

Euler Hermes Economic Research

Weekly Export Risk Outlook

30 April 2014

FIGURE OF THE WEEK

+0.1%

U.S. Q1 q/q annualised GDP growth (first estimate)

In the Headlines

Ukraine & Russia: Tensions escalate

The 17 April Geneva agreement between Ukraine, Russia, the EU and the U.S. aimed at de-escalation of the ongoing conflict has had little effect on the ground and tensions in eastern Ukraine escalated sharply last week. Pro-Russian separatists seized more government buildings in the east and also kidnapped around 40 people, including journalists and seven military observers linked to the OSCE. The U.S. and the EU accuse Russia of not helping to de-escalate the crisis and this week imposed further "soft" sanctions on a number of Russian officials and a few corporations. However, they refrained from enacting stronger economic sanctions and this had the impact of giving a temporary boost to the RUB and Russian stocks. However, the crisis took a toll on the Russian economy in Q1 as large capital outflows caused fixed investment to fall by almost -5% y/y. The Russian Ministry of Economy estimates that real GDP increased by just +0.8% y/y in Q1 (down from +2% in Q4 2013) and contracted by -0.5% q/q. Nonetheless, the Central Bank of Russia last week raised its key policy interest rate by 50bps to 7.5%, seeking to support the struggling RUB (down 9% year-to-date) and its impact on inflation, which increased to 6.9% y/y in March and is likely to remain markedly above the end-year target of 5%.

U.S.: Q1 GDP data are weather-affected

Q1 GDP was negatively affected by adverse winter weather and barely increased, registering +0.1% q/q and annualised, markedly below expectations and the +2.6% recorded in Q4 2013. Investment, net exports and government all contributed negatively. Although consumption did expand by+3%, real final sales (after taking account of inventories) were only +0.7% q/q and that was driven by increased utility usage and health care spending. Meanwhile, April consumer confidence edged down slightly from 83.9 to 82.3, still indicating weak consumption. The housing market provided more conflicting signals in March as new home sales fell -14.5% m/m and -13.3% y/y, driven in part by strong price growth of 11.2% m/m and 12.6% y/y. Similarly, prices of existing homes, measured by the Case-Shiller Index, increased by 12.9% in February. However pending home sales provided the first sign of what is hoped to be a spring rebound, gaining 3.4% in March, the first increase in nine months. The spring rebound also showed up in new orders for durable goods, which increased for the second consecutive month in March, gaining 2.6% and with widespread gains.

UK & Spain: Confidence bright spots

In **the UK**, positive surprises continue as GDP increased more than expected in Q1 (+0.8% q/q). Services were the main driver of growth (+0.7pps) mainly reflecting increases in output in business services and hotels/restaurants, while the industrial sector contributed a meagre +0.1pps with improving output in the manufacturing sector. Details on the demand side will be released on 22 May. EH expects private consumption and investment will be the main drivers of growth as the labour market continues its recovery – in February, unemployment reached its lowest level (6.9%) since Q1 2009 – while economic policies remain supportive for company activity. Upward revisions to EH growth forecasts of +2.4% in 2014 and +2.5% in 2015 are likely in the coming weeks. The outlook is also improving in Southern Europe. Official figures show that real GDP growth in **Spain** picked up in Q1 to +0.4% q/q (after +0.2% in Q4 2013), driven equally by both net exports and domestic demand (+0.2pps each). EH expects growth will reach +0.6% in 2014 and +1.2% in 2015. However, if the positive trend persists in coming quarters, upward revisions to EH forecasts are likely.

Eurozone: Not yet a good mix for the inflation outlook

The ECB Bank Lending Survey revealed that credit conditions for loans to SMEs remained unchanged in Q1 (remaining tight) while they eased for large firms. On the demand side, banks reported an increase in loan requests from corporates, for the first time since Q2 2011. However, the cross-country divergence continues with Italy still recording tight credit conditions and low demand for loans to corporates. Weak credit growth, record high unemployment, spare productive capacities, moderation in raw material prices and labour cost adjustments continue to exert downward pressures on consumer prices. The overall inflation rate remains low, at 0.7% in April (from 0.5% in March) with core inflation at 1% (from 0.7% in March). Preliminary statistics of the breakdown by country indicate a rise in inflation in Germany (1.1%), Italy (0.6%) and Spain (0.4%). The ECB is expected to take additional action, including further small cuts in interest rates after mid-year and some non-conventional measures (such as private asset purchases and targeted liquidity for SMEs) in Q3-Q4 after the end of the ECB Asset Quality Review and Stress Tests.

