Euler Hermes Economic Research

Weekly Export Risk Outlook

13 March 2019

FIGURE OF THE WEEK

-2.4%

Q4 2018 q/q GDP decline in Turkey

In the Headlines

Turkey: Full-year GDP contraction expected in 2019

Real GDP contracted by -2.4% q/q in Q4 2018, confirming the (technical) recession we have long predicted. In addition, the figures for previous quarters were markedly revised downwards: to -1.6% q/q in Q3 (from -1.1%); +0.05% q/q in Q2 (previously +0.6%); +0.9% q/q in Q1 (previously +1.7%). As a result, full-year GDP growth came in at just +2.6% in 2018, down from +7.4% in 2017. Moreover, the growth carry over for 2019 now stands at -2.6%. Hence we will revise downwards our growth forecast for this year to about -0.7%. In y/y terms, Q4 GDP dropped by -3%, driven by nosediving consumer spending (-8.9% y/y), fixed investment (-12.9%) and inventories (-4.7pp). Imports plunged (-24.4% y/y) in line with domestic demand while exports rose by +10.6% as firms' competitiveness has improved due to the sharp TRY depreciation (-33% in 2018). The rebalancing of the external sector continued in early 2019. The current account posted a modest monthly deficit of -USD0.8bn in January, much smaller than a year ago (-USD7.0bn in January 2018) so that the rolling 12-month deficit continued to narrow to -USD21.6bn in January 2019, down from a recent peak of -USD58bn in May 2018. We expect a current account deficit of around -2% of GDP in 2019 (down from -5.6% in 2017).

UK: Brexit me…later

As expected PM May lost again the vote on the "slightly revised" Brexit deal. The votes "against" exceeded those in favor by 149, which is lower than her defeat in January (230). Yet, it is a sizable defeat which questions her capacity to get the deal through. Around 75 Tories still voted against (down from 118 in January) while the 10 DUP MPs from her coalition rejected it again. Two other votes will follow on Wednesday and Thursday which in our view will end up with an extension of Article 50 beyond 29 March. The request will be debated and approved (unanimity needed) at the EU Summit on 21-22 March. Some conditionality might be required from the EU side. We have long argued that an extension period would open three relevant options: (i) a renegotiated Brexit deal; (ii) a second referendum; (iii) a renegotiated Brexit deal toward a permanent customs union (a softer Brexit). We think MPs are trying to force the third option, i.e. a softer Brexit through cross-party consensus. This situation keeps uncertainty high ("no deal" probability unchanged at 25%) and weighs on GDP growth (+1.2% in 2019).

France: For a fistful of dollars

The French export performance surprised on the upside in January 2019 despite growth concerns in Germany and China. Compared to a year ago, exports rose by +EUR2.5bn. It evidences that exports will again contribute visibly to economic growth in 2019 (+EUR14bn export gains are expected, after +18bn in 2018). In 2018, the strong export performance towards the U.S. (+4.4bn) and China (+2bn) added +0.2pp and +0.1pp to GDP growth, respectively. This story continued in January 2019, with +EUR0.8bn additional exports to each of these two markets. Transport equipment (mainly aeronautics) and chemicals (mainly pharmaceutical goods and cosmetics) are the main beneficiaries of this momentum. Meanwhile, France's five top EU export destinations (Germany, Spain, Italy, Belgium and the UK) generated only +EUR0.5bn export gains in January, reflecting the impact of the low growth momentum in core EU economies. Overall, the French external sector's improving performance is summarized by a narrowing current account deficit (-EUR6bn expected in 2019, after -EUR17bn in 2018).

Emerging Markets: Once upon a time

One year ago, manufacturing activity in Emerging Markets (EM) open to trade was outperforming other EM, on the back of strong trade growth. Things have changed a lot since then, driven by several trade uncertainties: the U.S.-China trade dispute as well as growing concerns about key sectors such as automobiles and telecommunication services. As a result, the aggregate Manufacturing PMI of open EM has been below the 50-threshold in the last six months (49.1 in February) and hit its worst level since May 2009. Several uncertainties are affecting demand (e.g. environmental rules and decreasing Chinese consumption of cars). As a result, producers have to cope with a high level of inventories, which has put output to the downside. Meanwhile, capital flows have returned to EM (USD30bn on average per month from November to February) thanks to more dovish monetary policy prospects in the U.S. Improving external credit conditions can surely help EM, but with poor translation into growth figures owing to trade uncertainties.

