Euler Hermes Economic Research

Weekly Export Risk Outlook

2 May 2019

In the Headlines

FIGURE OF THE WEEK

+0.4%

Q1 2019 GDP growth in the Eurozone (q/q, flash estimate)

U.S.: Fed on hold, manufacturing and income stumble, consumers rise

The Federal Reserve left interest rates unchanged, but cited concerns that inflation measures "have declined and are running below 2 percent" (the Fed's target). Inflation ran a cool +1.5% y/y in March. Chairman Powell described the situation as "transient", a remark some interpreted to mean a rate cut this year was less likely, so the probability of a cut fell from 66% to 53%. The April ISM manufacturing report fell -2.5 points to its lowest level in 31 months. New orders fell a sharp -5.7 points to 51.7; a reading below 50 indicates contraction. Seven of the ten components fell, leaving only six above 50. Real disposable income fell -0.2% m/m in March, the second loss in three months, putting the y/y rate to +2.3%, the slowest in two years. By contrast, personal consumption rose a strong +0.7% m/m, putting the y/y/ rate at +2.9%. Consumer confidence gained +5.0 points to 129.2, and while that's below recent highs, it is still historically strong. Q1 2019 GDP growth was stronger than expected at +3.2% q/q annualized, but the details were weak. Much of the gain was driven by the third consecutive increase in inventories, and a sharp decrease in imports, both indicating weak demand.

Eurozone: Positive surprise in Q1 GDP growth

According to the Q1 2019 GDP flash estimate, the Eurozone grew more than expected at +0.4% q/q, accelerating from +0.2% q/q in Q4 2018 which can partially be attributed to higher-than-expected inventory building. While external demand is expected to have remained weak in Q1, domestic demand, and in particular consumer spending, is likely to have accelerated as indicated by retail sales data in January and February. Going forward, we expect the Eurozone to fare better overall thanks to (i) resilient real wage growth, (ii) a positive fiscal impulse, (iii) a still very accommodative monetary policy stance, (iv) higher demand from China in H2 as the stimulus bears fruit and (v) rising economic confidence as key risks (escalation of the U.S.-China trade dispute, tariffs on U.S. car imports and a no-deal Brexit) fail to materialize. A potential inventory increase in Q1, however, poses a risk of a negative adjustment in the coming quarters if demand proves weaker than companies' expectations.

Spain: Political fragmentation matters for the medium-term

On 28 April, the socialist party (PSOE) won the general election, taking 123 seats out of 350 in Congress, while the Popular Party (PP, center-right) halved its 2016 number of seats (to 66). The right-of-center landscape is now fragmented between the PP, Ciudadanos (Cs, center with 57 seats) and Vox, the far-right party entering the legislative body for the first time with 24 seats. We see no immediate financial or growth risk: Spain has shown its resilience to political uncertainty, and the winning party is pro-European. Q1 GDP growth surprised on the upside (+0.7% q/q), accelerating from +0.6% in Q4 2018, and the manufacturing PMI rose to a three-month high of 51.8 points in April, up from 50.9 in March. In the medium-term, though, political fragmentation means passing structural reforms will be tougher. Forming a government will take long and socialists have to make some concessions to regional pro-independence parties to win their support. The Spanish economic miracle may come to an end on the back of decreasing cost competitiveness and a more challenging international environment.

France: Till April's dead, change not a thread…

France Q1 GDP growth came at +0.3% q/q, as industrial production recovered. However, demand did not follow suit and inventories contributed +0.3pp to q/q growth. Domestic consumption grew by +0.4% q/q, showing no particular catch-up from the stagnation observed in Q4 and despite the implementation of a fiscal package that will add EUR10bn to household disposable income in 2019. The household saving ratio is likely to have increased further from the 15.3% observed in Q4 2018 (+1pp from Q3). Moreover, excluding energy, household consumption in goods remained stagnant and residential investment decreased by -0.3% in Q1. This had an impact on several sectors, driving a further increase in insolvencies in Q1: the 12-months sum was up by +1.7% from a year ago. Moreover, road transport (+12.9%), housing (+12.8%), agrifood (+10%), food retail (+7.7%) and catering (+7%) experienced sharp rises of insolvencies. Along with the deterioration of the credit cycle, higher inventories should continue to drive a subdued growth of +1.2% in 2019.

