Euler Hermes Economic Research

Weekly Export Risk Outlook

15 December 2016

FIGURE OF THE WEEK

-1.8%

Q3 2016 y/y GDP decline in Turkey

In the Headlines

U.S.: Fed a bit more hawkish, other data disappointing

As expected, the Federal Reserve raised its policy Fed Funds rate by 25 basis points (bps) to a range of 50-75 bps – still a very low rate historically. More importantly the Fed indicated it would hike rates three times (at 25 bps each) in 2017 as opposed to the previous meeting when it projected just two hikes. We maintain our forecast that the Fed will hike two or three times in 2017. The Fed's moderately more hawkish stance was reinforced by the accompanying statement which noted "Market-based measures of inflation compensation have moved up considerably…"

Those measures include the 5 year TIP spread which has risen from 157 bps the day before the election to 200 bps currently, and the yield on the ten year Treasury note which had risen from 188 bps the day before the election to almost 260 bps currently. The Fed is also projecting three hikes in both 2018 and 2019, putting the Fed Funds rate at 2.9% by the end of 2019, approximately the same as its estimate for the long term rate of 3.0%. In other news, retail sales and industrial production both disappointed, inflation crept up, and in Canada, housing prices rose only +0.2% m/m, the slowest this year.

Turkey: Surprisingly strong drop in Q3 GDP

Real GDP contracted by -1.8% y/y in Q3, after still strong expansion of +4.5% y/y in both Q1 and Q2. A marked slowdown had been expected but not a decline. The demand-side breakdown reveals that further strengthening public spending (+23.8% y/y) was the only positive growth driver in Q3. Private consumption contracted by -3.2% y/y (+3.7% in Q2) and fixed investment by -0.6% y/y (+4.7% in Q2). Real exports dropped by -7% y/y (0% in Q2) while import growth remained robust at +4.3% y/y (+9.1% in Q2) so that net exports made again a large negative contribution of -2.8pps to growth in Q3 (-2.3pps in Q2). Along with the disappointing Q3 performance, a considerable revision of historical GDP data (which markedly increased the 2015 base) as well as weak early indicators for Q4 (real retail sales down -0.2% y/y and industrial production up just +0.2% y/y in October; PMI manufacturing at 48.8 in November) prompted Euler Hermes to significantly revise its full-year 2016 GDP growth forecast downwards to +1.3% (from +3% previously). The 2017 forecast was reduced to +1%.

World Economy: Let it be

Global GDP growth accelerated to +3.4% (q/q, seasonally adjusted annualized rate or saar) in Q3 2016, the best figure since Q3 2014. The growth acceleration in the U.S., to +3.2% q/q saar, and a second consecutive quarter of resilient growth in China (+7.7% q/q saar) were the drivers. Growth prospects are currently also improving in Emerging Markets (EM), particularly in Asia and in Eastern Europe, driving our aggregate EM manufacturing PMI to 50.9 in November, a steady rise from 49.5 in July and the best figure since August 2014. The bottom line is that the commodity price shock is fading and current reflation is helping corporate turnovers to recover. It led to a cyclical recovery, along with dovish monetary and (in Asia) fiscal policy. But there is still some divergence, with Turkey's PMI deteriorating from 49.8 to 48.8 and Brazil still stuck in recession (PMI of 46.2). This indicates that, against the background of subpar growth, policy fault lines may weigh heavily on the business cycle.

Spain: No free lunch

Mariano Rajoy was confirmed as Prime Minister for a second term after winning a parliamentary confidence vote that allows him to lead a minority government after ten months of political impasse. The new cabinet will need to build consensus across a hostile parliament in order to pass reforms. The aftermath of the housing bubble shrank tax collection by -EUR70.7bn between 2007 and 2009 and revenues are still -EUR28.7bn below the 2007 peak. Spain appears to be broadly on track for meeting its -4.6% fiscal deficit target in 2016, down from -5.1% in 2015, largely supported by a better than expected output performance. The government submitted to Brussels an amendment on its 2017 budget to meet next year's -3.1% deficit target, as it currently falls short by +EUR7.5bn. The estimated increases of tax collection include +EUR4.65bn by limiting corporate tax deductions, +EUR850mn by raising special taxes, +EUR1.5bn by improving tax effectiveness and +EUR500mn from fighting fraud. In addition, the Social Security fund is expected to run a -EUR2.6bn deficit in 2017 after having exhausted a +EUR66.8bn reserve fund within seven years.

