Euler Hermes Economic Research

Weekly Export Risk Outlook

26 October 2017

FIGURE OF THE WEEK

+6.8%

Q3 2017 y/y GDP growth in China

In the Headlines

Eurozone: ECB goes lower for longer

The ECB has taken another timid step in what looks set to be a very gradual exit process from its ultra-expansive monetary policy. At its October meeting the ECB announced an extension of its QE program into 2018 albeit at a reduced pace. Asset purchases will be continued until at least the end of September but from January onwards the monthly quota will be halved to EUR30bn. Due to the careful communication on behalf of the ECB over the past few months – which had prepared the grounds for another tapering step – the market reaction proved muted. Overall the ECB's announcement is quite dovish, which is likely to help keep a lid on EUR appreciation. For one it left the door open for a further QE program extension in size and/or length should economic or financial conditions deteriorate again. In addition forward guidance remained unchanged and with the reinvestment of principal payments to be continued for an extended period of time after the end of the QE program, the ECB will have a strong presence in bond markets for some time to come. Moreover the ECB's lower-for-longer decision means that an interest rate hike from current record lows is unlikely to be implemented before 2019.

China: Q3 GDP and Congress

Real GDP growth edged down to +6.8% y/y in Q3 (from +6.9% in Q2) due to slower expansion in the secondary sector (+6%) while services remained strong (+8% y/y). Monthly data point to a solid rise in nominal retail sales in September (+10.3% y/y) but weaker investment growth (+7.5% y/y in January-September). Overall, economic growth continues to be supported by fiscal measures and solid expansion of private consumption and is on track to achieve the government target of "+6.5% or higher". A gradual tightening of financing conditions helps to reduce financial risks (shadow banking activities, e.g.) but also translates into lower growth in investment and debt-intensive activities (construction, heavy machinery, e.g.). This more balanced economic performance provided a favorable background for the last Communist Party's Congress and echoed president Xi's speech on the need to bring China on healthier economic footing by containing financial risks. Assuming that financial authorities pursue a more prudent stance in 2018, economic growth is forecast to decelerate to +6.3%.

Germany: Boom goes on

Already upbeat sentiment in the German economy improved further in October. The Ifo business climate index notched up a steep 1.4 points and now stands at 116.7 points – a new record. Particularly encouraging is the fact that business expectations have improved appreciably. The economy was last so upbeat about the future almost seven years ago. We do not think that October PMIs published earlier by Markit contradict the Ifo figures. Markit reported a minimal drop in the Manufacturing PMI from 60.6 to 60.5 points. This leaves the index still well above the 50.0-threshold that signals an expansion in economic activity. Overall the latest sentiment surveys confirm our view that the boom in Germany will continue well into next year. To date we have been assuming a slight slowdown in growth momentum in the second half of 2017. The latest figures suggest that this slowdown has become at least less likely. This means that the risks to our current forecast of annual average growth of +2.2% this year and +2% next (in calendar-adjusted terms) are more on the upside than the downside.

France: Gimme some more!

Business confidence is still hovering at high levels (11 points above its long-term average in October, back to December 2007 levels) and bullish views on reforms are probably adding to the current optimism. In Q4, the capacity utilization rate increased to 84.9% and the share of firms reaching production bottlenecks ascended to 32.4% (highest rates since Q2 2008), giving good traction to the EH corporate investment forecast (+3.6% in 2017). Moreover, high expectations are currently nurtured in the corporate sector as the expected changes of demand indexes are the best since Q4 2000 (+21.5 for foreign demand, +16.6 for domestic demand). Moreover, corporates are currently expecting the implementation of long-awaited reforms. The government opened a six-month consultation in order to revamp corporate laws and address some well-known French bottlenecks, namely high DSOs (EH estimated it at 72 days in 2016, compared to 53 in Germany), poor access to credit for SMEs, as well as time and cost needed to register property or resolve insolvency. These are necessary conditions to push growth above +2% (EH currently forecasts +1.7% in 2017).

