Euler Hermes Economic Research

Weekly Export Risk Outlook

31 October 2019

FIGURE OF THE WEEK

+0.2%

Q3 2019 q/q GDP growth in Eurozone

In the Headlines

U.S.: Fed cuts, Q3 GDP solid

As expected the Federal Reserve cut interest rates 0.25% to a range of 1.5% - 1.75%. The Fed cited "… the implications of global developments for the economic outlook, as well as muted inflation pressures…" as reasons for the rate cut. A change in wording regarding what the Fed would do concerning the future path of rate hikes from "act" to "assess(es)", and Powell's statement that Fed members "see the current stance of monetary policy as likely to remain appropriate" suggest that future hikes may be on hold. However, we continue to think another cut is possible in December and two others at the beginning of 2020 as the US economy will continue to weaken. Q3 GDP was slightly stronger than expected at +1.9% q/q annualized, led by solid consumption of +2.9%, although that was down from last quarter's +4.6%. Trade uncertainty weighed on business investment, which fell -3.0%, the second consecutive decline, but residential investment rose for the first time in seven quarters, gaining +5.1%. We maintain our forecast of +2.4% for 2019 and +1.6% for 2020.

Eurozone: Soft winter ahead

Eurozone GDP increased by +0.2% q/q in Q3 2019, in line with our expectations, but above the consensus. Advanced indicators suggest domestic demand (mainly private consumption and construction) offset negative contributions from the external sector and the manufacturing recession. The fact that companies' assessment of stocks has stabilized in October is good news, but the unusually high levels continue to suggest a further negative adjustment in manufacturing production by the end of Q1 2020. Indeed, new export orders remain depressed, at their lowest level since 2013, which doesn't bode well for external demand prospects. Hence, GDP growth should remain low, at +0.2% q/q in Q4 before slowing to +0.1% q/q in Q1 2020 on the back of contracting growth in the UK and the US, but also higher US import tariffs on European car imports as soon as mid-November. The ECB's additional support in 2020 (two more rate cuts in March and September, coupled with a higher pace of QE as soon as April) and slightly more fiscal spending should help quarterly growth to pick up to an average of +0.4 q/q in H2 2020. We expect Eurozone GDP growth at +1.0% in 2020 (at best).

France: Autumn leaves

GDP growth marginally weakened to +0.25% q/q in Q3 from +0.35% in Q2, but with evidence that an industrial recession is at play. Domestic demand growth was fairly stable (+0.5% in Q3, as in Q2), driven by corporate and public investment. The consumer landscape is showing winners and losers, with housing and durable goods among the best performers and food and energy among the worst ones. Overall, domestic demand is still driven by better income growth (a fiscal stimulus) and the environment of low interest rates that helps to finance long-term spending. However, net exports made a large negative contribution to growth (-0.4pp) showing that external demand is low, contributing to a rise in inventories (+0.15pp contribution to growth). As a result, the industrial recession is now official (manufacturing output decreased by -0.5% in Q2 and -0.4% in Q3). Advanced indicators suggest a weakening economy in Q4, but still driven by the same stabilizing forces (fiscal stimulus, construction) that should help to smooth full-year growth to +1.2% in both 2019 and 2020.

Italy: No recession, but downside risks still loom large

In Q3 2019 Italian GDP increased by +0.1% with respect to the previous quarter. On an annual basis, the rate of expansion registered at +0.3% - the highest in a year. While on the positive side the Italian economy has avoided slipping into recession this year, it has largely treaded water since Q1 2018 as external headwinds coupled with elevated domestic political uncertainty simply proved too much to handle. Going forward, with political uncertainty more contained since the Europhile PD&M5S coalition took over in early September and the ECB taking another dovish turn, domestic demand should stage a timid comeback. The sweeping victory of Salvini's Lega party in regional elections in Umbria last week, however, showed that the political outlook is far from certain. External headwinds will meanwhile continue to test the resilience of Italian exports until next year, so that overall we expect GDP growth to accelerate only slightly to +0.4% in 2020, after +0.2% in 2019.

