Euler Hermes Economic Research

Weekly Export Risk Outlook

17 July 2019

In the Headlines

FIGURE OF THE WEEK

+1.6%

Q2 2019 q/q growth rate in China

Asia: Another trade fight to worry about

Recent trade tension developments between South Korea and Japan (regarding export restrictions of key components) add to the already tense world trade environment and could be detrimental to Asian trade hub economies. Singapore's Q2 growth came out much less than expected at -3.4% q/q. China's stability in that regard is essential for the region. China's q/q growth rate for Q2 accelerated to +1.6%, after a 3-quarter long deceleration, showing signs of an upcoming stabilization. Monthly data also suggest signs of improvement as industrial production accelerated to +6.3% y/y in June after +5.0% in May, while retail sales have accelerated as well. These figures point towards a recovery, albeit a slow one. Indeed, the positive impacts related to the monetary and fiscal stimuli are counterbalanced by external and structural difficulties. The official manufacturing PMI was in contraction territory in June at 49.5, the same as in May, while the non-manufacturing PMI declined to 54.2 in June (from 54.3 in May). Monetary and financial conditions did not significantly improve despite strong monetary support by the PBOC. Therefore, the PBOC is likely to implement additional cuts of the RRR (three before year-end) and additional targeted medium-term lending facility (TMLF) operations, while the government is likely to roll out new measures to support consumption.

Europe: New Commission, new reform agenda

On July 16th, the new European Commission President, Ursula von der Leyen, was confirmed by the European Parliament by a narrow majority of MPs (383 votes, just over the minimum of 374 required). She will replace the incumbent Jean-Claude Juncker on November 1st. Her job will not be easy as for the first time in 40 years, a Grand coalition - spanning the European People's Party (EPP), the Progressive Alliance of Socialists and Democrats (S&D) and the Alliance of Liberals and Democrats for Europe and Renaissance (ALDE & R) - will govern. The strength of the Greens (almost 10% of seats) suggests they will be the swing force. We expect the newly formed Commission to focus on purchasing power and social policy, security, defense and climate change over the next five years. This three-party agenda could also be supported by non-traditional parties. On the other hand, business-friendly reforms, and bolder, yet dividing, policy blocks for Europe, do not appear to be on top of the list. Check our clusters of priorities for the next Commission in our report.

Brazil: Pension vote calls for cautious optimism

Last week, the long-awaited pension reform bill passed the first lower house vote with more than the 60% majority needed (379 in favor, 131 against). Its current version could save the government around USD250bn over ten years. Brazil spends 13% of GDP on social security, above the 8% average in the G20, and 8.6% only on pensions. Three lessons can be drawn from this vote: (i) the bill is less ambitious than initial government plans, as it does not include states and municipalities, which will need to pass their own pension reforms for their civil servants. It also abandons the shift to a capitalization system (individual savings accounts). (ii) We are far from definitive adoption: we expect the bill to be watered-down further after amendments and when the bill then goes to the Senate after the summer recess. (iii) A successful vote would clear the way for tax reform and privatization. The president's Chief of Staff, Onyx Lorenzoni, announced a figure of BRL1.5tn (~USD400bn) in investment opportunities as part of the concessions and privatization program being prepared by the government.

Emerging markets: Waiting for the Fed

Emerging Markets are increasingly affected by the weakening trade momentum and are still not benefitting from better credit conditions. June data showed an aggregate manufacturing PMI below 50 (49.4) for a second month in a row, consistent with a contracting manufacturing output. The weakest indicators came from open economies with a PMI index that went to its lowest level since May 2009 (48.4), in a broad-based evolution in Asia, Eastern Europe and Latin America (Mexico). This shows that the trade dispute between the US and China has had an impact, particularly on key sectors in Asia (technology). It also shows that other aspects are at play, such as sectoral difficulties (automotive industry), that are broadening to cyclical sectors (chemicals). As a consequence, Emerging Markets should now adopt more dovish policies, particularly in Asia, where fiscal surpluses can give a leeway to implement stimulus. Lowering long-term rates around the world did not translate into a more dovish monetary policy in Emerging Markets and all eyes are turning towards the Fed's July 30-31 meeting.

