Euler Hermes Economic Research

Weekly Export Risk Outlook

July 26, 2017

FIGURE OF THE WEEK

116.0

Germany's Ifo Index in July, a new record high

In the Headlines

Germany: Ifo Business Climate Index points to strong Q2

In contrast to the slight dip in the purchasing managers' index (PMI Composite Output Index at 55.1 points in July, down from 56.4 in June), the Ifo Business Climate Index climbed to a new record level of 116.0 points in July. In our experience, the Ifo Index is an extremely reliable economic indicator. This suggests that the buoyant economic growth seen in the first quarter (+0.6% q/q) was maintained in the second quarter as well, particularly as hard economic indicators such as exports, retail sales and industrial production in the first two months of the second quarter also flag up dynamic business activity. We estimate seasonally-adjusted quarterly growth of +0.5% to +0.7% in the second quarter.

Particularly striking is the steep rise to an all-time high in the assessment of current conditions in the manufacturing sector since fall 2016, having previously practically stagnated for three years. It is also surprising that business expectations in manufacturing for the coming six months have improved although the rise in the EUR tends to undermine industrial price competitiveness.

UK: Brexit puts the brakes on the economy

The British economy gave another weak performance in the second quarter of 2017. According to the flash estimate published today it grew by +0.3% q/q in the three months to June after +0.2% q/q in the previous quarter. The initially feared sharp drop-off in economic activity in the immediate aftermath of the Brexit referendum did not materialize, instead in a gradual process the UK will have to say goodbye to the high growth rates of recent years. Since the turn of the year 2016/17 the British economy has cooled notably. Especially the elevated uncertainty surrounding the outcome of EU exit negotiations and the sharp acceleration in consumer prices – as a result of the marked depreciation of the GBP – weigh on economic activity. In the current year average quarterly growth is expected to more than halve from +0.5% q/q to +0.2% q/q. Overall we expect UK real GDP growth to slow to +1.4% in 2017, down from +1.8% in the previous year.

France: Summertime

Signals from business surveys and hard data are converging and pointing to a growth cycle. Supply and demand are improving at the same time. The quarterly business survey gives evidence of improving demand, as e.g. "foreign demand, past change" is up to +20 points, the best index since April 2011. Manufacturing production growth was +2.6% in May (y/y, 3-months moving average), the best figure since December 2015. Manufacturing confidence was stable at a high level in July (109 points, significantly above the long-term average of 100), and other sectors are increasingly exhibiting good figures. Building construction confidence is up to 105 in July (best figure since 2008) as activity, order books (7.3 months), employment and prices have rapidly improved at the same time. It supports our residential investment scenario (+3.8% in 2017). Moreover, the production capacity utilization rate returned to 84.3% in the manufacturing industry, the best index since July 2008. As 30.8% of corporates are running at full capacity, corporate investment should be on the rise: we expect +3.5% in 2017. The EH investment barometer confirms that 68% of corporates plan to invest equally or more in 2017.

South Africa: Easing, as expected

The South African Central Bank (CB) decided to cut its key policy rate by -25bp to 6.75%. This is the first rate cut recorded in five years (the CB had a hawkish bias) but it came after a slight recession and a sharp reduction in inflation (see also WERO July 19, 2017). All in all, this easing is just normal given economic conditions. However, consensus expectations were for no policy action as the political crisis has intensified (alleged bribery issues involving President Zuma), with a clear divide within the ANC and increasing calls for Zuma to resign before the scheduled end of his mandate (May 2019). A key issue is the disconnect between the troubled domestic situation and risk-appetite in global financial markets. Foreign investors are looking for yields, including in South Africa despite the country's loss of its investment grade ratings. More monetary easing is expected before year-end (to 6% or so). Overall, our growth (+0.6% in 2017) and inflation (+5% on average in 2017) forecasts are supporting this dovish scenario.

