Euler Hermes Economic Research

Weekly Export Risk Outlook

25 July 2019

In the Headlines

FIGURE OF THE WEEK

100.7

July 2019 manufacturing confidence in France

UK: New Prime Minister, same (old) hopes

As expected, Boris Johnson won the Conservative Party leadership contest (92,153 votes or 66%) and became PM of the UK on July 24th. In his first speech, he reiterated his aim: an EU exit on October 31st with or without a deal. In his congratulation letter, EU Council President Donald Tusk gave the impression that Brexit negotiations with the EU will not be easy. Moreover, Johnson has a fragile Parliament majority. The Conservative party has 310 voting MPs out of the total of 639, against 318 from the opposition. Until now, the DUP has been the junior partner in the coalition with Conservatives but Boris Johnson would need to strike a deal with them (notably on the Irish border) in order to continue to count on their 10 seats and have the 320 seats governing majority. As a reminder, the DUP has refused three times to back the deal Theresa May struck with the EU. Johnson wants to scrap the entire Northern Ireland backstop insurance plan, and has said he would not allow checks at the Irish border in any scenario. The risk of early elections by end-September (or a second referendum) has increased. We expect a new Article 50 extension until end-2020.

ECB: Easing is coming

At its July monetary policy meeting, the ECB opened the door to fresh stimulus measures to respond to the subdued Eurozone growth outlook and persistent below-target inflation. In an effort to pave the way for further rate cuts, the ECB changed its forward guidance to say that it expects interest rates “to remain at their current level or lower” at least through the first half of 2020. In addition, ECB President Mario Draghi stated that the central bank is examining further policy options, including 1) a reinforcement of its forward guidance on rates, 2) the introduction of mitigating measures to deal with the unwanted side-effects of negative rates and 3) the restart of the quantitative easing program, including its size and composition. He underlined the ECB’s determination to act by stressing the symmetry in its inflation target. We expect the ECB to announce a policy package in September that includes a 10bp cut in the deposit rate to -0.5%, together with the introduction of a tiered system, as well as the restart of the QE program. On the latter, we expect monthly purchases of at least EUR 30bn, with a stronger focus on corporate and supranational bonds and a higher issuer limit in relation to sovereign bonds. The bottom line: expect ECB monetary policy to remain low – or even lower – for much longer, at least through 2021.

France: The backseat of my car

The French industrial sector has reached a new low and the beat that its heart skipped has much to do with the car industry. The confidence in the manufacturing sector went to a fresh low (100.7) in July, back to levels observed in March 2015. One striking fact is the diminishing level of order books: 5.8 months in July (about one month below the level one year ago). Car makers are foreseeing the main weakness, having lost about two months of order books during the last year (6.5 months currently). It was not the first downward adjustment for the sector since car registrations decreased by -4.5% (y/y on average) in May-June. But this time, car makers have not suffered from rising inventories, having adjusted their output on the downside early enough. However, this means lower purchases from car suppliers, electronics, metals and plastics, where order books faltered also and inventories rose steadily. Capacity utilization evolved in conjunction, decreasing to 83.4% in July in the manufacturing sector (-1.2pp from a quarter ago). A stagnation of industrial production is likely in the next few months.

US: Housing market stalled

The US housing market continues to stumble. Existing home sales fell -1.7% m/m in June to a -2.2% y/y rate. While new home sales rose +7.0% m/m, it was well short of expectations after falling -8.2% m/m in May and -5.1% in April. The new home sales data is volatile, so a three-month moving average gives a clearer picture, and it is distinctly down at only +0.6% y/y. Prices for both existing and new homes rose in June to +4.3% y/y and 0.0% y/y, respectively. And prices are part of the problem; since the recession, prices of existing homes have risen 57% and those of new homes have risen 45%, yet wages have only gained 26%, making housing unaffordable for many. Weak housing activity also showed in starts and permits, which both fell in June. Congress and the President reached an agreement on a budget and an increase in the debt ceiling. The agreement removes one of the uncertainties hanging over the economy, although a government shutdown remains possible if the Treasury runs out of cash in September.

Note: WERO is taking a break. The next issue will be 28 August 2019.

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Countries in Focus

Americas

Latin America: Monetary policies to the rescue?

