Euler Hermes Economic Research

# Weekly Export Risk Outlook

July 6, 2017

## In the Headlines

FIGURE OF THE WEEK

+6.2%

**Q2 2017 y/y GDP growth in Vietnam**

### UK: Higher trade deficit and net direct investment outflows

The current account deficit continued to widen in Q1 2017 (by -£4.8 billion from Q4) to -£16.9 billion or -3.4% of GDP, the highest since Q3 2016. The main trigger was a worsening of the trade deficit which rose by - £2.6 billion to -£34.3 billion (or -6.9% of GDP) in Q1 as import growth outpaced export growth. Notably, imports of finished manufactured goods (mainly machinery and transport equipment), oil and semi-manufactured goods increased strongly. Moreover, the surplus on trade in services narrowed by -£1.4 billion to +£25.4 billion, or +5.1% of GDP, in Q1 as services imports rose (mostly maintenance) and exports contracted (mostly financial services, insurance and pension). Furthermore, Brexit has had an impact on direct investment which recorded the largest net outflows (-£20.1 billion) since Q3 2014 as foreign investment into the UK slowed following strong inflows in 2016. Inflows of financial derivatives and stock options boosted net portfolio investment inflows to £22.3 billion, the largest since Q3 2016. We expect inward investment to soften going forward as no clear outcome of the Brexit negotiations is expected by fall 2018, at the earliest.

### Ukraine: Growth momentum slows while prices rise again

The Central Bank maintained its key policy rate at 12.5% today, citing the need to reduce risks to achieving the inflation target set for 2017 (8%±2pp). After falling to a temporary low of 6.9% y/y in mid-2016, headline inflation has risen again to double-digits, posting an estimated 15% y/y in June and 13.8% in 2017 YTD. This is mainly a result of an ongoing liberalization of household energy prices, the impact of which is stronger than the UAH appreciation in recent months which should have an easing impact on inflation. The UAH has gained +4% against the USD since end-2016, however, it is still -5% down from a year ago. Meanwhile, real GDP growth slowed down to +2.5% y/y in Q1 from +4.8% in Q4 2016, mainly because last year's strong rebound in capital formation is gradually easing this year. Fixed investment still surged by +20.1% y/y in Q1 (though down from +27.1% in Q4) but inventories subtracted -1.4pp from Q1 growth (after +6.6pp in Q4). Consumer spending growth picked up to +2.8% y/y (+0.9% in Q4) and public spending recovered to +4.2% y/y (-2.2% in Q4). External trade activity moderated sharply from the rebound in H2 2016, with exports down by -0.4% y/y in Q1 (+9.7% in Q4) and imports up by just +2.9% y/y (+19.6% in Q4). We expect full-year growth of +2% or so in 2017.

### Vietnam: Riding on the exports wave

Economic growth accelerated to +6.2% y/y in Q2 (from +5.1% in Q1) led by manufacturing and services. On the expenditures side, there are signs that the improvement was broad-based. USD-denominated exports rose at a strong pace (above +20% y/y in Q2). And solid growth in retail sales (+10.6% y/y in June) suggests that domestic demand expansion is still robust. Going forward, there is room for further acceleration. The Nikkei Manufacturing PMI points to firm expansion in the short run (52.5 points in June, up from 51.6 in May) with a rise in output and new exports orders. Moreover, monetary policy should be broadly accommodative as inflation is under control at 2.5% y/y in June, in line with the Central Bank's target to keep inflation below 4%. Continued efforts from the government to raise the country's attractiveness should help unleash economic growth potential. Against this back-drop, we expect GDP growth to rise by +6% in 2017 (though below the government target of +6.7%).

### Emerging Markets: Keep on growing

Manufacturing PMIs suggest that the growth momentum holds on in Emerging Markets (EM). Although the Euler Hermes proprietary EM aggregate Manufacturing PMI eased slightly to 51.4 points in June from 51.6 in May, it remained above the 50-threshold for the tenth month in a row, confirming that EM are still in a growth cycle. Overall, the recovery is weaker than previous ones (e.g. 2010), with divergences between countries, but growth almost everywhere. The growth cycle is gathering momentum in Turkey, with the best figure (54.7) since November 2013. Mexico is also in a better situation (52.3, best index since May 2016). For these two countries, it is an exit from a period of protracted financial volatility, driven by political uncertainty in Turkey and by perceived risks regarding the trade relationship with the U.S. for Mexico. In contrast, Russia had the weakest PMI (50.3) since July 2016, indicating that the growth momentum is already fading, along with the recent moderation of oil prices from a peak US$56/bbl in April to an average of US$48/bbl in June.

