Euler Hermes Economic Research

Weekly Export Risk Outlook

22 September 2016

FIGURE OF THE WEEK

343

United Russia party's seats in the Duma (out of 450)

In the Headlines

U.S.: Fed hike in December now more likely

The Federal Reserve left the target Fed Funds rate unchanged at 0.25% - 0.50%, but signaled that a hike in December was likely. The accompanying statement read "The Committee judges that the case for an increase… has strengthened but decided… to wait for further evidence of continued progress toward its objectives." Three dissenters, an unusually high number, wanted to increase rates immediately. Furthermore, the "Dot Plot" indicated that 14 of 17 meeting participants expect a rate increase this year, making the likelihood of a December hike greater than 50%. Looking into 2017 however, the dot plot showed expectations of only two hikes to a median of 1.1%, as opposed to the June plot which projected three hikes to a median of 1.6%. Recent data has not supported the case for a hike. Retail sales fell -0.3% m/m in August, the first loss since March, bringing the y/y rate down to +1.9% from +2.4% last month. "Core" sales, which go into the GDP calculation, were down -0.1% m/m for the second consecutive month to +2.8% y/y. Industrial production fell -0.4% m/m in August to a -1.1% y/y rate, the 12th consecutive negative y/y reading.

EU: More investment to boost growth

Last week, in his State of the Union Speech, EU Commission President Juncker announced a doubling of the Investment Plan for Europe to EUR630bn by 2022. Supporting both infrastructure projects and SMEs, the European Fund for Strategic Investment (EFSI), the special vehicle created in 2015 to drive the plan, has already helped to raise EUR116bn (50% of what was planned) for infrastructure projects in 26 EU countries and has financed preferential loans for more than 200,000 SMEs. Assuming the Plan is fully implemented and generates the expected amount of investment, it is forecast to double the pace of annual nominal investment growth to above +5% while the impact on real GDP growth in the EU is predicted at an additional +0.5pps on average per year up to 2022. If the implementation continues at its current pace, the growth boost would be more limited to +0.3pps per year. Sectors most concerned by this investment boost are SMEs, R&D and Innovation, Energy and Transport. The countries to have benefited the most up-to-date are the UK, Italy and France.

Russia: No surprises in Duma election

Preliminary results show that the ruling United Russia (UR) party, supported by President Putin, took 54% of the vote in last Sunday's parliamentary election, securing a three-quarter majority of 343 seats out of 450 in the Duma (lower house). Other parties represented in the Duma will be the Communists (13%, 42 seats), the nationalist LDPR (13%, 39 seats) and the party A Just Russia (6%, 23 seats) – all three are considered as government-friendly and have supported most policy initiatives of UR during the past legislative period. The rebound in support for UR from 49% (238 seats) in 2011, in the process recapturing the constitutional majority it had lost then, reflects a recovery of Putin's popularity. However, it also masks an increasing voter apathy as reflected in the drop of voter turnout to just 47%, the lowest since Putin came to power in 2000. Large anti-government protests as seen after the polls in 2011 are not to be expected this time, even though there were some reports of electoral fraud. Euler Hermes expects continuity of Kremlin policies and politics.

Japan: QQEYCC

The Bank of Japan (BoJ) unveiled a new strategy called "Quantitative and Qualitative Monetary Easing with Yield Curve Control" (QQEYCC), which is broadly a fine tuning of the previous "QQE with a Negative Interest Rate". The arsenal of interest rates was reinforced to get more control on the yield curve. While the short-term policy rate remains at -0.1%, for now, the BoJ announced that it will now guide the yield on 10-year JGBs to zero (recently close to -0.3%) in order to support banks' profitability. Regarding asset purchases, JGBs with a wide range of maturities will be qualified now. Moreover, the BoJ will apply an inflation overshooting framework in which it commits itself to increase the monetary base until y/y CPI inflation stabilizes above the price stability target of 2% (thus abandoning its monetary base targeting). Looking ahead, Euler Hermes forecasts GDP growth to strengthen gradually to +0.7% in 2016 and +1% in 2017 and a progressive improvement of average annual inflation from 0% in 2016 to +1.5% in 2017.

