Euler Hermes Economic Research

Weekly Export Risk Outlook

8 December 2016

In the Headlines

FIGURE OF THE WEEK

-2.9%

Q3 2016 y/y GDP decline in Brazil

Eurozone: QE for longer, but lower monthly asset purchases

By a broad consensus, the ECB Governing Council decided to reduce the monthly pace of asset purchases (Quantitative Easing, QE) from EUR80bn to EUR60bn starting in April 2017 and to maintain it until December 2017. Overall, this means an extension of the QE program for 9 months by EUR540bn in total. This decision was contrary to expectations of an extension for 6 to 9 months at the current pace. The decision has been justified by three reasons: (i) the risk of deflation has largely waned compared to when they announced the rise of the amount back in March 2016; (ii) an increase in inflation expectations; (iii) indications of a stronger global recovery after the relative resilience post surprises (Brexit, Trump, and result of the Italian referendum). The ECB also announced an extension of the securities' perimeter to sovereign and corporate bond purchases with yields below the ECB deposit rate (-0.4%) and of lower maturities (lower bound of 1 year instead of 2 years). The ECB acknowledged a still subdued inflation outlook, +1.3% in 2017 and +1.5% in 2018, in the context of moderate GDP growth, +1.7% in 2016 and +1.6% in 2018. At the same time, Mario Draghi said that should the economic outlook deteriorate, an increase in the amounts or the duration of the QE program will be likely.

Brazil: Dragging through the depths

The Central Bank lowered its key policy interest rate last week by 25bps to 13.75%, in line with market expectations. It was the second cut in four years after the start of an easing cycle in October, to fuel growth in the battered economy. Markets expect a third rate cut as early as January 2017, by 50bps. Inflation was 0.3% m/m in October, similar to the 0.2% m/m registered in September, and continued its downward trend to 7.9% y/y from 8.5% y/y in September. Industrial production fell again in October, by -1.1% m/m and -5.5% y/y after a marked correction in September. Real GDP contracted by -0.8% q/q and -2.9% y/y in Q3, dragged down by a -3.1% q/q and -8.4% y/y plunge in investment and a -0.6% q/q and -3.4% y/y decrease in private consumption, the worst performing components so far this year. Exports continued to decline for a second consecutive quarter and dropped -2.8% q/q in Q3, after -1.8% q/q in Q2. Euler Hermes forecasts full-year GDP to contract by -3.5% in 2016 but an exit from recession in 2017, with growth of +0.6%.

India: From Demonetization to Disruption

In early November, Indian authorities unexpectedly decided to ban high value bank notes and replace them with new ones in an attempt to curb informal activity. Although the underlying objective is positive, poor organization and logistics issues have resulted in a negative cash shock, with people struggling to get access to the new cash. While the impact on the economy is still to be seen, some disruptions are anticipated, e.g. less expenditures by cash-dependent agents, especially households, SMEs and B2C businesses. The sharp decrease of the services PMI to 46.7 in November (54.5 in October) supports this view. Against this backdrop, the authorities are likely to support the economy. Logistical efforts to ease the transition have already been taken (further printing, more guidance). Accommodative monetary policy of the RBI should bear some fruits. The *demonetization* move is set to help banks to improve their balance sheets thanks to higher deposits and enable further lending going forward. Overall, EH expects GDP growth to slow to +7.2% in FY2016-17 before accelerating to +7.5% in FY2017-18.

Greece: Positive step for debt sustainability, more is needed

At the Eurogroup meeting on 5 December debt relief measures for the Greek debt have been finally announced. In the following weeks the European Stability Mechanism will implement a number of measures that will help reduce the debt by 20pps of GDP by 2060 (from the current 180% of GDP). Overall, the debt relief measures are a positive step forward that, combined with the improvement in the economic outlook, will probably allow the capital controls to be lifted entirely in H1 2017. The bond swaps will lead to savings in terms of interest expenditures for the Greek government while the swap of Greek notes will support the recapitalization of Greek banks. However, the Eurogroup said that no new measures should be expected until 2018 when the current bailout expires. The Eurogroup recalled that the primary surplus target of +3.5% of GDP reached by 2018 should be maintained for the medium-term while the IMF was asking for a reduction to +1.5% of GDP. An official decision on the IMF participation in the Greek bailout will be given in early 2017.

