Euler Hermes Economic Research

# Weekly Export Risk Outlook

24 September 2019

## In the Headlines

FIGURE OF THE WEEK

-0.3%

Q2 2019 q/q GDP decline in Argentina

### U.S.: Housing market improves but leading indicators decline

The housing market finally produced data that was somewhat more encouraging, although its volatility merits caution. After three straight declines, housing starts rose a huge +12.3% m/m in August to a strong +6.6% y/y rate. Housing permits gained a steep +7.7% m/m to an outsized +12.0% y/y, but to demonstrate the volatility, the y/y rate just last month was only +0.1%. Existing home sales are a bit less volatile and rose +1.3% m/m to a solid +2.6% y/y. Prices for those homes fell -0.8%, the second straight decline, to +4.7% y/y, but that is unfortunately faster than wage growth of +3.2% y/y. The low supply of homes for sale has also been an impediment since the recession and in August it fell to 4.0 months, a five-month low. The bottom line is that August housing data was a significant, if volatile, improvement, but structural issues remain. The Index of Leading Indicators, which projects conditions 6-9 months out, has unfortunately been on a distinct downturn. Out of the past four months it has been positive only once, and the y/y rate has declined to +1.1% in August from +6.3% a year ago.

### Eurozone: Growth trough expected in Q1 2020

Advanced indicators continue to point to very weak economic growth ahead. We expect +0.2% q/q in both Q3 and Q4. The manufacturing PMI fell -1.4 points to 45.6 in September (consensus was at 47.3) on the back of further deteriorations in new orders and employment intentions. Services fell from 53.5 to 52.0, relatively in line with consensus. While the deterioration was generalized, most of the fall was explained by Germany. We expect the trough in Eurozone GDP growth to be reached in Q1 2020 (0% to +0.1% q/q) on the back of adverse effects of U.S. protectionist measures on Europe (punitive tariffs on Airbus, 10% import tariff on car imports) as well as higher volatility from the U.S.-China trade dispute and a negative impact from adjustments in the high level of inventories. The ratio of inventories to new orders rebounded in September (1.15) and is now at its highest since 2011. Overall, Eurozone GDP growth is forecast at a meager +1% in 2020. While downside risks remain high, a full-blown recession should be avoided thanks to a resilient consumer on the back of disposable income and low interest rates, which will prevent the services and construction sectors from going into contractionary territory.

### Germany: Heightened recession risk also for 2020

In September the mood in the German economy recorded its first – albeit timid – improvement since March with the ifo business climate index rising +0.3 points to 94.6. The slight uptick was attributable to a somewhat more positive assessment of the current business situation. However, companies' business expectations for the coming six months suffered another setback. Moreover, the business climate in Germany's important manufacturing industry recorded a further deterioration – albeit a more limited one compared to previous months. The ongoing decline in business expectations suggests that the risk of a recession will remain acute also in 2020. The combination of a subdued outlook for world trade and the German car industry as well as lingering elevated political uncertainty surrounding trade and Brexit appear too much to handle for the German economy, despite a still relatively resilient services sector. In 2019 as well as 2020, we expect the German economy to grow by only +0.6% and hence only about half as fast as the Eurozone as a whole.

### France: Cars

In France, the manufacturing sector is still impacted by low confidence in the car supply chain. Overall, manufacturing confidence was quite stable in September at a level of 102 points that is quite the same as was observed during the past six months and on average in 2015-2016, when manufacturing production grew by about +1% per year. However, carmakers, car suppliers, metals and plastics still exhibit low order books and significant inventories. Intermediate goods involved in the car supply chain are particularly impacted. The new information now is that carmakers are again building inventories above the average. The weak trend of car registrations in export destinations such as Germany, Italy and the UK is one explanation, but domestic orders of French carmakers are also quite low, suggesting a downtrend of car sales in the next months, including at home. Overall, continuing demand pressures in the car industry point to a landing of manufacturing production after a good H1, putting overall GDP growth on the downside (+0.2% q/q expected in Q3 2019).

