Euler Hermes Economic Research

Weekly Export Risk Outlook

5 October 2016

FIGURE OF THE WEEK

USD52

Barrel price of benchmark Brent crude oil (+5% y/y)

In the Headlines

UK: Against headwinds

Prime Minister May's announcement on Tuesday at the Conservative convention that Art. 50 would be triggered by March 2017 and the fact that she seemed to aim for a "hard Brexit" caused the GBP to fall by -2% to a 31-year low against the USD. Meanwhile, the real economy has shown positive signs of continued growth despite uncertainty. The manufacturing PMI posted a strong 55.4 in September, up from 53.4 in August, with both output and new orders strengthening, thanks to better price competitiveness of UK goods due to GBP depreciation. The construction sector showed positive signs too as its output expanded for the first time since May, with the PMI up to 52.3 in September from 49.2 in August. Residential building was the main contributor to this expansion while commercial construction declined, still affected by Brexit uncertainty. Activity in the services sector, accounting for about 80% of British GDP, rose also but at a slower pace (PMI at 52.6 in September, down from 52.9). Measures worth GBP5bn were already announced by the government to support the economy. More is expected on 23 November when the Autumn Statement is presented by the Chancellor of the Exchequer.

U.S.: Continued weakness

Real personal consumption expenditures fell -0.1% m/m in August, the first loss since January. The decline drops the y/y rate to +2.6% from +2.9% in July. The data further suggest consumption will rise only around +2.5% annualized q/q in Q3, down sharply from +4.3% in Q2. In addition disposable income rose only +0.1% m/m in August, driving the y/y rate down to +2.4% from +2.6%. The final revision to Q2 GDP growth showed an annualized growth rate of only +1.4%, dragged down by a -7.9% drop in investment, the worst of the recovery. Similarly, construction spending fell in August by -0.7% m/m to a -0.3% y/y rate, the first negative in 62 months. Residential construction was up only +1.3% y/y now vs. +22.8% one year ago, and non-residential construction is down -1.3% vs. +9.6% last year. The ISM manufacturing index gained +2.1 points in September to 51.5, as the new orders component gained +6.0 to a robust 55.0. But manufacturing is still weak as shipments of core capital goods fell by -0.4% m/m in August, the fourth consecutive decline, while new orders are still falling -3.1% y/y.

China: Improving slowly

Industrial profits increased by +8.4% y/y in January-August, supported by both decreasing costs and a "positive" price effect. On the one hand, Chinese producers benefited from low commodity prices and accommodative monetary policy ensuring access to cheap credit. On the other hand, they have profited from declining deflationary pressures (producer prices fell by -0.8% y/y in August, the least negative rate since April 2012). Meanwhile, latest official PMIs continue to send a mixed message, as the dichotomy between manufacturing and non-manufacturing activity persists. Growth continues to be driven by services as indicated by the non-manufacturing PMI of 53.7 in September (53.5 in August). The manufacturing PMI remained in the expansion territory but at a low level (50.4 in both August and September) suggesting a modest momentum in the short run. Regarding the sub-components, output increased while new orders weakened slightly. In that context, policymakers are expected to maintain their accommodative stance, with fiscal support being the main tool while the monetary authorities will focus on reducing financial risks. Euler Hermes forecasts GDP to grow by a resilient +6.5% in 2016.

Emerging Markets: Back to school

Growth is accelerating in Emerging Markets' (EM) manufacturing sectors. The Euler Hermes proprietary aggregate EM manufacturing PMI increased from 49.8 in August to 50.1 in September, thus rising above the 50.0 threshold indicating growth for the first time since end-2014 and signaling that EM GDP growth may perhaps accelerate for the first time in two years. The growth drivers include (i) improving "credit" conditions from stabilizing exchange rates to a recovery in capital inflows (driven by a dovish Fed and a dovish China); (ii) reinvigorated commodity prices; (iii) a recovery of producer prices (deflationary pressures are receding, particularly in China); (iv) fading Brexit fears (more generally, fading EU political risk) fueling Eastern European optimism. Overall, the Euler Hermes forecast of EM growth accelerating from +3.8% in 2016 to +4.5% in 2017 is in line with that positive news. Supportive for the forecast is that some large economies in recession will eventually grow again in 2017, albeit at a moderate pace (+1% in Russia and +0.6% in Brazil).

