

Euler Hermes Economic Research

Weekly Export Risk Outlook

21 May 2014

In the Headlines

FIGURE OF THE WEEK

+0.2%

Eurozone q/q Q1 GDP growth

Eurozone & France: The recovery is still struggling to take off

GDP increased by +0.2% q/q in Q1, below expectations. Cross-country divergences widened among the 10 largest economies, with (i) a pick-up in growth in Germany (+0.8% q/q), Belgium (+0.4%) and Spain (+0.4%); (ii) slowdown in France (0% q/q) and Austria (+0.3%) and (iii) contraction in the Netherlands (-1.4% q/q), Italy (-0.1% q/q), Portugal (-0.7% q/q), Greece (-1.1% y/y) and Finland (-0.4% q/q). Disaggregated component details are not yet available, except for France (see below). Overall, the Q1 GDP data can be explained partly by the unseasonal warm weather that lifted construction, notably in Germany, Spain and the Netherlands, but subtracted growth due to lower consumption, production and exports of energy, particularly in the Netherlands and Portugal, with some refineries closed for maintenance. The data confirm that the eurozone recovery is fragile. Unemployment remains at high levels, the banking sector is still in the process of cleaning-up balance sheets, deflationary pressures remain elevated and further structural reforms are needed. The ECB meeting on 6 June remains key (see last week's comment 'All eyes on the ECB in June'). EH expects GDP will increase by +1% in 2014.

In **France**, Q1 GDP was flat, despite expectations of a small rise. The breakdown was even worse as private consumption fell -0.5% q/q, gross fixed capital formation was down -0.9% because of a large fall in household investment (-2.6%) and net exports contributed negatively (-0.2pps). Investment still remains 10% below the previous peak with little prospect of a strong rebound. The only positive was the change in inventories (+0.6pps). Although this increase may be distorted by the production of capital goods such as large vessels or aircraft waiting to be shipped (and temporarily considered as inventories) it may signal acceleration in exports in Q2.

Ukraine & Russia: Update

Ukraine is today due to host the third round-table talks in one week under the auspices of the OSCE as attempts continue to find a negotiated settlement to the crisis in the east of the country. The talks will include members of the interim government and regional leaders, but pro-Russian separatists will again be excluded. Meanwhile, the interim government admitted that the presidential election scheduled for 25 May cannot be held in large parts of the Donetsk and Luhansk regions that declared independence on 12 May because fighting between government troops and separatists is continuing. In **Russia**, the Federal Statistics Service announced that Q1 real GDP growth slowed to just +0.9% y/y (+2% in Q4 2013) suggesting contraction of around -0.5% q/q. Domestic demand has faltered, with fixed investment declining by -4.8% y/y as investor confidence fell sharply, reflected by net capital outflows of USD64 billion in Q1. Consumer spending has also lost momentum, impacted by rising inflation (7.3% y/y in April) and RUB depreciation. As Russia's direct involvement in the Ukraine crisis started only in March, EH expects further moderation in Russian economic output in Q2.

India: Modinomics raises hopes

The National Democratic Alliance, a centre-right coalition led by the Bhartiya Janata Party (BJP), won a landslide victory in general elections, with 336 seats (282 for the BJP) out of a total 543 in the Lok Sabha (lower house). This is potentially the strongest mandate to govern since 1984. The Indian National Congress, which led the previous coalition, won only 59 seats. Narendra Modi, the leader of the BJP, is set to head the new government. His recent track record, as chief minister of Gujarat, made him popular as that state has recorded rapid economic growth. The expectation is that business-friendly policies will ensue, with an improved commercial regulatory framework. Accordingly, financial markets reacted positively, with government bond yields falling and the stock market up. EH forecasts a gradual recovery (GDP up +5.3% in FY2014/15 and +6% in FY2015/16) reflecting sound official monetary actions and progressive implementation of supply-side policies.

U.S.: Inflationary pressures

Industrial production contracted -0.6% m/m in April after big gains (+0.9% and +1.1%) in the previous two months. The decline was driven by a sharp -5.3% drop in utilities as warmer weather emerged. The housing market is exhibiting signs of a long-awaited rebound, with starts up 13.2% m/m in April, the third consecutive increase, while permits increased for a second month, gaining 8%. Meanwhile, inflation increased significantly in April, with producer prices up 0.6% m/m and 2.1% y/y, the highest in over two years. Food prices leapt 2.7% after gaining 1.1% in March and, over the past year, food and energy prices increased by 4.9% and 3.8%, respectively. Consumer prices increased 0.3% m/m and 2% y/y, again driven in part by food prices (up 0.4% m/m for three straight months) and energy prices, which increased by 3.3% y/y.