Countries in Focus

Americas

Jamaica: Positive signs, but still too low growth

Major economic reforms have been undertaken under an IMF program since May 2013. The support is scheduled to end in April 2017 but negotiations about an eventual successor program are ongoing. Notably, the tax system was rebuilt, fiscal discipline has improved, and a PetroCaribe debt buyback allowed a reduction of public debt. The efforts seem to be paying off as the economy is showing some positive signs. In 2016, average annual inflation is expected to fall to 3.5% (from 8.3% in 2014), the fiscal account will be almost balanced at -0.2% of GDP (from -6% in 2011) and the current account deficit should narrow to -2.9% of GDP (from -12% in 2011). However, although decreasing, public and external debt have remained at worrisome levels of 124% and 104% of GDP in 2015, respectively. Moreover, economic growth is still subdued, forecast at +1.5% in 2016 (after +1.1% in 2015) dragged down by low commodity prices, modest growth in the U.S. and weak domestic demand.

Europe

UK: Status quo but new rate cut likely by year-end

Given the unexpected resilience of recent economic data, the BoE decided to maintain the status quo but indicated that it remains open to a policy rate cut “close to, but a little above, zero” later this year. This decision follows a number of changes announced by the BoE during the summer (notably: one 25bps rate cut to +0.25%, further credit easing measures and the expansion of the asset purchase scheme). The next move could come at the following meeting on 3 November, when the BoE will also release its updated forecasts for 2017. A preliminary estimate for Q3 GDP will be published on 27 October. Currently, the BoE expects inflation “to rise to around its 2% target” in H1 2017 and estimates that GDP will grow by +0.8% in 2017. As for 2016, the BoE expects a slowdown in H2 mostly due to decreased business spending associated with uncertainties over the UK’s vote to leave the EU. Euler Hermes expects GDP to grow by +1.6% in 2016 and +0.7% in 2017.

Africa & Middle East

Ethiopia: Leveraging on industrialization

PSA Peugeot Citroen recently inaugurated its first assembly unit in Ethiopia. The project embodies a promising trend in Ethiopia and other parts of Africa which sees a growing share of FDI flows to value-added sectors such as manufacturing. Ethiopia’s industrial output grew by +21.2% in 2014 and currently accounts for 14% of GDP. The country’s Special Economic Zones have also attracted Chinese FDI in textiles and the shoe industry. EH expects economic growth in Ethiopia to reach +7% in 2016, among the highest in Africa. However, economic imbalances remain large. The current account deficit is forecast at -8% of GDP in 2016 and still only partly financed by FDI inflows (50%). And public debt is expected to rise to more than 60% of GDP. In the context of such debt-driven growth, high returns on ongoing infrastructure projects, continued attractiveness as a manufacturing hub and political stability (shaken by recent public protests) are required to continue the positive trend.

Asia Pacific

India: Strengthening the muscles?

The trade deficit stabilized in August (-USD7.7bn) with a strong contraction in imports (-14.1% y/y) and a smaller decrease in exports (-0.3% y/y, after -6.8% in July). Inflation eased somewhat to 5.1% y/y (after 6.1% in July) due to lower growth in food prices. Advanced indicators still point to a positive economic outlook. The manufacturing PMI grew to 52.6 in August (from 51.8 in July) with increases in new orders from both home and abroad. The services PMI rose to 54.7 (from 51.9) with a strong increase in new business. Credit conditions are still mixed. The Central Bank has eased its key policy interest rate significantly over the past two years (-150bps since end-2014) but bank loans growth is still modest (around +10% y/y). Assuming lower inflation in the coming months (below 6%) the Central Bank may ease further in order to boost credit growth. This would help to improve private investment and potentially ignite a solid and sustainable growth cycle in the medium term.

What to watch

- September 23 – Austria July industrial production
- September 23 – Canada July retail sales
- September 23 – EU September PMIs (preliminary)
- September 23 – Hungary Q2 current account
- September 23 – Poland August unemployment rate
- September 26 – Czech Rep. Sept. business confidence
- September 26 – Czech Rep. Sept. cons. confidence
- September 26 – Germany Sept. Ifo business climate
- September 26 – Israel interest rate decision
- September 26 – U.S. August new home sales
- September 27 – Germany August retail sales
- September 27 – Brazil August current account
- September 27 – Hungary August unemployment rate
- September 27 – U.S. Sept. consumer confidence
- September 28 – Germany Sept. GfK cons. confidence
- September 28 – Mexico August unemployment rate

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