Euler Hermes Economic Research

Weekly Export Risk Outlook

27 September 2017

FIGURE OF THE WEEK

+2.7%

Q2 2017 y/y GDP growth in Argentina

In the Headlines

Germany: New government faces major challenges

Although the German election took place against the backdrop of a thriving economy, the ruling parties have lost votes. While voters have reshaped the political landscape, results should allow a new coalition to provide policy continuity. Alongside migration and social justice, the government will have to focus on maintaining the economic upswing. Lasting economic success cannot be taken for granted. Subdued investment activity continues to be the Achilles' heel of Germany's economic development. Germany should take policy measures to improve investment conditions for the private sector. Removing bottlenecks in public investment is another important task.

Germany's role in the European project is a case in question. A new government will need to ensure the country remains a reliable European partner, counters populist and nationalistic tendencies and assumes a defining role in further integration. Even the participation of somewhat euro-skeptic parties such as the Bavarian CSU or the liberal FDP would not alter such expectations. Still, all German mainstream parties expect more effective policy cooperation among euro members. A stronger European commitment to the fiscal rules of the Stability and Growth Pact is also high on German parties' agenda.

A clear positioning of Germany in the discussions on Eurozone and EU reforms is needed. Yet this is no mean feat and unlikely to happen fast, given the expected difficult coalition-building process. Emmanuel Macron has recently outlined his plan for Europe. In a constructive contest of reform plans with France, Germany could become an integration engine in Europe. German politicians implicitly expect Macron to ‘get his own house in order’ as a quid pro quo for new Eurozone reforms. Chancellor Merkel can hardly demand reforms from Macron while she herself procrastinates. Simultaneous pro-growth reforms in the Eurozone’s two major economies would lift the entire currency area. They would also constitute a solid launch pad for institutional reforms designed to put the euro on a more sustainable footing.

U.S.: Effects of Hurricanes appear

New home sales declined for the second consecutive month in August falling -3.4% m/m to -1.2% y/y. Sales in the South were affected by Hurricanes Harvey and Irma and dropped -4.7% m/m to -9.2% y/y. Sales fell in West and Northeast as well, declining -2.6% m/m and -2.7% m/m respectively. Prices of new homes fell a sharp -6.2%, the fifth decline in eight months, to only +0.4% y/y. Consumer confidence fell -0.6 points but remains near 17 year highs, despite a drop in hurricane-ravaged Texas and Florida.

A full week after Hurricane Maria hit Puerto Rico, home to 3.4 million US citizens, the island still lies in ruins. Supplies of food, fuel, medicine, and water are all low and falling. The government declared bankruptcy earlier this year, and the economy, which has been in recession for over 10 years, may take many years to recover. Note that Puerto Rico produces 16 of the top 20 selling drugs in the US, putting the industry at risk.

On other news, the latest and perhaps last attempt to repeal and replace Obamacare has failed. Tax reform is up next as the GOP will reveal its plan this week.

Eurozone: Robust performance paves way to QE reduction

The September Purchasing Managers’ Index (PMI) for the Eurozone suggests that economic momentum in the common currency area did not lose steam in the third quarter. The composite PMI for the manufacturing and service sector posted a mild increase reaching a four-month high in September with 56.7 points. While Germany and France benefit from an already-high momentum the robust upswing in the other Eurozone member states continued at almost the same pace.
Particularly encouraging is the renewed acceleration in jobs growth. Manufacturing led the way, with the survey showing the strongest rise in employment for 20 years. All told, we continue to expect GDP growth of 2.1% in the Eurozone this year. The rosy economic outlook and the build-up of price pressures, sends the European Central Bank (ECB) a clear signal. The bank may announce at its October meeting a reduction in Quantitative Easing (QE) purchases from early 2018.