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Brazil: Disappointing figures for Q1

The central bank's activity index for March contracted by -0.1% m/m (seasonally-adjusted), after stagnating in February. This resulted in an expansion of +1% y/y (+0.3% q/q) for the whole of Q1, below the +1.7% y/y in Q4 2013. Economic weakness stems largely from a lack of growth in industrial production since 2011 but domestic demand is also fading, with retail sales contracting by -0.5% m/m in March, after a flat outcome in February. Private consumption is hampered by persistent inflationary pressures, particularly since the beginning of the year (6.3% y/y in April, compared with 5.6% in January) despite tightening monetary policy. The central bank increased the key interest rate (SELIC) by 375bps over the past 12 months, to 11% in April, weighing against growth. EH expects real GDP growth of +2 % in 2014 and +2.5 % in 2015 (annual average growth of around +5% between 2003 and 2008). Moreover, if negative trends persist, forecasts may be revised downwards.

Europe



Central Europe: Q1 GDP growth points to ongoing recovery

The recovery in the group of 11 EU members in the CEE region continued in Q1, as indicated by real GDP growth of +2.6% y/y (advance estimate), slightly up from +2.4% in Q4 2013. **Romania** remained the vanguard, even though export-led growth slowed to +3.8% y/y (+5.2% in Q4). **Hungary** gained momentum, reaching growth of +3.5% y/y (+2.7% in Q4), the strongest expansion since end-2006. Strengthening domestic demand helped **Poland**'s growth pick up to +3.3% y/y in Q1 (+2.7% in Q4). In **Slovakia**, growth accelerated to +2.4% y/y (+1.5% in Q4) as a result of improving industrial production and retail trade. Q1 GDP growth in the **Czech Republic** increased to +2% y/y (+1.2% in Q4), driven by strengthening external and domestic demand. The recovery in **Bulgaria** remained modest, but shifted to domestic demand-led growth of +1.1% y/y in Q1 from export-led +1.2% in Q4. EH expects full-year growth in this region will pick up to +2.3% in 2014 from +1.1% in 2013.

Africa & Middle East



Qatar & UAE: Class act

At a semi-annual index review last week, MSCI, a leading provider of information for investment decisions, announced officially that **Qatar** and **United Arab Emirates** will be re-classified from frontier market status to emerging markets (EM), effective from the end of the month. Within the EM index, the two countries will have a combined weight of just over 1% but the move will ensure larger investment inflows through tracker or passive funds and, moreover, it also indicates a broader statement of the economic development of the two countries and advances in relation to market depth and accessibility for investors. The outlook for the two GCC countries remains positive, reflecting their use of oil and gas wealth to diversify their economies. For **Qatar**, EH expects GDP growth of around +5% and +6% in 2014 and 2015, respectively, after an annual average GDP growth of +14.2% in 2004-13, and +4% and +4% for **UAE**, respectively, (+3.9%).

Asia Pacific



Thailand: Held back by the political crisis

Q1 GDP contracted by -0.6% y/y (after growth of +0.6% in Q4 2013), reflecting deteriorating conditions stemming from a protracted period of political uncertainty. This is the first contraction since the major flood in Q4 2011. On the domestic side, with the exception of public consumption (up by +2.9%), all GDP components were down in Q1, including private investment -9.8% y/y and private consumption -3%. Exports declined by -0.4% y/y in Q1 and imports fell by -8.5%. Meanwhile, the army's imposition of martial law earlier this week adds to the concerns about reaching a potential short-term resolution of the conflict as it is generally viewed as yet another coup. Even so, and with consideration of previous similar events, markets barely reacted, with expectations that a short respite may support stability. EH expects GDP growth will remain limited in 2014 (around +1.8%) far below potential (+4%) and growth last year of +2.9%.



What to watch

- May 22 – Brazil & Mexico April unemployment
- May 22 – Eurozone May flash PMI
- May 22 – Russia April retail sales
- May 22 – UK Q1 GDP (2nd estimate)
- May 22 – US April existing home sales
- May 23 – Canada April CPI
- May 23 – Germany Q1 GDP (details)
- May 23 – Germany May Ifo business conditions
- May 23 – Taiwan Q1 GDP
- May 23 – US April new home sales
- May 23 – Mexico Q1 GDP
- May 24 – Colombia presidential elections
- May 25 – Lithuania presidential elections
- May 26 – Egypt presidential elections
- May 27 – Hungary monetary policy meeting
- May 27 – South Africa Q1 GDP
- May 27 – US March Case-Shiller home price index
- May 28 – Philippines Q1 GDP

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