

Euler Hermes Economic Research

Weekly Export Risk Outlook

2 July 2014

FIGURE OF THE WEEK

+1.9%

EH's revised forecast for U.S. GDP growth in 2014

In the Headlines

U.S.: Sharp GDP contraction in Q1

The final estimate of Q1 GDP showed a sharp contraction of -2.9% q/q annualised, below consensus expectations of -1.8%. Exports fell -8.9%, reflecting weak demand from China and Western Europe. Inventories also contributed negatively (-1.8pps) and investment contracted by -1.8%. Personal consumption decelerated to +1%, mainly as a result of the severe weather and technical adjustments in health care spending (which had surged in Q4 2013 because of Obamacare). Overall, the sharp GDP contraction in Q1 reflects largely temporary factors, suggesting a rebound in the coming quarters. Advanced indicators show positive signs for Q2: retail sales increased strongly in the first two months (4.7% y/y in April and 4.3% in May), consumer confidence climbed to 85.2 in June (80.5 on average in Q1) and unemployment fell to 6.3% in April (6.7% in March). Business confidence also improved, with the ISM manufacturing index averaging 55.2 in Q2 (52.7 in Q1) and growth in manufacturing output accelerating to 3.4% y/y in April and 3.8% in May (2.5% in Q1). As a result, EH now expects GDP growth of +1.9% in 2014, but this largely reflects a technical adjustment, given the sharp contraction in Q1.

Eurozone: Five-year roadmap

On 28 June, the European Council voted at the qualified majority for the new head of the European Commission. Out of 28 countries, only the UK and Hungary voted against the centre-right European People's Party candidate, Jean-Claude Juncker. Newly-elected MEPs within the European Parliament will approve or veto this appointment by mid-July. The new European Commission will be fully in place by October. The European Council also agreed the strategic agenda of key priorities for the next five years. These remain focused on jobs, growth and competitiveness, with priorities on SMEs, investment, global attractiveness of the region and enhancement of governance (including banking union, debt mutualisation and budget control). On 1 July, Italy took over the EU Presidency for the next six months at a crucial time; all eyes are on the results of the ECB Asset Quality Review and EBA stress tests due in October ahead of the installment of the Single Supervisory Mechanism for banks in early November. Italy and France continue to be within an Excessive Deficit Procedure, although for different reasons (high public expenditure in France and high interest expenditure in Italy). The Italian Presidency intends to influence the European debate on the speed of fiscal consolidation in order to support economic growth and Juncker will play a key role in this debate as he is considered a strong supporter of further European integration.

Bulgaria: Banking sector woes but limited risk of systemic crisis

Last week, domestic-owned Corporate Commercial Bank (CCB, the 4th largest lender) and First Investment Bank (3rd largest) were subject to "organised attempts (cyber attacks) to destabilise the financial system", according to Bulgarian authorities. Several people have now been arrested and the BNB (central bank) took control of CCB. Since Monday, the banking system appears to be stabilising after the European Commission approved a BGN3.3 billion (EUR1.7 billion) emergency credit line from the BNB to provide liquidity support to banks under attack. The BNB has already raised BGN1.3 billion through a special bond issue for this purpose and covered by 10 mainly foreign-owned Sofia banks. The European Commission stressed that Bulgaria's banking system, which is 70% foreign-owned, is fundamentally sound, well-capitalised and has comparatively high levels of liquidity, which is in line with a recent analysis by the IMF. Although non-performing loans – a legacy from the 2009 crisis – are high at 17% of total loans, coverage by provisions is comfortable at 73%, although this is affecting profits. EH sees no immediate threat to the financial system as a whole or to Bulgaria's 15-year old currency board. Separately, also last week, Bulgaria raised EUR1.5 billion in a well-received eurobond issue with a yield at just 3.1%.

Japan: Abe-phoria limits fall-out from the sales tax

As expected, domestic activity weakened in April-May, reflecting the impact of the increase in the sales tax (5% to 8% in April). In particular, household expenditure continued to decrease in May (-8% y/y from -4.6% in April) in line with retail sales (-0.4% y/y and -4.4% in April). Industrial production also lost momentum (+0.8% y/y from +3.8%). However, encouraging signs of recovery are emerging. Indeed, in June, (i) manufacturing PMI recorded its first increase in three months, to 51.5 from 49.9 in May, (ii) consumer confidence increased for the first time in six months and (iii) investor confidence gained traction after P. M. Shinzo Abe revealed the third policy arrow. Moreover, unemployment decreased to a 16-year low in May (3.5%, down from 3.6% in April) and inflationary pressures remain under control; excluding food and energy items, the CPI in May increased by 2.2% y/y. Against this background, EH expects GDP growth will improve gradually and reach +1.4% in full year 2014, despite the negative impact in Q2 because of the sales tax.