EULER HERMES
A company of Allianz

Countries in Focus

Americas

Argentina: No surprises, but uncertainty and tougher times ahead

Alberto Fernández won the presidential election with 48% of the vote, a victory that had been largely priced in since the primaries in August. Incumbent Macri received 40% of the vote share, yet his coalition should have a sizable weight in Congress. Argentina is in a worse place than in 2015: the debt-to-GDP ratio almost doubled during Macri's mandate and is now close to 100%. The unemployment rate is at 10.1% and inflation above 50%. After dropping to 25.7% in 2017, the poverty rate has reached 35.4%. We expect a protracted recession (-3% this year, -4% next year) as sharper financing conditions affect consumers and companies; political risk should increase, weighing on the business environment and non-payment risk. Indeed, Fernández' policy platform fits our illiberal cycle narrative – renegotiating debt, intervening to revive growth by boosting domestic consumption – but there is little leeway to do so. There remains a sizable risk of a deeper public debt restructuring, with haircuts on capital (Fernandez hinted at a haircut of about 20%) or a disorderly debt default.

Europe

Russia and Ukraine: Monetary easing also in Eastern Europe

The Central Bank of **Russia** lowered its key policy interest rate by 50bp to 6.50% last week, citing a more rapid disinflation than expected and declining inflation expectations. Headline inflation fell from 4.3% y/y in August to 4% in September and 3.8% in the first half of October. We expect it to decline further to 3.5% by year-end and forecast an average inflation of 3.8% in 2020. This leaves room for further monetary easing in the next quarters, especially as the economic growth outlook remains bleak. We forecast GDP to expand by +0.7% in 2019 and +1.1% in 2020. Also last week, the National Bank of **Ukraine** cut its policy interest rate, by 100bp to 15.50%. The move appears appropriate and the overall monetary policy stance remains cautious, as inflation fell to 7.5% y/y in September and we forecast it to reach 7.0% by year-end. Disinflation has been supported by a sizeable appreciation of the UAH in 2019 (+9% YTD vs. USD). In 2020, we expect a stabilization of the currency and of inflation (average 6.8%).

Africa & Middle East

Africa: Cannot be serious?

Many African economies are among the best improvers in the World Bank's latest Doing Business survey, but deeds do not seem to be aligned with words yet. The improvement of Nigeria's ranking (131st) is strong and mainly driven by a global rank of 15 on the "getting credit" item. However, the access to credit is very poor in the economy and the recent easing of monetary policy did not translate into credit growth. This "getting credit" item also shows other surprising results, such as the 4th rank of Zambia, a country that is over-indebted (public debt should reach 87% of GDP next year). Obviously, some reforms have been implemented well, e.g. in Morocco which is now ranked 53rd. Yet, the growth impact has been quite low and insolvencies grew by +9% y/y in H1 2019 while, more generally, the payoff of reforms decreased, given the global trade recession observed in 2019. Togo's improvement was strong (+40 ranks to 97th). The country is a good example of broad-based reforms and infrastructure building, which have been helping to create a trade hub.

Asia Pacific

Hong Kong: Slipping into recession

Hong Kong fell into a deeper than expected recession in Q3. GDP growth came in at -3.2% q/q in Q3, after -0.4% q/q the previous quarter. Two consecutive quarters of negative q/q growth mean that Hong Kong has fallen into a technical recession, as widely expected. The breakdown shows that the slowdown is broad-based, with household spending, investment and external trade all deteriorating. Government spending picked up pace this year, but evidently not enough to make up for other downside pressures. Ongoing social unrest, uncertainty in the external environment and the continued slowdown in China mean that the downturn in the Hong Kong economy could last. Hong Kong's Financial Secretary said this week that a full-year economic contraction is "very likely". After +3.0% in 2018, we expect Hong Kong's GDP growth at +0.4% in 2019 and +0.3% in 2020, with downside risks to these forecasts.

What to watch

- November 1 – Eurozone October manufacturing PMI
- November 1 – US October employment report
- November 1 – South Korea October Inflation
- November 1 – India October manufacturing PMI
- November 1 – Czechia October manufacturing PMI
- November 1 – Russia, Turkey Oct. manufacturing PMI
- November 4 – Poland October manufacturing PMI
- November 4 – Turkey October inflation
- November 5 – Spain October Manufacturing PMI
- November 6 – Poland monetary policy decision
- November 6 – Bank of Japan monetary policy meeting minutes
- November 6 – Portugal Q3 unemployment rate
- November 6 – Spain and Argentina September industrial production

View all Euler Hermes Economic Research online
https://www.eulerhermes.com/en_global/economic-research.html

Contact Euler Hermes Economic Research Team
research@eulerhermes.com

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