Countries in Focus

Americas

Argentina: The worst is over

Real GDP expanded by +0.7% q/q in Q2, after +1.2% in Q2. The hint of recovery in Q1 was unconvincing on a year-on-year basis (+0.2%). Yet the Q2 figure (+2.9% or +2.7% in non-seasonally adjusted terms) confirms the country's emergence from recession. Private consumption was the main driver of growth, contributing positively (4.4pp) for the first time in 4 quarters. This can be partly attributed to a slowdown in inflation: 32.2% on average in Q1, 24.4% in Q2.
Investment registered a strong growth, buoyed by President Macri's market-friendly reforms to open the economy and enhance competitiveness. Borrowing costs (interest rates on bonds) have fallen from 7.2% in March to 6.1% in June. Yet, markets remain sensitive to political developments, as shown by the temporary increase in interest rates in the primary elections period this summer. The performance of Macri's "Let's change" movement in legislative elections next month will be key for the pursuit of reforms.

Europe

Ukraine: Robust domestic demand, weak external demand

Real GDP growth eased to +2.3% y/y in Q2 from +2.5% in Q1 and +4.8% in Q4 2016. The main driver of the slowdown in Q2 was public spending which contracted by -7.8% y/y (+4.2% in Q1). In contrast, the recovery in consumer spending gained momentum with a +6.7% y/y rise in Q2 (+2.7% in Q1) and should hold up in Q3 as indicated by the strong increase of real retail turnover by +8.3% y/y in July-August (+7.3% in H1). Fixed investment continued to surge by +23.7% y/y in Q2 (+20.1% in Q1) while inventories deducted -0.7pp from growth (Q1: -1.3pp). Strengthening domestic demand drove import growth to +4.6% y/y (+2.9% in Q1) while exports fell by -2.1% y/y (-0.4% in Q1) so that net exports subtracted -3.4pp from Q2 growth (-1.8pp in Q1). Overall industrial production remained weak, down by -0.4% y/y in the first eight months of the year. We expect GDP growth to edge down further in H2 due to base effects, resulting in full-year growth of +2.1% in 2017 (after +2.3% in 2016).

Africa & Middle East

Saudia Arabia: Low growth affects payment behavior

Recently released official data show that real GDP contracted by -0.5% y/y in Q1, following an upwards revised +2.2% y/y in Q4 2016 and full-year 2016 GDP growth of +1.7% (also upwards revised from +1.4% previously). The main triggers for the sharp deceleration were the November 2016 OPEC agreement to cut oil output as well as reductions in civil service bonuses which had affected consumer spending. These cuts were reversed in April 2017 in order to revive private consumption.
We expect economic expansion to resume in H2 and forecast full-year GDP growth at +0.5% in 2017, followed by +2% in 2018. Meanwhile, corporate payment behavior has deteriorated in Saudi Arabia. A recent study by Euler Hermes shows that days sales outstanding (DSO) have increased from an average 62 days in 2014 to 67 days in 2016 (see also our Economic Outlook on payment behavior and DSO) and they are considerably higher in some sectors such as construction, telecom and electronics.

Asia Pacific

Indonesia's monetary policy: Easing further

Bank Indonesia cut its policy rate for the second consecutive month. The institution lowered its key repo rate by 25bp to 4.25 citing low inflation, modest current account deficit and a need to support current economic improvement as key reasons behind its decision. Indeed, August inflation climbed to +3.8% y/y compared to an inflation target of 4.0±1%. The current account deficit was contained at -1.5% GDP in the first semester. Economic growth has improved (5.0% in Q2 2017) since a low point of +4.9% in 2015, but the pace of acceleration is still modest. Assuming that credit growth quickens in the remainder of the year, economic growth should pick up speed and reach +5.1% in 2017.

What to watch

- September 27 – Italy business & consumer sentiment
- September 28 – Germany Sept. GfK consumer climate
- September 28 – Germany Sept. inflation (estimate)
- September 28 – U.S. Q2 final GDP estimate
- September 29 – Eurozone inflation
- September 29 – Canada July GDP
- September 29 – Germany August retail sales
- September 29 – U.S. August personal income and consumption expenditures
- September 29 – Canada August GDP
- September 30 – China Caixin Manufacturing PMI (Sep)
- October 2 – Russia Q2 GDP (with details)
- October 3 – Kazakhstan Q2 GDP
- October 3 – Turkey September inflation

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