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Countries in Focus

Americas



Mexico: Growth will be above the regional average

The index of real activity expanded strongly in February (+0.5% m/m and +1.5% y/y), mainly driven by services and primary activities. Nevertheless, private consumption remains weak. Retail sales (-1.7% y/y in February) have now fallen by more than -5% since the last peak reached in November 2013. Against this background, price growth continues to slow. Inflation decreased to 3.8% y/y in March (after 4.5% in January due to tax hikes), returning within the official target range (3% +/- 1pps). Accordingly, the central bank decided to keep the key policy interest rate at 3.5%. Activity may strengthen further this year, mainly reflecting the recovery in the United States and still supportive domestic economic policies. Moreover, recently-adopted structural reforms will sustain investment in the short-term and will lead to a more-balanced growth model in the longer-term. EH expects GDP to increase by +3.3% in 2014 and +3.9% in 2015, above the regional average.

Europe



Hungary & Turkey: Monetary policy

The National Bank of **Hungary** today lowered its key policy interest rate by 10bps to 2.5%, marking the 21st cut and a cumulative reduction of 450bps since August 2012. The easing cycle is likely to end soon, even though inflation is very low (0.1% y/y in March) as a result of administered price cuts for household energy. However, the HUF has lost 4% against the EUR year-to-date, making it the weakest currency in central Europe this year. At the same time, the economic recovery is gathering pace, reducing the need for further stimulus. The Central Bank of **Turkey** (CBT) kept its key policy interest rates steady last week (one-week repo rate at 10%), resisting government pressure to lower rates. The TRY has stabilised after the sharp interest rate hike at end-January, but inflation has continued to increase, to 8.4% y/y in March, and is likely to remain above the CBT's target of 5% (with an uncertainty band of ±2pps) for some time.

Africa & Middle East



Côte d'Ivoire: A gem?

The UNSC lifted the embargo on Côte d'Ivoire's international diamond export trade, which had been in place since 2005 and was designed to limit earnings from "blood diamonds" being used to fuel conflicts. The UN cited better governance of the sector and progress towards implementation of the international regulatory Kimberley Process. It will take time for formal output to recover from the current annual maximum of 300,000 carats but potential revenues from the diamond trade will boost government finances and the external trade account. Removal of the embargo also signals that the country is being re-assimilated globally, particularly as international companies label the country's new mining code as investor-friendly, with gold and mineral output also likely to increase. EH expects GDP growth of +8% in 2014 and also in 2015 (annual average +0.5% in the ten-year period to end-2011).

Asia Pacific



South Korea: GDP growth stabilised in Q1

Q1 GDP increased by +0.9% q/q (similar to Q4 2013), slightly above expectations (consensus of +0.8%). The main growth drivers were manufacturing (+2.1% after +0.8% in Q4) and construction (+1.4% after -2.4%). Service activity decelerated to +0.6% (after +0.8%). The other sectors contributed negatively to GDP growth, with contractions in agriculture, forestry and fishing (-4.3%, +7.4% in Q4) and electricity, gas and water supply (-4.5% after +8.3%). On the demand side, net exports boosted GDP growth, as exports increased by +1.7% (after +1.4%) while imports decreased by -0.5% (after +2.9%). Investment also accelerated strongly (+3.5% after -0.7% in Q4) driven by construction and intellectual property products. Final consumption expenditure weakened in Q1 (+0.2% after +0.6%), reflecting a slowdown in household expenditure and a contraction in public consumption. In 2014, EH expects GDP growth of +3.5%, up from +3% in 2013.



What to watch

- May 1 – China April manufacturing PMI
- May 1 – US April manufacturing PMI
- May 1 – US April vehicle sales
- May 1 – US March personal income and spending
- May 2 – Spain April PMI
- May 2 – EU April business confidence index - PMIs
- May 2 – Eurozone March unemployment
- May 2 – Japan March unemployment
- May 2 – US March factory orders
- May 2 – US April non-farm payrolls
- May 2 – US April unemployment
- May 5 – Colombia April CPI
- May 5 – Eurogroup meeting
- May 7 – Brazil March industrial production

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