Countries in Focus

Americas

Argentina: A strenghtened mandate for Macrinomics

Last Sunday, President Mauricio Macri's coalition *Cambiemos* (Let's Change) won the midterm elections in Argentina, with more than 40% of the national votes. It benefited from a deeply divided opposition, with former president Kirchner's movement running against the traditional Peronist party. Although the Macri coalition did not win a majority of seats in Congress, the victory of Macri's "gradualism" is a positive signal to investors; the pace of liberalization of the Argentinian economy should quicken and structural reforms should be proposed as soon as on 1 November (labor, tax, pension and capital markets reforms, amongst others). While there has been a clear "Macri effect" on markets (portfolio inflows soaring since his election and bonds currently outperforming Latin American peers), attracting investment remains the biggest challenge for Argentina. In the four quarters up to Q1 2017, Argentina received just USD4.8bn in FDI inflows, compared to USD85bn for Brazil and USD31bn for Mexico.

Europe

Turkey and Hungary: Too loose for too long?

The Monetary Policy Committee (MPC) of **Turkey** kept its policy interest rates unchanged today, even though inflation rose to 11.2% y/y in September and the TRY fell by -9% against the USD since the previous MCP meeting six weeks ago. Despite a hawkish tone in accompanying MPC press release reflecting concerns about inflation, we do not expect rate hikes in the near term. Looking ahead, inflation is set to ease slightly in 2018 while GDP growth should slow, so that the MPC is likely to begin modest monetary loosening next year.

The Monetary Council (MC) of **Hungary** also left its key policy interest rate (3-month deposit rate; +0.9%) and the overnight deposit rate (-0.15%; cut from -0.05% in September) unchanged this week, despite strong economic momentum (real GDP rose by +3.7% y/y in H1 2017, up from +2% in 2016), core inflation (+2.9% y/y in September) approaching the MC's 3% inflation target, and wage growth above +12% y/y in January-August. We expect inflation to exceed the target in the coming months and the MC to shift towards moderate tightening in 2018.

Africa & Middle East

South Africa: All eyes on politics, but mind the economy

Renewed skepticism has affected South Africa since a gap of 0.7% of GDP between planned and actual tax revenues in 2017 was revealed as low growth is weighing on public finances. This information is crucial after the downgrade to speculative grade by international rating agencies in March. EH has revised its fiscal deficit forecast from -3.8% to -4.5% of GDP for both 2017 and 2018 and the public debt forecast for 2018 from 54% to 55.5% of GDP, as economic growth is projected to remain subdued (+1.2% in 2018, after +0.6% in 2017), even though advanced indicators point to an uptick in the short term. In September, business confidence recovered to 93.0 points from 89.6 and retail sales accelerated. Moreover, past shocks to private sector spending implied some rebalancing. The current account deficit should narrow to -2.5% of GDP in 2017 while core inflation stood at +4.6% y/y in September, giving some room to the Central Bank to continue its easing cycle (after the -25bp cut in July).

Asia Pacific

Japan: Abe remains firmly in the driver's seat

Prime Minister Abe's coalition retained its grip on parliament with a two-thirds majority in the Lower House election on 22 October. The win clears the way for Abe to proceed with his goal of amending the pacifist constitution given a changed security environment. On economic policy, Abe has signaled higher spending on education and child care to foster productivity and labor force participation in the light of the adverse impact of population aging and decline on the potential growth rate. Although the VAT rate hike should be implemented as scheduled (October 2019), part of the funds raised are earmarked for investment in the human resources initiative. This would result in postponement of the target date for achieving a primary fiscal surplus. The details on how the government intends to strike a balance between fiscal consolidation and economic growth will ultimately be decided in the Fiscal Year 2018 basic plan for economic and fiscal management and reform to be announced in June next year.

What to watch

- October 27 – France October consumer confidence
- October 27 – Russia CBR monetary policy meeting
- October 30 – Germany September retail sales
- October 30 – Germany October inflation (1st estimate)
- October 30 – Japan BoJ monetary policy meeting
- October 30 – Spain Q3 GDP growth (1st estimate)
- October 30 – Spain October inflation (1st estimate)
- October 31 – Brazil October PMI Manufacturing
- October 31 – China October NBS PMI Manufacturing
- October 31 – Eurozone Q3 GDP growth (1st estimate)
- October 31 – France Q3 GDP growth (1st estimate)
- October 31 – Mexico Q3 GDP growth (1st estimate)
- October 31 – Taiwan Q3 GDP growth (1st estimate)
- November 1 – Brazil October trade balance
- November 1 – UK October PMI Manufacturing
- November 2 – Spain October PMI Manufacturing

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