

Euler Hermes Economic Research

Weekly Export Risk Outlook

23 April 2014

FIGURE OF THE WEEK

21

Consecutive months of Japanese trade deficits

In the Headlines

Southern Eurozone: Getting rosier, but mind the gap

Investors' confidence in southern European countries picked-up from end-2013. The ongoing adjustment measures (including fiscal and competitiveness), improved economic prospects since H2 2013, the successful bailout exit for Ireland last December and reduced investor appetite for emerging market assets triggered a rise in portfolio inflows and foreign direct investments in southern European countries. The reform package announced by Italian PM Renzi and positive economic surprises in Spain have also reassured investors and allowed a significant fall in 10-year yields (more than 400bps since end-2013, to 3%). The return in confidence allowed Portugal and Greece, still under a financial assistance programme, to issue successfully long-term bonds, for the first time since 2010-11. Nevertheless, substantial fragilities remain. Unemployment continues at very high levels, the banking sector is still in the process of cleaning-up balance sheets and additional fiscal consolidation measures and structural reforms are needed. Indeed, deflationary pressures remain elevated and the EUR too strong. This could make competitiveness gains even more difficult, while putting pressure on the deleveraging process through higher real interest rates. The challenge for the region is to return to sustainable positive growth while managing still very high levels of debt.

China: Macro-economic policy fine tuning is ongoing

Effective from 25 April, the PBOC will cut the reserve requirement ratio for rural commercial banks (-2pps) and for rural credit co-operatives (-0.5pps). This is intended to support bank lending growth at a time when credit is slowing and industrial activity losing momentum (HSBC Manufacturing PMI for April at 48.3). Moreover, currency intervention to depreciate the RMB against the USD continues, with the PBOC setting the USD/CNY reference rate at 6.1599 on 23 April, the lowest since September and the RMB depreciating by -2.9% against the USD since the beginning of the year. Such intervention should support export growth, limit erosion of competiveness due to decelerating productivity and rising labour costs, while correcting earlier appreciation (+2.5% per year since 2009). Meanwhile, the government is about to pass laws that will permit, under strict conditions, local authorities to issue bonds to finance pivotal projects. Overall, the gradual correction of past imbalances and broadly supportive macro policies reinforce EH's view of a smooth landing for the Chinese economy (+7.5% in 2014).

US: Industry warms up, but housing remains cool

Industry is enjoying a post-winter recovery. Industrial production increased sharply in March, for the second consecutive month, up +0.7% m/m and +3.8% y/y. Moreover, the gains were widespread as the sub-components of manufacturing, mining and utilities all improved, with y/y increases of +2.8%, +7.9% and +4.4%, respectively. Capacity utilisation was up for all three sub-components, with manufacturing and the total index hitting post-recession highs, although still below long-term averages. Meanwhile, the housing market is still experiencing difficulties. Housing starts increased by +2.8% m/m in March but were still down -5.9% y/y. Permits showed just the opposite behaviour, falling -2.4% m/m in March but rising +11.2% y/y. Existing home sales fell for the seventh time in eight months and were down -7.5% y/y, reflecting tight inventory, rising prices and higher mortgage rates. Inventory was a tight 5.2 months and prices increased for the third time in four months, putting the y/y rate at +7.9%. Mortgage application volume y/y is down -16% for purchases and -69% for refinancings.

Morocco: North African beacon

In Q1, GDP growth was +2.5% y/y, down from +4.5% in Q4 2013, with the agricultural sector contracting by -3.4% y/y after +18.5% in Q4 2013. However, the data are more positive than on initial inspection as the contraction in agriculture partly reflects the stronger earlier data, which was a rebound after drought conditions. Moreover, the non-agricultural sector expanded by +3.5% in Q1 (+2.2% in Q4 2013), which is the strongest quarterly growth for this part of the economy for over one year. Indeed, after a year of contraction, the construction sector, a bellwether for the state of the overall economy, recorded growth of +3.9% y/y. With growth in the eurozone expected to gain momentum, albeit modestly overall, demand for Moroccan manufacturing, tourism and construction will improve. However, attempts to reduce the fiscal deficit through lowering subsidy provision are likely to weaken domestic demand. Taking all these factors into consideration, EH now expects GDP growth of +4% in 2014 and +4.5% in 2015 (annual average +4.4% in the ten-year period to end-2013).

