

Euler Hermes Economic Research

Weekly Export Risk Outlook

29 October 2014

FIGURE OF THE WEEK

USD86

Barrel price of benchmark Brent crude oil (-20.7% y/y)

In the Headlines

Ukraine: Election result and outlook

Five pro-European parties and the Russia-leaning Opposition Bloc (9.3% of the vote) comprising supporters of former president Yanukovich will enter a new parliament following the 26 October elections. With 93% of the vote counted, PM Yatsenyuk's People's Front (22.2%) is narrowly ahead of President Poroshenko's Bloc (21.8%). These two parties are likely to form a coalition. Total voter turnout was 52%; it was higher in the west and centre but low in the south and east of the country, and no voting was held in Crimea, which Russia annexed in March, as well as in the separatist-controlled areas of Donetsk and Luhansk. The latter two plan to hold their own elections on 2 November, and Russia will recognise the results. This could undermine the fragile truce and peace process that took effect on 5 September. Although a pro-European majority in the Kiev parliament provides a good basis for wide-ranging political and economic reforms, Poroshenko may encounter difficulties. The large number of parties and the differences between the president and PM reflect divisions about reforms, the approach towards the separatists and Russia, as well as personal rivalries. And if economic reforms turn out to be very harsh or if demands from the Maidan revolution are not met, there is also a risk of new protests. On a positive note, Ukraine is likely to receive by the end of the year two tranches of EU loans (total EUR760 mn). However, a second tranche of the USD17 bn IMF loan is unlikely to be released before a new government has been formed.

UK & Belgium: Momentum should slow (or remain soft)

Preliminary estimates forQ3 GDP in the **UK** show expansion of +0.7% q/q, slowing from +0.9% in Q2. The largest contribution to Q3 growth came from the service sector (+0.6 points) which also slowed from Q2. Demand-side GDP data will be available on 26 November. We expect private consumption will remain the major contributor to GDP growth and continue to be so in the coming quarters, supported by an adjustment in savings and the ongoing labour market recovery. However, the economy has lost some momentum over the past quarter, notably in the manufacturing sector, while the inflation outlook and wage growth remain weak. This means interest rates are likely to remain at a record low level of 0.5% at least until Q2 2015. We expect GDP growth will slow to +2.5% in 2015 after +3% in 2014. In **Belgium,** preliminary Q3 GDP data show expansion of +0.2% q/q, in line with our expectations. A demand-side GDP breakdown will be available on 28 November and is likely to show that domestic demand was the main driver of growth. Net trade is expected to provide a negative contribution to growth reflecting weak exports in part due to the impact of the Russian crisis (Belgium extra-EU exports fell by -10.7% y/y in August). We maintain our GDP growth forecasts of +0.9% in 2014 and +1% in 2015.

Germany: Mixed news

The IFO Business Climate Index fell for the sixth consecutive month, to 103.2 in October (from 104.7 in September) and its lowest level since December 2012, although still slightly above the long-term average of 101.4. Both the current and expectation components fell, by 108.4 from 110.5 and 98.3 from 99.3, respectively. This conflicts with the October Composite Output PMI from last week, which ticked up to 54.3 (from 54.1 in September) as a result of an increase in the Manufacturing Output Index after two months of decline (to 53.3 from 51.0 in September) while the Services Activity Index fell to a four-month low of 54.8 (from 55.7). More positive news comes from the GfK Consumer Climate Indicator for November (calculated from October survey results), which edged up to 8.5 (from 8.4) with both income expectations and willingness to buy components improving. The GfK Indicator suggests private consumption growth of +1.5% in 2014, while Euler Hermes expects +0.9%. The full-year German GDP growth forecasts of Euler Hermes are +1.4% for 2014 and +1.2% for 2015.

U.S.: Patchy housing data, but consumer confidence

Sales of new single family homes were almost flat in September, gaining only +0.2% m/m, but August sales were up a marked +15.3% m/m, bringing the level of sales to its highest since July 2008. Prices of such housing fell a sharp -9.7% m/m, the most since October 2010, driving the y/y rate to -4%. Prices of existing homes as measured by the Case-Shiller Index also fell in August, edging down -0.1% m/m (+5.6% y/y). The pending home sales index, a precursor of existing home sales edged up +0.3% m/m in September to 105.0. Meanwhile, orders of durable goods orders fell a disappointing -1.3% m/m in September. Non-defence capital goods ex-aircraft, a proxy for future business spending fell for the fourth time in six months, losing -1.7% m/m. However, the consumer confidence survey provided positive news, rising 5.5 to 94.5, the highest level in nearly seven years, and notably above the 90 level representing a stable economy.