Countries in Focus

Americas



Brazil: Weak outlook for domestic demand

According to the latest central bank inflation report, the official forecast for inflation for the end of the year was increased from 6.1% y/y to 6.4%. Moreover, the official forecast for GDP growth in 2014 was revised down to +1.6% from the earlier projection of +2%. Inflationary pressures in June eased to 6.2% y/y (from 7.8% in May) but the central bank expects inflation will converge on the 4.5% target only in H1 2016. Monetary policy is therefore likely to remain hawkish, despite a weakness in domestic demand. Meanwhile, job creation in May fell sharply to less than 59,000, compared with more than 105,000 in April, and consumer confidence in June deteriorated from 107.6 to 106.3. Moreover, credit conditions in May also deteriorated, with the average lending rate increasing to 21.4% from 18.1% and credit growth slowing to +12.7% y/y, the weakest pace in ten years, and thereby exerting more downward pressure on private consumption.

Europe



Turkey: Modest monetary easing

Last week, the Monetary Policy Committee (MPC) lowered its key policy one-week repo rate by 75bps to 8.75%, following a 50bps cut in May, but kept the overnight borrowing (8%) and lending (12%) rates unchanged at their post-increase levels from January. The repo rate cut was implemented as credit growth is at reasonable levels and there is an expectation of declining inflation as the adverse impact of the TRY depreciation in 2013 will gradually wane. However, private sector credit growth remained high at 29.3% y/y in April, more than twice the long-term average of all emerging markets. Moreover, inflation continued to rise, to 9.7% y/y in May from 7.8% in January, even though the TRY strengthened by 9% over the same period. EH expects inflation will remain markedly above the MPC's target of 5% (with an uncertainty band of ±2pps) until end-2014. On the political front, PM Erdogan announced that he will run for the presidency in August elections.

Africa & Middle East



Rwanda: Growth area

GDP growth in Q1 was +7.4% y/y, indicating a recovery from expansion of only +4.1% in Q4 2013. The improvement reflected a stronger contribution from the services (+8.3%) and the agricultural (+5.5%) sectors, with higher output from both domestic food and export crops. Meanwhile, in May, inflation was at a three-year low of 1.9% y/y. Although there are price pressures stemming from imported goods from neighbouring Kenya and Tanzania, the outlook is of moderate inflationary growth. Accordingly, last week, the central bank reduced its key repo interest rate (on hold since June 2013) by 50 basis points to 6.5%, citing the need for an easing in monetary policy to support continued strong economic growth. EH expects GDP growth of +7% in 2014 and +8% in 2015 (increased FDI and public spending on infrastructure projects – domestic and regional), broadly similar to the annual average over the period 2000-13 and notably above the average for Africa as a whole.

Asia Pacific



China: Support measues, Act 3

After the government and then the monetary authorities, it is the turn of the banking regulator to announce measures to support economic growth. Starting 2 July, the method of calculating the loan-to-deposit ratio will be relaxed. The ratio will be maintained at 75% but with a narrower definition of loans and a broader definition of deposits. Firstly, the following will be removed from the calculation of loans: (i) funds under the PBOC's relending programme dedicated to boost lending to small firms and rural companies and (ii) loans backed by bond issuance with a maturity of more than one year and without room for early payment. Secondly, deposits will include negotiable certificates of deposit sold to companies or individuals. Overall, this will strengthen measures already taken to sustain credit but in a more balanced way, improving credit allocation while informal credit growth will slow. EH expects that GDP growth will accelerate in H2 and register +7.5% for the full year.



What to watch

- July 3 – China HSBC/Markit services PMI
- July 3 – ECB meeting
- July 3 – EU composite PMIs
- July 3 – U.S. June non-farm payrolls
- July 3 – U.S. June unemployment
- July 3 – U.S. May trade balance
- July 3 – U.S. June non-manufacturing ISM
- July 4 – Germany May factory orders
- July 4 – Egypt June international reserves
- July 4 – Hungary May industrial production
- July 5 – Colombia June inflation
- July 8 – Latvia June inflation
- July 9 – Ghana June inflation
- July 8 – Japan June bankruptcies
- July 8 – Brazil June inflation
- July 8 – Japan May current account
- July 9 – Czech Republic June inflation
- July 9 – India June local car sales

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Contact Euler Hermes Economic Research Team
research@eulerhermes.com

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