Countries in Focus

Americas

U.S.: Very weak jobs and retail sales

The economy added only +20k jobs in February, far short of the +180k expected. The result was a combination of: a payback from very strong growth in the prior two months; an error band of +/-100k; bad weather cutting construction by -30k, the biggest loss in over eight years; and a weaker economy. The entire services sector gained only +53k jobs vs a 12-month average of +166k. A payback from the end of the government shutdown dropped the unemployment rate from 4.0% to 3.8% and cut the underemployment rate from 8.1% to 7.3%. Wages gained +0.4% m/m to +3.4% y/y, the highest in almost 10 years. The weakness in job creation plus the increase in wages suggest that employers are trying to lure people into jobs, but can't find the right people to hire. January retail sales rose +0.2% m/m, but December was revised down from -1.2% m/m to a terrible -1.6% m/m. Sales are growing +2.3% y/y, while core sales are up +2.7% y/y, less than half the pace six months ago.

Europe

Czech Republic: Rate hike possible at end-March

Q4 GDP growth accelerated to +3.2% y/y from +2.6% in Q3. This took growth for all of 2018 to +3% (down from +4.4% in 2017) which was entirely driven by domestic demand, a shift from the broad-based performance in 2017. Notably, fixed investment surged by +10.2% in 2018 (+3.7% in 2017) thanks to rising spending on machinery, infrastructure and housing. Consumer and public spending grew by +3.2% and +3.9% in 2018, respectively. The latter picked up to an average +5% y/y in H2, reflecting rising public sector wages and a shift to fiscal stimulus amid signs of an economic cooling at midyear. Export expansion slowed to +4.5% (+6.7% in 2017) while imports remained stable at +6%, so that net trade subtracted -0.8pp from 2018 growth (+1.1pp in 2017). Meanwhile, inflation picked up to 2.7% y/y in February, up from 2.5% in January and 2% at end-2018. Strengthening growth in Q4 combined with rising inflation have boosted the likelihood of a policy interest rate increase at end-March.

Africa & Middle East

Kenya: The place to be

Kenya is attracting more and more attention. 2018 growth figures are not fully out yet, but it seems that GDP grew by +6%, recovering from +4.9% in 2017. Kenya's growth performance is one of the broadest based in Africa (significant contributions from agriculture, trade, transport, telecoms and construction). It illustrates the country's willingness to become a trade and logistics hub in the region, along with diplomatic activism (e.g. improving relationship with Ethiopia, mediation in the dispute between Uganda and Rwanda). Moreover, Kenya is reforming fast (rank 61 in the latest Doing Business survey) including the latest moves regarding urbanization, by lowering the size from which a county is defined as an urban area in order to improve the access to basic infrastructures. It includes the access to power in a country where we estimate that USD100bn of additional spending would be needed by 2030 to close the equipment gap with a middle-income economy (e.g. Mexico). Against this backdrop, accurate financing will be the main issue, since FDI inflows finance only 16% of the current account deficit.

Asia Pacific

China: Trade bump or trade slump?

USD-denominated exports dropped sharply by -20.7% y/y in February and imports contracted by -5.2%. For now it is probably too early to blame external and domestic demand for this fall as January and February figures are generally distorted by the Chinese New Year holidays. A more nuanced approach consists in averaging the first two months in order to reduce the seasonal effect. This points to decreases of exports by -4.6% y/y and imports by -3.1% y/y in January-February. Looking forward, we expect this trend to reverse from Q2 onwards. Based on the first nine days of March (+39.9% y/y for exports) China's customs chief predicts a strong recovery. Our view is that this is plausible, assuming that China and the U.S. find a trade agreement by Q2. On the import side, we expect domestic demand to get some traction helped by expansionary policies (5% of GDP fiscal package) and more generous monetary conditions. GDP growth is set to remain relatively solid at +6.4% in 2019.

What to watch

- March 14 – Germany February inflation (final)
- March 14 – Ireland Q4 GDP (first estimate)
- March 14 – Slovakia February inflation
- March 14 – Turkey January industrial production
- March 14 – Ukraine Central Bank meeting
- March 14 – U.S. January new home sales
- March 15 – Eurozone February inflation (final)
- March 15 – Poland February inflation
- March 15 – U.S. February industrial production
- March 18 – Eurozone January trade in goods
- March 18 – Japan February exports
- March 18 – U.S. February housing market index
- March 19 – UK January wage growth
- March 19 – U.S. January factory orders
- March 20 – U.S. Federal Reserve announcement

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