy, UK Inflation
- September 13 – Eurozone Industrial Production (July)
- September 13 – Spain CPI (August)
- September 14 – UK wages and employment change

View all Euler Hermes Economic Research online
http://www.eulerhermes.com/economic-research

Contact Euler Hermes Economic Research Team
research@eulerhermes.com

Publication Director
Ludovic Subran, Chief Economist
ludovic.subran@eulerhermes.com