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Countries in Focus

Americas



Brazil: Presidential challenges

In a close-run presidential vote, Dilma Rousseff was re-elected with 51.64% of the votes, compared with 48.36% for Aécio Neves. A significant challenge is to rejuvenate the economy, which slipped into recession in Q2 and with evident inflationary pressures (6.75% y/y in September, the highest in three years; the official target is 4.5%). During her first term, Rousseff experienced difficulties in relation to implementation of structural reforms - aiming to sustain investment, increase the competitiveness of industry and improve the business environment - and these obstacles are likely to continue. Neves is generally seen as more pro-business and the initial market response to the election result was negative. We expect the economy will stagnate this year and growth is unlikely to exceed +1% in 2015 (probably around +0.8%), a disappointing rate compared with an annual average growth of +5% between 2003 and 2008. Moreover, risks are mainly on the downside.

Europe



Eurozone: Progressive credit stabilisation in 2015

Loans to non-financial corporations continue to contract, by -2% y/y to EUR4286 bn in September, the lowest since January 2008. A moderate pick-up was registered in Germany (+0.7% y/y) and France (+0.8%), with Italy showing a y/y decline (-0.9) despite a pick up in September, Spain's deterioration continued (-11.8%). Credit is expected to stabilise in the coming months, as suggested by the Q3 ECB's Bank Lending Survey: (i) stabilisation in domestic demand; (ii) the ECB measures (including covered bond purchases, ABS/RMBS purchases and TLTRO operations); (iii) expected additional measures in H1 2015 - either OMT-type of QE (purchases of sovereign bonds on the secondary market) and/or corporate bond purchases; and (iv) the end of the ECB AQR and stress tests. The latter (released on Sunday) are positive, overall, and show that capital shortfalls are largely contained (EUR9.5 bn for 13 banks, including EUR3.3 bn in Italy), which compares with EUR57 bn of capital raised since end-2013.

Africa & Middle East



Tunisia: Transition nearing an end? Now the hard part

Preliminary results indicate that the centrist secular Nidaa Tounes group received the most votes (over 38%) in last Sunday's legislative elections, giving the party at least 83 seats in the new 217-seat assembly. The moderate Islamist al-Nahda party will have around 65 seats. The elections were relatively peaceful and observers did not report any significant polling violations. The new parliament and government – the first after a transition administration - are therefore likely to be broadly secular in nature, although formation of a coalition government will need to balance a cross-section of interests. While a degree of consensus exists across the political spectrum in relation to economic reforms and the country has retained relatively strong civil institutions, significant risks remain, including weak job creation and security issues in rural areas and along porous borders. We expect GDP growth of +3% in 2014 and +5% in 2015, subject to domestic stability considerations.

Asia Pacific



Japan: Diverging signals

The trade balance deteriorated to -JPY1070 bn in September (from -JPY912 bn in August) reflecting weak external demand. In contrast, industrial production increased by +2.7% m/m (from -1.9% in August) and retail sales expanded by +2.7% m/m (from +1.9%) suggesting private consumption is recovering. The outlook remains fragile, with continuing divergence in private sector surveys. While the Markit Flash Manufacturing PMI improved to 52.8 in September (51.7 in August), confidence levels in small businesses decreased for the third consecutive year and consumer confidence deteriorated for the second month. Lower commodity prices are likely to provide some respite for manufacturers but are unlikely to boost output significantly. We expect the BoJ will keep its policy stance unchanged in the short term, while awaiting further data. This may come soon, particularly with a further deceleration in inflation, and is likely to result in additional monetary easing in Q1-15.



What to watch

- October 30 – EC October business/consumer confidence
- October 30 – Germany October CPI
- October 30 – U.S., Spain, Austria & Latvia Q3 GDP
- October 30 – South Africa Q3 unemployment
- October 31 – Eurozone September unemployment
- October 31 – Eurozone October CPI (preliminary)
- October 31 – U.S. Sept personal income & spending
- October 31 – Japan Sept CPI (nation), Oct CPI (Tokyo)
- October 31 – Japan monetary policy statement
- October 31 – Colombia September unemployment
- October 31 – Argentina September industrial production
- November 3 – U.S. October ISM manufacturing index
- November 3 – EU October manufacturing PMIs
- November 3 – Brazil & Mexico October manufacturing PMI
- November 4 – Brazil September industrial production
- November 4 – U.S. September international trade

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