Countries in Focus

Americas

U.S.: Improving Slowly

Recent data indicates an improving but still tepid economy. A robust +178,000 jobs were created in November and the unemployment rate dropped from 4.9% to 4.6%, the lowest in nine years, but it was due to a sharp decline of -226,000 in the labor force. Other negatives included a -0.1% m/m drop in hourly earnings to a +2.5% y/y rate and, for the first time in six years, retail jobs shrank during the holiday sales month of November. The November ISM manufacturing index gained +1.3 points, the third consecutive gain, to 53.2, in the expansionary range above 50. But a separate manufacturing report showed that core orders for durable goods rose only +0.2% m/m to a -4.3% y/y rate. The ISM services index rose +2.4 points to a solid 57.2, and despite a -0.7 point slip, new orders remained high at 57. Weak productivity has plagued the recovery, and while it did rise +3.1% q/q annualized in Q3, the first gain in four quarters, the y/y rate is flat.

Europe

Austria: Improving outlook

The repeat second round of the presidential election held on 4 December was won by the independent, Greens-backed and pro-European Alexander van der Bellen (53.8%) over the EU-sceptic Norbert Hofer (46.2%) from the nationalist FPÖ. Van der Bellen thus increased his margin of victory from the first poll in May (50.3% to 49.7%) which was later overturned by the Constitutional Court due to procedural flaws. On the economic front, Q3 real GDP increased by +1.2% y/y (unchanged from Q2) and +0.4% q/q, up from +0.3% q/q in Q2. Growth in Q3 was driven by domestic demand, with private consumption up by +0.4% q/q, government consumption by +0.2% q/q and fixed investment by +0.7% q/q. Net exports subtracted -0.1pp from Q3 growth as exports expanded by +0.2% q/q and imports by +0.3% q/q. Euler Hermes forecasts full-year real GDP growth to pick up from +0.9% in 2015 to +1.3% in 2016 and +1.5% in 2017.

Africa & Middle East

South Africa: Frozen

Economic growth plummeted once again to +0.05% q/q in Q3. Almost zero growth is the new normal since Q1 2015. The increase of +0.9% q/q in Q2 was just an illusion, driven by the recuperation of the mining sector (which weighed down on growth of -0.3% in Q1). With no growth and 6.4% y/y inflation in October, private sector confidence is still very weak, particularly business confidence. Car sales decreased by -9.4% y/y in November. The employment ratio is among the weakest in the world, at 39% (compared to a global average of 60%). And the political situation is still not supportive. The ANC is increasingly divided after electoral defeats and social tensions in different regions of the country, shaking the end of the second term of President Zuma (the next elections are scheduled for 2019) even if he avoided an impeachment last week. This provides a downside risk to our base case growth scenario (+1.5% in 2017, after +0.5% in 2016).

Asia Pacific

Australia: Crack in the wall?

Q3 real GDP contracted by -0.5% q/q, the first decline since Q1 2011. The decrease was a result of a fall in investment (both public and private) and lower government consumption. Private consumption remained resilient (+0.4% q/q). Net exports subtracted -0.2pps from Q3 growth with lower exports expansion compared to imports. On the production side, the drop was mainly related to a fall in construction activity (-3.6% q/q). High frequency indicators suggest a modest and fragile recovery. Retail sales have recovered progressively since August. Business sentiment in both manufacturing and services has improved with PMIs exceeding the 50 threshold that indicates sector expansion. However, the construction sector will remain a drag on growth as both hard data (e.g. building permits) and business surveys suggest a decline. In that context, policymakers are expected to step up policy easing measures. Euler Hermes expects GDP growth to slow to +2.3% in 2016 (from +2.4% in 2015).

What to watch

- December 9 – Brazil November CPI
- December 9 – France October industrial production
- December 9 – Estonia and Ireland Q3 GDP
- December 9 – Germany October balance of payments
- December 9 – UK October construction output
- December 9 – U.S. December consumer sentiment
- December 12 – Mexico October industrial production
- December 12 – Poland and Romania November CPI
- December 12 – Romania October industrial production
- December 12 – Turkey Q3 GDP
- December 12 – Turkey October balance of payments
- December 13 – Canada November housing price index
- December 13 – Germany ZEW survey
- December 13 – Germany, Spain and UK November CPI
- December 13 – Russia Q3 GDP with production details
- December 14 – U.S. Fed policy announcement
- December 14 – Eurozone October industrial production

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