# Countries in Focus

Americas

## Argentina: Double-dip recession ahead

The economy contracted -0.34% q/q in Q2, after -0.04% in Q1. Private consumption stagnated after dropping for four straight quarters, while investment grew for the first time since Q4 2017 (+1.5% q/q). Compared to Q2 2018, the economy contracted -1.8% y/y, giving signs of bottoming out – the pace of contraction slowed from the -4.9% recession average. But recent financial turmoil, heightened political risk and the announcement of a restructuring should plunge Argentina back into recession in Q3, spilling over to 2020. After moderating in July, economic sentiment dropped to its lowest ever recorded by our proprietary NowRisk indicator (since 2011) in August. Indeed, companies should prepare for a sharp tightening of financial conditions, which should pass-through to the real economy, just like in 2018, via the currency channel (imported inflation and highly restrictive monetary policy hurting consumer spending and investment) and the business sentiment channel (hurting investment as well).

Europe

## UK: One in six companies doesn't feel ready for a "Hard Brexit"

Similar to Q1, economic activity in Q3 will be driven by contingency stockpiling ahead of the 31 October Brexit deadline. The Bank of England Q3 survey showed that one in six companies felt it is not ready for a "Hard Brexit", i.e. a WTO trade regime from early November, up from just below one in ten previously. Almost 20% of the firms said they planned to do more contingency planning, down slightly from 25% in the July survey. However, more than 30% of firms said they were changing arrangements for haulage and/or ports, more than in previous surveys. While we expect a last-minute extension of Article 50 until mid- or Q3 2020, the risk of a "Hard Brexit" remains high (40%). We expect a technical recession at the turn of the year on the back of contingency stockpiling resorption. Overall, GDP growth should be weak in 2020 (+0.8% after +1.2% in 2019). Investment intentions in the next 12 months turned negative in Q3, for the first time since 2009, due to lower demand and tighter credit conditions.

Africa & Middle East

## Egypt: Wages

In Egypt, social tensions that recently erupted were also important in the 2011 revolution and thereafter (purchasing power issues). Higher bread prices were a key trigger for the 2011 revolution. After years of capital controls, the government devalued the EGP by -50% in November 2016 and implemented a sequential unwinding of subsidies. It implied an acceleration of inflation that peaked above +30% in 2017 (+7.5% y/y in August 2019). The government also froze the minimum wage. These three policy measures helped to reduce the trade deficit through import substitution (producing at home). The unemployment rate decreased to 7.5% in Q2 2019 (from 12.6% in Q2 2016), annual GDP growth recovered to about +6%, and foreign reserves reached 10 months of import cover (three months before 2017). In April 2019, the government hiked the minimum wage by +67%, ending a five-year freeze. However, about three-fourths of the population is not subject to any minimum wage. In the next years it will be key to broaden wage increases to the whole population in order to smooth social tensions and stabilize growth.

Asia Pacific

## Indonesia: Accommodative monetary policy to support growth

Last week, Bank Indonesia (BI, the central bank) cut its key policy interest rate by 25bp to 5.25% and announced a number of macroprudential lending rules to boost bank lending capacity and demand for new loans. Since inflation has remained in check (3.5% y/y in August, equal to the mid-point of BI's 2.5%-4.5% target range) and the IDR stable (YTD +3% vs. the USD), BI is focusing on supporting growth. Although real GDP growth edged down only slightly to +5.1% y/y in H1 2019 from +5.2% in 2018 as a whole, this solid outcome was only achieved thanks to stepped-up public spending (+6.7% y/y) and a stronger slump in real imports (-7.2% y/y) than in exports (-1.9%) so that net exports made a positive contribution to overall growth in H1. We expect the export recession to continue in Q3 as nominal USD-denominated exports contracted by -7.5% y/y in July-August 2019. And we project at least one more rate cut in 2019 to prop up the economy as the global growth and trade outlook falters. Full-year GDP growth is forecast at +5% in 2019 and +4.6% in 2020.

# What to watch

- September 25 – Czechia interest rate decision
- September 25 – U.S. August new home sales
- September 26 – Mexico interest rate decision
- September 26 – Ukraine August industrial production
- September 27 – Brazil August unemployment rate
- September 27 – Colombia interest rate decision
- September 27 – France August consumer spending
- September 27 – Spain August retail sales
- September 27 – U.S. August durable goods orders
- September 27 – U.S. August personal income and spending
- September 30 – Egypt Q2 GDP
- September 30 – Kenya Q2 GDP
- October 1 – U.S. September ISM manufacturing index
- October 2 – France September car registrations

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