Countries in Focus

Americas

US: Mixed data

Recent economic reports have been mixed. Retail sales rose +0.4% m/m in June, beating expectations of a +0.1% increase. Gains were widespread across most major industries, although gasoline sales dropped -2.8% m/m on falling prices. After stripping out volatile items, core sales, which are a direct input into the GDP calculation, rose a substantial +0.7% m/m. On a y/y basis, total sales are growing at a decent +3.4%, but that's well below last June's +6.0%. By contrast, core sales are running at a solid +4.6% y/y, stronger than the recent trend. The manufacturing sector, however, continues to struggle and barely remains in positive territory. Manufacturing industrial production did rise +0.4% m/m in June, but readings have been very weak through the last six months, and as a result the y/y rate fell from +0.7% to a mere +0.4%. Over the past year, manufacturing production has been weakest in apparel at -9.7% y/y and strongest in computers and electronics at +5.3% y/y.

Europe

Eurozone: Mind the downside pressures on export prices

Eurozone exports rebounded in May: +6.1% y/y in value terms from +4.6% in April and +2.1% in March. Intra-Eurozone exports increased by +4.9% y/y vs. +3.8% in April. Extra-Eurozone exports increased by +7.1% y/y vs. +5.3% in April. Export gains YTD stood at EUR27.2bn for intra-Eurozone trade and EUR46.1bn for extra-Eurozone trade. Extra-Eurozone exports registered a strong rebound for machinery and transport equipment (+7% y/y after +0.8% in April). However, advanced surveys continue to suggest depressed export new orders in the industry sector in June (a negative balance of opinion of -14.1, the lowest level since 2013). Overall, we expect Eurozone exports to grow by +2.2% in volume terms in 2019 (after +3.2% in 2018) and by +2.6% in value terms (after +4.6% in 2018), given the downside pressures on prices likely to be exerted by the unusual stock accumulation at the global level. Export prices contracted by -0.1% q/q in Q1 2019.

Africa & Middle East

Nigeria: Start me up

After the election period, there were some signs that economic policy would become more growth-supportive in Nigeria. After the surprise easing of monetary policy (Wero, March 27th), the Central Bank came up with new measures to unleash bank credit. From October, commercial banks will have to cope with a minimum 60% loan-to-deposit ratio after the Tier-1 lenders ratio decreased to 54% in 19Q1 from 61% in 18Q1 and 76% in 17Q1. The measure is also accompanied by incentives (higher weight in ratio calculation) for loans to SMEs. This should help Nigeria make the most of progress made in the rules that organize access to credit in the last few years (as shown by the 12th position in that indicator in the World Bank Doing Business ranking). Low access to credit is among the bottlenecks that prevent Nigerian corporates to benefit from decent payment terms (75% of payments are made in cash, according to our estimates). Overall, we expect GDP growth to accelerate a bit to +2.4% in 2019, from +1.9% in 2018

Asia Pacific

Singapore: The canary in the coal mine

GDP growth was negative in 19Q2 for the first time since 15Q1 and with a magnitude not seen since 2012. Singapore's economic cycle is a good predictor of the global cycle since it is highly open and a major trade hub, particularly for electronics. The cyclical pattern of Singapore shows how impactful the trade dispute was, since inventory-building led to a growth acceleration in Q1 to +3.8% (q/q annualized) and then an adjustment to the downside in Q2 (-3.4%). The contraction was broad-based, from a manufacturing recession (-6% in Q2, 3rd quarter of contraction in a row) to a turnaround in the service sector (+4.4% in Q1 – above medium run average – and -1.5% in Q2). Overall, early indicators of the cycle went down to levels last seen in mid-16 and consistent with a contraction (the electronics PMI was 49.2 in June). GDP growth should decelerate from the +3.2% seen in 2018 to +1.8% in 2019. There are clear downside risks but a negative figure should be avoided.

What to watch

- July 18 – South Korea monetary policy meeting
- July 18 – Indonesia monetary policy meeting
- July 18 – South Africa monetary policy meeting
- July 19 – Spain May business turnover
- July 22 – Taiwan June export orders
- July 22 – Colombia May economic activity
- July 23 – US June existing home sales
- July 24 – US June new home sales
- July 24 – France July business confidence
- July 25 – US June durable goods orders
- July 25 – US June international trade
- July 25 – ECB meeting
- July 26 – US Q2 GDP

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