Countries in Focus

Americas

Argentina: No smooth sailing on inflation

The change of course of inflation has enabled the Argentinian reference rate to be decreased to 24.75%, down from the 38% peak registered in April. Looking forward to the end of the year, November's market expectations anticipate an additional -75bps decline, -35bps less compared to October. However, consumer confidence remains stagnant since the beginning of Q2 as inflation is still a concern. In October, it accelerated for a second consecutive month to +2.7% m/m and +43.7% y/y, carrying the effects of changes in regulated energy prices. Euler Hermes forecasts inflation to record +39.1% y/y by the end of 2016 and to continue to ease to +19.9% y/y by the end of 2017. Argentinians still have confidence in the new government and its reform agenda to put the economy back on its feet and address the inherited macroeconomic imbalances and weakened institutional framework.

Europe

Ireland: The Celtic Tiger is here to stay

Q3 GDP increased by 4% q/q from +0.7% in Q2. On the supply side, all main sectors registered positive growth: the manufacturing sector increased by +4.0% q/q; the construction sector increased by +4.3%; agriculture increased by +0.7% q/q; distribution, transport, software and communications +5.3% q/q. On the demand side, personal consumption - which accounts for approximately 53% of domestic demand - increased by +0.7% q/q and government consumption increased by 0.8% q/q. Firms' inventories rebounded after 2 consecutive quarters of decline: +0.8pp. Exports increased by +1.7% q/q and imports fell strongly by -8.6% q/q on the back of lower imports of intellectual property products and a significant fall in equipment investment (-17.8% q/q). This brought total net trade contribution to growth to +10.2pp (or EUR6.4bn). GDP growth should stand above 4% in 2016 and reach +3.5% on average in 2017-18, twice higher compared to the eurozone average.

Africa & Middle East

Egypt: Growth to come to a sudden stop

Egypt has delivered long awaited and welcomed reforms in early November. The free floating exchange rate (the EGP depreciated by -52% thereafter) and subsidies cuts were necessary in order to rebalance its growth model and qualify for IMF loans (see also WERO 09 November 2016). The immediate positive impact was related to liquidity issues. Capital flows returned to Egypt, the equity market skyrocketed and import cover recovered to more than four months, a 5-year high. But the immediate negative impact was also quite striking since inflation accelerated from +13.6% y/y in October to +19.4% in November. Such an inflation shock should weigh heavily on consumer confidence and have a strong impact on consumption. As a result, growth is expected to come to a sudden halt and Euler Hermes has revised downwards its forecasts to 0% in 2017 (which would be the worst growth since 1967) and +1.5% in 2018, after +3.5% in 2016.

Asia Pacific

China: Ending the year on a high note?

Economic activity indicators improved in November. Real industrial production increased by +6.2% y/y (from +6.1% in October). Nominal retail sales accelerated to +10.8% y/y (from +10.0% y/y) supported by a continued rise in auto sales. Fixed asset investment expanded by +8.3% y/y. USD-denominated exports edged up by +0.1% y/y in November (after -7.3%). Regarding prices, both consumer prices (+2.3% y/y) and producer prices (+3.3% y/y) picked up. Forward-looking indicators point to an improvement with rises in both the official manufacturing PMI (51.7 in November) and the non-manufacturing PMI (54.7). Looking ahead, GDP growth is set to prove resilient in 2017, forecast at +6.2%, after +6.7% in 2016, underpinned by solid private consumption and favorable fiscal policy. Downside risks stem from high credit risk, persisting excessive capacities, a weakening currency and limited export growth prospects with a more protectionist U.S.

What to watch

- December 16 – Eurozone November CPI
- December 16 – France December business confidence
- December 16 – Russia interest rate decision
- December 16 – US November housing starts
- December 19 – Colombia October trade balance
- December 19 – Germany December Ifo business climate
- December 19 – Ukraine Q3 GDP (2nd estimate)
- December 20 – Ghana Q3 GDP
- December 20 – Hungary interest rate decision
- December 20 – Turkey interest rate decision
- December 21 – Eurozone Dec. consumer confidence
- December 21 – New Zealand Q3 GDP
- December 23 – Canada October GDP

Contact Euler Hermes Economic Research Team
research@eulerhermes.com

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