Euler Hermes Economic Research

Weekly Export Risk Outlook

15 November 2017

FIGURE OF THE WEEK

-80%

Venezuela imports 2012 - 2017

In the Headlines

Germany: Economy humming

After healthy growth earlier this year, real GDP made gains in Q3 2017 as well. Seasonally and calendar-adjusted growth rose by 0.8%. The German Federal Statistical Office has also revised up the sequential rate for the first quarter 2017 to 0.9% (from 0.7%). Thus, calendar-adjusted growth looks set to reach 2.5% in 2017, up from the previous estimate of 2.2%. In an encouraging sign, gross fixed investment contributed to growth in the third quarter.

This was mainly thanks to machinery and equipment investment. Net exports also contributed, as exports rose faster than imports. By contrast, government and private consumption contributed little to growth, remaining mired at the prior quarter level. The latest economic data such as the Ifo business climate index and industrial capacity utilization, indicate that the economy will continue to purr. Next year growth also looks set to be well above 2%. Given pent-up demand, we estimate that machinery and equipment investment will make a substantial contribution.

China: Tightening credit starts to dent growth

Value-added industrial production increased by +6.2% y/y in October, falling from +6.6% in September. Likewise, retail sales expanded +10.0% y/y, slowing from +10.3% last month. From January to October, fixed asset investment grew +7.3%, 0.2 percentage points lower than during the first nine months of the year. Investment in real estate development climbed +7.8% in the first ten months, 0.3 percentage points lower than that of the first nine months.

Business activity has been slowing as measures were taken to rein in credit risk. Chinese banks extended CNY664bn in new RMB loans in October, almost half the amount recorded in September (CNY1.2tn). That is due to the tightening in lending to non-bank financial institutions. The current figures highlight that economic growth will be more moderate in the second half of 2017, after real GDP growth peaked in the first half of the year (+6.9% y/y). EH expects real GDP growth of +6.7% in 2017.

Russia: Recovery is losing steam

A flash estimate by RosStat indicates that Q3 real GDP growth decelerated to +1.8% y/y, in line with our expectations, down from +2.5% y/y in Q2. Full details are not available as yet, but an acceleration in retail sales to +2.1% y/y in Q3 from +1% in Q2 suggests that the recovery in consumer spending has strengthened.

However, the expansion in industrial production slowed down to +1.2% y/y in Q3 from +3.8% in Q2. Moreover, the Manufacturing PMI eased to 51.1 points in October from 51.9 in September, still indicating growth going forward but at a more moderate pace. The Services PMI also fell, to a three-month low of 53.9 points in October, though this still suggests solid expansion in the next months.

We expect the recovery to lose some further steam in Q4 and forecast full-year growth of +1.5% in 2017. Next year, growth should pick up to +1.9% or so thanks to some one-off factors such as pre-election spending and the 2018 FIFA World Cup.

Venezuela: Partial default, full-blown crisis

The rating agencies S&P and Fitch have declared Venezuela in partial default on its sovereign debt. The country might be in the red to the tune of USD150bn, as it failed to make USD200mn in interest payment within the 30-day grace period. Market-based restructuring seems unlikely, since new US sanctions block American financial institutions from investing in new bonds. Also, the new Venezuelan constituent assembly is not recognized by the international community.

An official default risks further aggravating the economic and humanitarian crisis. The country has lost close to a third of its GDP since 2012. Moreover, imports shrank by 80% (from USD5.2bn monthly average in 2013 to USD1.3bn in 2017) leading to severe shortages in food and medicine. And foreign exchange reserves including gold barely cover 2 months of imports.

Going forward, Venezuela could try to default only on its sovereign debt and preserve its public oil company debt (PDVSA), hence protecting oil revenues. Russia might lend a hand: the terms of a bilateral restructuring agreement could be announced soon.