Countries in Focus

Americas

Colombia: Long-awaited peace needs more time

In a referendum last Sunday, Colombian voters rejected the historical peace agreement proposed by the government that would have ended a 52-year long conflict with the FARC, which has caused considerable drug trafficking issues and at least 200,000 deaths. A narrow majority of 50.21% rejected the presidency's proposal of global amnesty allowing rebels to avoid jail if they confessed to their crimes. The final decision was a surprise as pre-referendum polls gave a solid advantage of almost two thirds in favor of the "yes" camp. Although the agreement represented a concrete way forward for peace, it is likely that Colombians perceived some terms as too complaisant with the FARC. The president of Colombia, Juan Manuel Santos, and the commander in chief of the FARC, Timoleon Jimenez, vowed to continue to seek peace in order to clear the current grey area the country is stuck in.

Europe

Germany: Despite some easing, consumer spending remains solid

Real retail sales fell by -0.4% m/m in August, following a +0.5% increase in July. In y/y terms, retail sales grew by +3.7% in August, rebounding from the -1.5% drop in July, taking the cumulative increase in January-August 2016 to +2.2% y/y. This indicates a moderate slowdown from the +2.6% rise in 2015 as a whole. Meanwhile, the overall GfK Consumer Climate Indicator rose from 10.0 in August to 10.2 in September, the highest in almost 15 years. However, it is forecast to fall back to 10.0 in October and the Economic Expectations component fell for the third consecutive month in September, likely dampened by the Brexit vote. All in all, German consumer sentiment is not entirely immune to the current rise of uncertainty but remains stable at a comparatively strong level (the long-term average of the GfK Consumer Climate Indicator since 2001 stands at 5.6). Euler Hermes expects (working day-adjusted) private consumption growth to moderate somewhat from +1.9% in 2015 to around +1.5% in 2016.

Africa & Middle East

Morocco: Drought weighs but manufacturing is competitive

Q2 real GDP growth slowed down to +0.5% y/y (+1.2% q/q) from +1.7% y/y in Q1. The slowdown was driven by a -10.9% y/y contraction in the agricultural sector, caused by a severe drought, as cereal production was down -70% y/y according to the Ministry of Agriculture. In contrast, GDP in the non-agricultural economy increased by +2.1% y/y in Q2, underpinned by a thriving manufacturing sector, which expanded by +7.3% y/y compared with +2.9% y/y in Q1. Increased competiveness due to rising FDI inflows from producers such as Renault is driving the growth of exports, thereby reducing the current account deficit to -1% of GDP in 2016. Euler Hermes will revise down the full-year 2016 GDP growth forecast from +2% to +1.5% as a consequence of the drought. However, the +4.5% forecast for 2017 will be retained because Morocco's growth fundamentals continue to be strong and the country will remain an African investment and manufacturing hub.

Asia Pacific

Japan: Is there a light at the end of the tunnel?

Business confidence remains low as the economy struggles to regain momentum, while both the Central Bank (BoJ) and the Government have announced measures to support growth. The BoJ Tankan survey results disappointed in Q3 as the large manufacturing businesses index remained low at 6 (unchanged from Q2) while large non-manufacturers' confidence deteriorated further from 19 to 18. The lack of confidence can be explained by slow growth in aggregate demand (domestic and external), the strong JPY (exchange rate vs. USD stood at 104 on 4 Oct.) depressing price competitiveness, and weak profit growth. Meanwhile, the Nikkei manufacturing PMI recovered to 50.4 in September (49.4 in August) but it is probably too early to declare victory as sub-components still suggest a weak outlook with low new orders. Going forward, fiscal stimulus is expected to pick up in Q4. Euler Hermes forecasts GDP growth of +0.7% in 2016.

What to watch

- October 6 – Germany August factory orders
- October 7 – Brazil and Ukraine September inflation
- October 7 – Canada September employment report
- October 7 – France, Germany, Hungary, Spain and UK August industrial production
- October 7 – U.S. September employment report
- October 10 – Egypt September inflation
- October 10 – Germany August foreign trade
- October 10 – Italy, Slovakia and Turkey August industrial production
- October 10 – Singapore Q3 GDP growth (flash estimate)
- October 11 – South Africa August manufact. production
- October 11 – Hungary, Poland and Romania September inflation
- October 12 – France September inflation
- October 12 – Eurozone August industrial production
- October 12 – Mexico August industrial production

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