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Countries in Focus

Americas



Ecuador: Activity expanded more than expected in 2013

In 2013, real GDP growth reached +4.5%, above the official target of +4.05% but below the economic growth registered in 2012 (+5.1%). Economic activity accelerated towards the end of the year, as GDP increased by +5.6% y/y in Q4, after +1.2% in Q3. Growth was mainly driven by the non-oil sector (+4.9%, which represents around 85% of GDP), particularly construction (+0.9pps of GDP growth), while oil activity moderated to +1.4%. On the demand side, investment was the main driver of growth (+6.6%) and international trade remained resilient (exports increased by +4.5% and imports by +4.2%). Public consumption remained strong (+4.3%) while private consumption increased by only +3.4%. EH expects overall GDP growth will moderate to +3.8% in 2014, before picking-up to +4% in 2015.

Europe



Eurozone: Q2 starts on a positive note

The Composite PMI Index improved to its highest level in three years in April (+0.9 points to 54.0). In the manufacturing sector, output increased for the tenth consecutive month and new orders remained in expansionary territory, mainly driven by exports. Activity in the services sector increased for the ninth consecutive month, at the fastest rate since June 2011. Germany continued to lead the upturn, while France revealed renewed weakness. In the rest of the eurozone, activity continued to strengthen in both manufacturing and services and employment showed the first recovery signs since May 2011. As it stands, eurozone GDP growth is likely to average 0.4%-0.5% q/q in the first two quarters of 2014. EH expects GDP growth to reach +1% in 2014. That said, downside risks prevail and relate to the protracted period of low inflation, the strength of the EUR, the weakness of the banking sector, the elevated stock of private and public debt and high unemployment. As a result, the ECB is expected to announce further stimulus measures later in the year.

Africa & Middle East



Algeria: Elections unlikely to herald reforms

Incumbent President Abdelaziz Bouteflika was duly re-elected in polls on 17 April, receiving around 81.5% of the vote. Opposition figures claimed that electoral malpractices took place but the result was widely expected. Bouteflika appears frail and the succession process is opaque, although powerful vested interests (le pouvoir) are likely to ensure that a new leader, when required, will emerge from the military and security agencies. Political reforms are unlikely in the short-term and oil and gas wealth will continue to be used to appease potential social protests. The business and regulatory environment is challenging for those seeking commercial dealings with the country but Algeria has substantial financial assets (international reserves amount to USD194 billion and provide three years of import cover) and ability to meet payments is not in question. EH expects tight security to limit social protests relating, in particular, to lack of job prospects.

Asia Pacific



Japan: 21 months of trade deficits

The trade deficit in March was the 21st consecutive monthly shortfall and it widened to -JPY1.45 trillion from -JPY0.80tn in February and -JPY0.35tn in March 2013. The deterioration reflects rising import costs because of JPY depreciation (-16% under the premiership of Shinzo Abe), the rise in the energy import bill, particularly petroleum, up by +18.7 y/y, but also (and more broadly) strong domestic demand before the increase in sales tax. Exports recorded limited growth (+1.8%) dampened by weak demand in key markets, including South Korea (down by -6.2%), Thailand (-12.5%) and Indonesia (-7.2%). These trends confirm EH's view that the current account surplus in February (+JPY0. 61tn) was temporary, with little likelihood of a strong improvement in H1. Overall, the current account surplus will remain at a low level relative to previous years and EH expects it will be equivalent to 1% of GDP in 2014, constrained by limited demand in key markets and an elevated import bill.



What to watch

- April 24 – Germany April IFO business climate
- April 24 – US March durable goods orders
- April 25 – Brazil March current account
- April 25 – Mexico monetary policy decision
- April 25 – Brazil March current account
- April 25 – UK March retail sales
- April 28 – US March pending home sales
- April 28 – European Commission economic forecasts
- April 29 – US February Case-Shiller home price index
- April 29 – US April consumer confidence
- April 29 – UK Q1 GDP (preliminary estimate)
- April 30 – US Q1 GDP (advanced estimate)
- April 30 – US Fed meeting (FOMC decision)
- April 30 – Japan March industrial production
- April 30 – Spain Q1 GDP (preliminary estimate)

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