Euler Hermes Economic Research

Weekly Export Risk Outlook

9 May 2019

FIGURE OF THE WEEK

+0.5%

March m/m rise in industrial production in Germany

In the Headlines

U.S.- China trade talks: Escalation

On 5 May, President Trump announced plans to raise tariffs, arguing that current U.S.-China talks are too slow. From 10 May, tariffs on USD200bn of imports from China would increase to 25% (from 10% currently). Remaining untaxed U.S. imports from China would face duties shortly. This move comes as (i) China and U.S. officials are expected to meet in the U.S. to discuss a trade deal and (ii) trade data continue to show signs of weakness. For instance, March trade figures were disappointing for a lot of major export-driven economies (e.g., South Korea, Japan, Singapore, Hong Kong) and early releases for April (South Korea, USD-denominated exports down -2% y/y) are not encouraging. On top of tariffs, uncertainty is acting as a drag on trade as corporates delay investment and new orders. Escalating tensions add further complication. We estimate that if the U.S. implemented the announced tariff hike to 25% from 10% on USD200bn of imports from China, the average U.S. tariff would rise above 6%. And this could cost -0.5pp of global GDP growth and -2pp of global trade growth over the next two years.

Turkey: Sliding again

On 6 May, Turkey's electoral body ordered Istanbul's local elections to be rerun after a narrow victory by the opposition CHP’s candidate in March, thus overturning a rare defeat for President Erdogan. The President’s AK Party had demanded the rerun, claiming there were irregularities behind the CHP's win. However, the key element for the AKP’s loss of key municipalities in the March local elections is likely to have been voter discontent over increasing economic instability (including high inflation and rising unemployment). We do not expect this to alter until 23 June, for which the rerun has been scheduled. Instead, the further loss of political credibility and rise in uncertainty is likely to unnerve investors even more and exacerbate ongoing financial market risks. The TRY has lost -4% since the announcement and stood at 6.23 per USD at the time of writing, the weakest rate since September 2018. The ISE 100 Index has lost -5% since end-April and market interest rates are on the rise. The Central Bank may need to revert to (unorthodox) monetary tightening in the near term. Meanwhile, the economy continues to contract, e.g. reflected in the manufacturing PMI which fell to 46.8 points in April (47.2 in March).

Germany: Strong GDP growth in the cards for Q1

Seasonally adjusted industrial production rose by +0.5% in March compared with the previous month. Overall, production in Q1 2019 was +0.5% above the average level of Q4 2018.The German industrial weakness of the second half of 2018 has thus not yet been overcome, but the situation is at least stabilizing largely thanks to an increase in the production of consumer goods. In addition, construction is currently a very important pillar of the German economy. Together with the good data on private consumption, the German economy should have grown by at least +0.4% q/q in the first quarter of 2019. However, GDP growth is likely to lose momentum again in the further course of the year. Fundamentals underpinning domestic demand remain strong, but in view of still constraint impulses from abroad – as the Chinese economic stimulus takes time to feed through and the risk of an escalation of the U.S.-China trade dispute weighs on sentiment – investment but also private consumption should increasingly lose momentum. Overall, we continue to expect German GDP to grow by +1% in 2019.

France: Ticket to ride

In March, French exports still grew the way they grew, putting Q1 export gains at +EUR6.3bn (compared to Q1 2018), with aeronautics (+2.1bn), chemicals (+1.7bn) and electronics (+0.7bn) being the Top3 growth sectors. The first driver was an abnormal increase by +1.8bn to the UK (jewelry grew by +0.5bn, car exports by +0.3bn) after precautionary purchases ahead of the 29 March initial Brexit deadline (eventually extended). We expect that French exports to the UK will moderate during the next months. China remained another key story in Q1, accounting for +1.4bn of exports gains (mainly aircrafts). In the Eurozone, exports towards Italy showed the strongest increase (+0.4bn, mostly driven by pharmaceuticals) as the country exited from recession in Q1 (+0.2% q/q GDP growth). Other key Eurozone export destinations began the year in slow motion. Germany is a case in point as French exports to the neighbor stagnated (car suppliers faced a - EUR150mn export decline). Overall, the performance achieved in Q1 gives traction to an expected +EUR14bn of French export gains in 2019 (+18bn in 2018).