The pause in rate hikes by the Federal Reserve (Fed) was not enough to boost prospects in Latin American countries in H1 amid trade tensions and weak domestic developments. Now that Fed rate cuts are expected and global inflationary pressures have abated, Latin American central banks are set to follow suit and cut interest rates to boost activity. In Brazil, a rate cut is likely at the end of the month. Progress on the pension reform and inflation being back below the 4.25% target (+3.4% y/y in June) should allow it. Activity contracted in Q1, and still struggles to bounce back (-0.3% m/m in April, +0.5% in May). In Mexico, while high policy risks remain, monetary policy has been restrictive so far (unlike Brazil) due to stubbornly high inflation: a gradual easing cycle could support an economy close to recession. In Chile and Peru, central banks envisage extending the monetary stimulus. In Colombia, the stance should remain accommodative, yet the data do not point to further cuts.

Europe

Eurozone: Tighter bank credit conditions for SMEs in Q2

Credit standards (i.e. banks' internal guidelines or loan approval criteria) for loans to European SMEs tightened in Q2 (5%) while they remained broadly unchanged for loans to large corporates (1%). This was contrary to banks' expectations of a further easing, reflecting increased concerns about economic outlook and rising risk aversion. Among the large Eurozone countries, credit standards on loans to corporates tightened considerably in France, Italy and, to a lesser extent, Germany, while they remained unchanged in Spain and continued easing in the Netherlands. The net percentage share of rejected loan applications continued to increase for loans to corporates, reaching a record high level. However, loan demand proved high in Q2, in line with expectations, on the back of the still low level of interest rates and fixed investment intentions, albeit to a lower extent compared to the previous quarter. Banks expect company loan demand to remain strong in Q3.

Africa & Middle East

South Africa: Between a rock and a hard place

South Africa is increasingly entrenched between leeway for monetary easing and a snowball effect on growth and debt. The South African Central Bank joined a set of Emerging Markets (Korea and Indonesia) that eased their policy rate preemptively before the US Fed, which is expected to do the same at the end of the month. The easing in South Africa was by -25bps, sending the policy rate to 6.5% (after a hike of the same path in November 2018). However, as low growth has continued for six years now (2019 should see +0%), the fiscal deficit is reflecting heightened cyclical pressures and should reach -5% of GDP. This low growth is also a byproduct of structural factors, such as the blind run of the power sector, where investment and financing were both missing for a long period. Now that Eskom needs financing, there is an upside risk to both debt and taxes, since the government will have to finance a USD 9.2bn (2.5% of GDP) cash injection in the next three years, meaning no respite for growth even in 2020 (+1%).

Asia Pacific

South Korea: Economic policy at play

Trade tensions are affecting Asian trade hubs but Korea avoided a recession with +1.1% q/q growth in 19Q2, after -0.4% in 19Q1. Policy is supportive: Last week, the Central Bank eased its policy rate by -25bps to 1.5% for the first time since 2016 (inflation was +0.6% y/y on average in 19H1). The government implemented a fiscal stimulus from April, aiming at tackling air pollution and supporting exports, using a part of last year's fiscal surplus (+2.8% of GDP in 2018 and +1.6% of GDP in 2019). In 19Q2, the growth recovery was mainly led by local services sectors (incl. health and social spending), driven by government consumption growth (+7.3% y/y in 19Q2). Exports decreased by -13.5% (y/y) in June in nominal terms (-8% on average in H1), mainly led by technology (semiconductors mainly) and petrochemicals. The evidence shows that prices went down more than volumes (+0.3% overall in H1) and exports from other sectors still grew. GDP growth should avoid a hard landing in 2019 (+2.2%) on the back of policy support.

What to watch

- July 25 – Argentina June trade balance
- July 26 – Spain July inflation and June retail sales
- July 30 – Eurozone July Eurostat business and consumer confidence
- July 30 – France Q2 GDP
- July 30 – UK Q2 business insolvencies
- July 31 – Federal Reserve policy announcement
- July 31 – Spain Q2 GDP (flash estimate)
- July 31 – Eurozone Q2 GDP
- July 31 – Mexico Q2 GDP (preliminary estimate)
- July 31 – Canada May GDP
- July 31 – Eurozone July inflation rate
- July 31 – Brazil interest rate decision

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