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Countries in Focus

Americas

Argentina: Sell-off as political risk emerges again

Last week, a market sell-off caused the value of the Argentine peso (ARS) against the USD to plunge by -5%. The trigger of the sell-off was the prospect of a successful return to power of former President Cristina Fernández de Kirchner, although we are still five months away from the election. During her mandate, interventionist policies were mainstream and the country was unable to recover access to international financial markets. Besides, the January monthly activity index points to a continued recession after the -2.5% annual GDP contraction in 2018. Moreover, doubts have arisen on President Macri's adjustment program as he imposed price controls to curb runaway inflation (55%). In a controversial move, the Central Bank reacted to the sell-off by abandoning the currency non-intervention zone; it will now use its USD72bn foreign reserves to support the currency and fight against inflation. Meanwhile, the encouraging ongoing twin deficit rebalancing and a gradual economic recovery from Q2 could alleviate such market pressures.

Europe

Russia: Growth slowed in Q1, monetary policy unchanged

According to a flash estimate of the Ministry of Economics, real GDP growth decelerated to a disappointing +0.8% y/y in Q1 2019 from +2.7% in Q4 2018. A slowdown had been indicated by high frequency activity indicators but the extent surprised. Industrial production and retail sales growth moderated to +2.1% and +1.8% y/y in Q1, respectively, after both had expanded by +2.7% in Q4. Moreover, the manufacturing and services PMIs eased slightly but remained well in growth territory in Q1, at average 51.3 and 54.9 points, respectively. In April, the manufacturing PMI remained solid though it decreased to 51.8 from a two-year high of 52.8 in March. For now, we maintain our full-year GDP growth forecast of +1.5% for 2019. Meanwhile, the Central Bank of Russia (CBR) kept its key policy interest rate unchanged at 7.75% last week. Consumer price inflation edged up to 5.3% y/y in March from 5.2% in February. We maintain our forecast that inflation will average around 5.0% in 2019.

Africa & Middle East

Kenya: I can stand the rain

Kenya recorded +6.3% GDP growth in 2018 (the highest figure since 2010) driven by a wide range of sectors such as agriculture, transport, telecoms, trade, education and manufacturing. This range of growth drivers is also helping to stabilize the momentum even in a year where one driver is missing. It explains why the average expansion was that high during the last 10 years (+5.9%). Overall, the main reason for the growth acceleration in 2018 from the +4.9% observed in 2017 (the lowest figure since 2012) was better crops since agriculture grew by +6.2% and added +1.5pp to GDP growth in 2018, after just +0.5pp in 2017. Manufacturing production was the other area that recovered in 2018 (an impact of political normalization) with an increase by +4.2% (the highest since 2012) after a mere +1.9% in 2017. Financing is also a key issue, since Kenya is preparing to issue about USD2.5bn of Eurobonds, partly to secure the refinancing of maturing debt. Fiscal consolidation is also a precondition to limit new financing needs (public debt was 56% of GDP in 2018) and avoid financing shocks.

Asia Pacific

South Korea: The cost of trade dependence

Preliminary estimates show that real GDP decreased by -0.3% q/q in the first quarter of 2019 (after +1% q/q in Q4 2018). Exports declined at a faster pace than in the previous quarter (-2.6% q/q after -1.5% in Q4). Private consumption growth slowed significantly to +0.1% q/q (from +1%). And this deterioration in demand led to a sharp decrease in investment (-2.8% q/q). Going forward, we expect economic growth to improve as trade recovers and policy support gets stronger. USD-denominated exports decreased at a slower pace in April (-2% y/y after -8.2% in March). Business sentiment improved slightly and the manufacturing PMI now signals expansion (50.2 points in April after 48.8 in March). The policy mix is turning increasingly accommodative. The government recently announced an extra budget of KRW6.7tn and we pencil in a policy rate cut of -25bp in the next months to boost growth.

What to watch

- May 3 – Belarus Central Bank meeting
- May 3 – Turkey April inflation
- May 3 – U.S. April employment report
- May 3 – U.S. April ISM non-manufacturing index
- May 5 – Saudi Arabia April non-oil private sector PMI
- May 5 – UAE April non-oil private sector PMI
- May 6 – Argentina March industrial production
- May 6 – Indonesia Q1 GDP
- May 6 – Germany April services PMI
- May 6 – Russia April services PMI
- May 7 – France March trade balance
- May 7 – Germany March factory orders
- May 8 – Brazil Central Bank meeting
- May 8 – Germany March industrial production
- May 8 – Portugal Q1 unemployment rate

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