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Countries in Focus

Americas

U.S.: Employment rebounds

The April employment report was quite strong as the economy added +263k jobs, easily beating expectations of +180k. The unemployment rate dropped from 3.8% to 3.6%, the lowest in over 49 years, while wage gains remained steady at +3.2% y/y. There were some soft spots as the labor force fell by a steep -490k, the fourth consecutive decline, driving the participation rate down by -0.2pp as a result. The work week shrank to a -0.3% y/y rate which drove weekly wage growth down to +2.9% y/y; it had been +3.5% just four months ago. Productivity surged at a +3.6% q/q annualized rate, the most in five years, and the first time above the long-term average of +2.1% in the entire recovery. The ISM non-manufacturing index fell slightly, losing -0.6 points to 55.5 points. But it was the fourth decline in five months and six of the ten components fell. Survey respondents reported concerns over both slowing demand and finding labor.

Europe

Czechia: Monetary tightening while economy slows

Last week, the Czech National Bank (CNB; the central bank) raised its key policy interest rate by 25bp to 2.0%, a move that contrasts with the stance of many other central banks which recently have halted tightening or even turned more expansionary against the backdrop of moderating global growth. The CNB argued that it expects consumer price inflation to remain in the upper half of its 2% ± 1pp target range this year. Indeed, CPI inflation hit the 3% upper bound of that band in March, however, mainly due to strong price rises for foodstuff and energy. Hence, core inflation remained in check, at 2.1% in March (after 2% in February). Meanwhile, the economy shows clear signs of cooling. The Manufacturing PMI has been below the 50.0 threshold since December 2018 (46.6 in April) indicating contraction, mainly due to subdued demand and declining new orders. Industrial production growth dropped to +0.2% y/y in Q1 from +2.3% in Q4. We may revise downwards our current GDP growth forecast of +2.5% for 2019 (after +3% in 2018) following the release of Q1 growth estimates next week.

Africa & Middle East

South Africa: Economic policy in 3D

After the election, the South African government will have to fix 3 Depletions that hurt growth in the past: power, jobs and financing. Early deindustrialization and a painful “demining” of the economy are pervasive. The manufacturing sector lost -3pp of its share in GDP (from 16.5% to 13.5%) and the mining output lost about half (to 8% of GDP) in the last 25 years, despite high subsidies. Power shortages were painful for these energy-intensive sectors. Among the possibilities to improve that situation, it seems that the government may allow more coal use and increase the emission limit allowed in coal-fired power plants. Output losses also had an impact on jobs and inclusion, since the unemployment rate remains at 27%, an issue that will have to be solved as well. Additionally, it seems that South African companies felt short of cash in 2018. Their working capital requirement increased to 70 days of turnover (58 days in 2017) and evidence of rising debt for key corporates was pervasive. Such reforms will take time and GDP growth is likely to stall at +1% in 2019 (+0.8% in 2018).

Asia Pacific

China: It is getting complicated

Latest figures were a bit of a mixed bag. On trade, while exports decreased (-2.7% y/y in April after +14.2% in March) imports made their comeback (+4% y/y) after four months of contraction. Credit indicators recorded a slight slowdown but remained firm compared to previous months. M2 rose by +8.5% y/y in April (after +8.6% in March, +8.3% in Q1). Total social financing, a measure of aggregate credit to the real economy, grew by +10.4% y/y (+10.7% in March, +10.4% in Q1). Producer prices continued to pick up speed (+0.9% y/y after +0.4% in March) providing a boost to April’s turnover. PMIs suggest expansion in the near term yet the pace might be more modest in the manufacturing sector. Looking ahead we expect China’s economic growth to slow to +6.4% in 2019 (from +6.6% in 2018). Yet, we also see a rise in downside risks following Trump’s announcement to raise tariffs.

What to watch

- May 10 – France March industrial production
- May 10 – U.S. April consumer prices
- May 13 – China April vehicle sales
- May 13 – Czechia, Romania April consumer prices
- May 13 – Turkey March balance of payments
- May 14 – Canada April home prices
- May 14 – Hungary, Romania March industrial product.
- May 14 – Turkey March industrial production
- May 15 – Bulgaria April consumer prices
- May 15 – EU and various member countries: Q1 GDP growth (flash estimates)
- May 15 – Poland Central Bank meeting
- May 15 – Poland April consumer prices
- May 15 – Romania Central Bank meeting
- May 15 – U.S. April industrial production and retail sales

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