# Countries in Focus

Americas

## U.S.: Pricing pressures falling

According to the government's final estimate, Q1 GDP grew at a +1.4% q/q annualized rate, slightly stronger than previously thought, but still rather weak. Consumption contributed the most but grew only +1.1%. More recently, consumption has grown +0.2% and +0.1% m/m in April and May, respectively, putting the y/y rate at +2.7% and setting the foundation for a stronger Q2. Disposable income rose a strong +0.6% m/m so that the y/y rate reached +2.2%. Pricing pressure remained weak as both headline and core inflation fell to 1.4% y/y in June. On the supply side of the economy, the ISM manufacturing report was quite strong, gaining +2.9 points to 57.8, the highest level in nearly three years. Nine of the ten components rose and nine are now above the 50 level signaling expansion. New orders gained a steep +4.0 points to 63.5 and production rose +5.3 points to 62.4. And like the personal consumption report, inflationary pressures waned on the manufacturing side for the third consecutive month.

Europe

## Croatia: Macro risk has declined but a micro one is looming

Q1 real GDP grew by +2.5% y/y (seasonally adjusted by +0.6% q/q and +3.4% y/y), down from +3.4% y/y in Q4 2016. Growth in Q1 was driven by domestic demand, with consumer spending up by +3.4% y/y, public spending by +1.6% and fixed investment by +5.4%. External trade activity was also vigorous, with exports up by +8.6% y/y, but the stronger import expansion by +10.1% meant that net exports subtracted -0.4pp from Q1 growth. Going forward, troubles facing Croatia's largest private company, Agrokor (which accounts for an estimated 7-8% of GDP) are likely to weigh on growth as well as public finances. We forecast full-year GDP growth to ease slightly from +3% in 2016 to +2.9% in 2017 and +2.7% in 2018. The annual fiscal deficit narrowed markedly to -0.8% of GDP in 2016, from -3.4% in 2015 and an average -6% in 2009-2014, thanks to revenues benefiting from the growth rebound and fiscal restraint. We expect the shortfall to rise to a still adequate -2% of GDP in 2017-2018.

Africa & Middle East

## Ghana: Good news

Real GDP growth surprised on the upside in Q1, at +6.6% y/y, driven by increasing output in new oil fields. Moreover, attractiveness for foreign investors pulled capital flows into the country. This helped to finance the fiscal deficit (-7% of GDP expected in 2017) and to push foreign exchanges reserves higher, despite uncertainty during H1 2017 on the willingness of the government to extend its IMF program (see also WERO February 22). As a result, import cover unexpectedly increased, from three months in January to 4.5 months in April. Moreover, as inflation eased markedly from about 20% y/y in Q1 to 12.6% in May 2017, the Central Bank has begun to cut its monetary policy interest rate by a cumulative -300bp in March-May, to 22.5%. And, as the government has finally asked to extend the duration of the IMF program by 8 months to December 2018, these good news should anchor positive investor expectations and help to finance the current account deficit (-6% of GDP expected in 2017).

Asia Pacific

## China: Slower momentum ahead

The Caixin Composite PMI declined to 51.1 points in June (from 51.5 in May) due to a drop in the Services PMI to 51.6 (from 52.8). On the manufacturing side, however, the business survey signaled an improvement into modest growth territory with a rise of the Manufacturing index to 50.4 (from 49.6) thanks to rising output and new exports orders. These results contrast with the official PMIs which both signaled solid expansion: the NBS Manufacturing PMI at 51.7 and the Non-manufacturing PMI at 54.9 in June. Looking ahead, economic growth is set to remain resilient but lose some pace. So far, the economy continued to benefit from improved external demand and favorable fiscal policies. However, a tightening of property markets and especially credit conditions through regulation point to slower growth going forward. Euler Hermes expects economic growth to rise by +6.7% in 2017 before slowing to +6.3% in 2018.


# What to watch

- July 7-8 – G20 Summit in Hamburg
- July 7 – France & Germany May industrial production
- July 7 – Brazil, Mexico and Russia June CPI
- July 7 – UK May industrial production
- July 7 – UK June house price index
- July 7 – U.S. June employment report
- July 7 – Canada June employment report
- July 10 – Ukraine June CPI
- July 10 – Eurozone Finance Ministers Meeting
- July 11 – Poland, Hungary and Romania June CPI
- July 11 – Romania May industrial production
- July 11 – South Africa May manufacturing production
- July 12 – Brazil May retail sales
- July 12 – Hungary and Spain May industrial production
- July 12 – Mexico May industrial production
- July 12 – UK May unemployment rate

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