Countries in Focus

Americas

U.S.: Inflation rising, confidence high

Producer price inflation took an unexpectedly large increase in October, rising +0.4% m/m vs. expectations of only +0.1%. For the first time in three months, energy prices were not the cause as they were unchanged, whereas they had grown +3.3% and +3.4% m/m in the prior two months, a product of hurricane disruptions. On a y/y basis producer prices rose from 2.6% to 2.8%, while the core rate rose from 2.2% to 2.4%. Sentiment indicators were mixed but still remained very high. The Consumer Sentiment survey set a 14 year high in October at 100.7, slipped -2.9 points in November but remains at a very high 97.8. Similarly, the current situation component set a 17 year high in October, slipped -2.9 points in November, and remains very high at 113.6. Business sentiment in the NFIB survey is also strong and is holding near the 12 year high set after the election, rebounding +0.8 from last month's decline.

Europe

Italy: Robust Q3 performance as Euroboom spills over

Italy's economic recovery is finally gaining traction: GDP grew +0.5% q/q in Q3 while the annual growth rate accelerated to +1.8% y/y. These were the strongest growth rates seen in almost seven years. For 2017 as a whole we expect Italian GDP growth to come in at +1.6% before slowing to +1.3% in 2018. Key drivers of this marked acceleration in Italy's economic recovery – since joining the Euro average annual GDP growth registered below 0.3% – are the cyclical upswing in Europe, low interest rates, and improving competitiveness. Underneath this welcome growth uptick, however, Italy's structural weaknesses, in particular high debt and low potential growth, still loom large. The 2018 general election is unlikely to be a game changer: With a hung parliament a near certainty our base case includes a coalition government consisting of at least four parties from across the political spectrum. The chances of such heterogeneous partners agreeing on ambitious reforms are low.

Africa & Middle East

Egypt: In the mood

Last year Egypt surprised by deciding to abandon its fixed exchange rate regime. Gloomy forecasts referred to rising inflation and a severe growth downturn. Yet these have not materialized. GDP, however, grew by +4.2% in 2017 (fiscal year). Over the year, Egypt has implemented reforms designed to extricate the economy from a financial crisis, including a partial unwinding of capital controls (see WERO, June 22). The reform agenda helped issue Eurobonds to the tune of USD 11 bn. The latest announcement was of a plan to pay oil providers USD 3.5 bn of debt to (e.g. Saudi Aramco) within the next two years. At the same time, the government announced that the primary fiscal deficit was down to -0.2% of GDP in Q3. A balanced primary budget is now a realistic goal. Still, inflation has peaked in July (+33.6% y/y) and should reach +23% by year-end. EH expects growth to accelerate to +5% in 2018.

Asia Pacific

Japan: Slower GDP growth in Q3 while streak extends

As expected, real GDP growth slowed in Q3 after the solid increase seen in Q2. According to the first preliminary estimate, real GDP grew 0.3% q/q (1.7% y/y). Compared to the second quarter the growth contributions coming from net exports (+0.5pp) and domestic demand (-0.2% pp.) reversed sign. A modest increase in private non-residential investment and an inventory build-up were an insufficient counterbalance to the drop in public investment (-2.5% q/q) and private consumption (-0.5% q/q). The correction in these latter components must largely be seen as payback after unsustainable strength in Q2. The sharp improvement in net exports reflected a marked increase in exports (+1.5% q/q) and a decline in imports (-1.6% q/q). Manufacturers' upbeat output projections for early Q4 are a clear sign that upward momentum in the economy remains intact after seven consecutive quarters of GDP growth. Japan's economy remains on track for average annual growth of 1.5%.

What to watch

- November 15 – Colombia Q3 GDP
- November 16 – Italy September foreign trade
- November 16 – Malaysia Q3 GDP
- November 16 – Egypt monetary policy meeting
- November 17 – UK October retail sales
- November 17 – China October House Prices
- November 19 – Thailand Q3 GDP
- November 20 – Nigeria Q3 GDP
- November 21 – Argentina BCRA meeting
- November 22 – Eurozone November consumer confidence survey
- November 23 – Mexico Retail sales Sep
- November 23 – Mexico Banxico meeting minutes

Contact Euler Hermes Economic Research Team
research@eulerhermes.com

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