Countries in Focus

Americas

Canada: Strong consumption, another BoC hike likely

Unlike their neighbors to the south, Canadian consumers are buying at a furious pace. Retail sales rose +0.6% m/m in May, the third consecutive increase, putting the y/y rate up to a very strong +7.3%, well above the long-term average of +4.6%. All major categories are up y/y, with double-digit gains in autos, electronics and appliances, building materials, and gasoline. Even without autos and gasoline, sales are up +4% y/y vs. a long-term average of +3.6%. Furthermore, real sales volumes are also up +6.4% y/y, more than twice the average. Separately, inflation remains tepid, but two of the three core inflation measures from the Bank of Canada (BoC) rose +0.1% m/m in June to +1.4% and +1.6% y/y. Although inflation is still weak, the very strong consumer, plus the continued strength of the housing market, and the sharp rebound in the energy sector will most likely cause the BoC to hike rates one more time this year.

Europe

Bulgaria: Economic momentum continues

Advanced indicators point to continued robust economic momentum. Industrial production growth edged down from +4.1% y/y in Q4 2016 to +3.9% y/y in Q1 2017, but accelerated to an average +5.9% y/y in April-May 2017, taking the average of the first five months to +4.7% y/y, well above the +2.7% recorded in full-year 2016. External trade activity has also gained impetus in January-May 2017: Nominal exports of goods rose by +17.7% y/y but imports surged still stronger at +21% y/y, largely due to rising energy prices. Working-day adjusted real GDP grew by +3.5% y/y in Q1 2017, after +3.4% in full-year 2016. However, a look at the breakdown of GDP reveals that Q1 growth was not well-balanced as it was mainly driven by domestic consumption and a strong build-up in inventories (which added +1.9pp to Q1 growth). Hence, despite the strong Q1, we expect economic growth to moderate from +3.4% in 2016 to +3% in 2017 as we expect the build-up in inventories to fade over the rest of the year.

Africa & Middle East

Iran: Sharp but temporary uptick in growth in FY 2016

According to recently released data by the Central Bank of Iran, real GDP rose by +13.4% in fiscal year (FY) 2016 (which ran from March 21, 2016 to March 20, 2017) as the oil sector rebounded strongly after the sanctions relief following the nuclear deal in January 2016. The oil sector soared by +61.6% in FY 2016 on the back of a +27% increase in crude production and the exports of pent-up supply after years of sanctions. The non-oil sector grew by a modest +3.3% though it picked up to +5.6% y/y in the final quarter of FY 2016. The one-off surge in oil production and exports should fade in FY 2017 and we expect headline growth to ease to +4.2%. Structural issues will inhibit the realization of stronger growth potential. Notably remaining U.S. sanctions on Iran's financial sector refrain western banks from doing business with the country. And given the risk of new U.S. sanctions and the nuclear deal falling apart, foreign investors remain wary about engaging in Iran on a large scale.

Asia Pacific

Indonesia: Steady as she goes

The manufacturing PMI has been hovering around the 50-threshold since the start of the year (49.5 in June), indicating a steady GDP growth rate. Private consumption is expected to be a stable growth factor in 2017 – in Q1 it contributed +2.7pp in Q1 to the GDP growth rate of +5% y/y – as inflation is quite stable (EH expects average price growth of +4.5% in 2017). Further, accommodative monetary policy (almost zero real policy rates) and the government's strong commitment to infrastructure investment drove a pick-up in the construction industry (+6.3% y/y in Q1, up from +5.3% in 2016), indicating that growth drivers are gradually evolving. Moreover, exports are on the rise due to improved global trade dynamics and last year's price hikes for palm oil and coal so that we expect the contribution of exports to growth to improve (it was +1.75pp in Q1). Overall, annual real GDP growth is forecast to gradually accelerate from +5% in 2016 to +5.1% in 2017 and +5.2% in 2018.

What to watch

- July 27 – Germany July GfK consumer climate index
- July 27 – Turkey Central Bank meeting
- July 27 – U.S. June durable goods orders
- July 27 – U.S. June international trade
- July 28 – Canada May GDP
- July 28 – Germany July CPI (preliminary)
- July 28 – Russia Central Bank meeting
- July 28 – Austria, Sweden Q2 GDP (flash estimates)
- July 28 – France, Spain Q2 GDP (flash estimates)
- July 28 – U.S. Q2 GDP
- July 31 – Germany June retail sales
- July 31 – Belgium, Latvia, Lithuania Q2 GDP (flash est.)
- July 31 – Serbia Q2 GDP growth (flash estimate)
- August 1 – Eurozone Q2 GDP (flash estimate)
- August 1 – U.S. June personal income and outlays
- August 1 – U.S. July ISM non-manufacturing survey