Euler Hermes Economic Research

Weekly Export Risk Outlook

4 December 2019

FIGURE OF THE WEEK

+4.5%

Q3 2019 y/y GDP growth in India

In the Headlines

Global Trade: The Tariff Man strikes again

December started with three main hawkish news on the trade front: (i) new 100% tariffs on selected U.S. imports from France, which will not be implemented before January; (ii) 10-25% tariffs on Argentina's and Brazil's metals effective immediately; (iii) comments from President Trump, downplaying the urgency of a phase one deal with China, saying he "could wait" until after the 2020 election. This had an adverse impact on markets, which were pricing in a phase one deal soon. Tariffs could have a sizable impact for France (-EUR2.1bn in export losses) as sparkling wine, beauty products and suitcases will be the most affected. However, some of the costs will be borne by the U.S. consumer and not by exporters (so export losses could be overestimated) since goods such as sparkling wine are not substitutable (luxury goods, controlled designation of origin). We estimate potential losses for Argentina's (-USD102mn) and Brazil's (-USD282mn) steel and aluminum exporters. Such political volatility, after the suspension of the October tariff hike on China, strengthens the assumption that uncertainty should continue to weigh on trade next year, in line with our +1.7% forecast for global trade growth in 2020 (after +1.5% this year).

Turkey: Growing again, albeit modestly

Q3 real GDP grew by a seasonally adjusted +0.4% q/q, after +1% in Q2 (revised down from +1.2%), and by +0.9% y/y (unadjusted). The latter marked the first increase after three quarters of y/y decline. As Turkey's recession began a year ago in Q3 2018 at the peak of its financial crisis, base effects are now showing. Consumer spending grew by a modest +1.5% y/y in Q3 2019, also after three quarters of decline. Continued strong fiscal stimulus boosted public spending by +7% y/y (up from +3.4% in Q2). Fixed investment contracted for the fifth consecutive quarter, reflecting the much weakened financial position of companies owing to the sharp currency depreciation over the past two years, though the decline moderated to -12.6% y/y from -22.4% in Q2. The overall strengthened domestic demand also led to a +7.6% y/y increase in imports, after four quarters of decline, while export expansion slowed to +5.1% y/y (from +8.1% in Q2) so that net exports in Q3 made the first negative contribution (-0.9pp) to overall growth since Q1 2018. Looking ahead, we expect the modest recovery to continue in Q4 and next year and forecast full-year GDP growth of +0.1% in 2019 and +2.3% in 2020.

Canada: Tepid growth as expected

Third quarter GDP came in largely as expected, growing at a +1.3% q/q annualized rate which was much slower than Q2's +3.5% (revised down from +3.7%). Consumption was tepid at +1.5% which, although better than last quarter's +0.5%, perhaps indicated consumers' unease about the trade situation. Indeed exports shrank -1.5% and overall net exports took -0.6pp off of the headline. But trade concerns were absent in business investment which gained a strong +9.5%, and residential investment soared +13.3%, the highest in eight years, as the housing market continued to expand. Overall inflation remained tepid at 1.4% y/y. With weak inflation and a GDP report essentially in line with the Bank of Canada's forecast, any rate cut is still some months away. We maintain our GDP growth forecast for all of 2019 at +1.7%, and while 2020 is expected to be similar, it will be dependent on any downdraft in global trade, or a sharp slowdown in the U.S.

Emerging Markets: Rational inattention?

Manufacturing activity has not shown any sign of improvement in Emerging Markets (EM) in November, except in China. There, the official manufacturing PMI increased from 49.3 to 50.2 points, triggering a higher aggregate EM index of 49.5. However, excluding China, the aggregate EM manufacturing PMI fell to 49.1 (the lowest since April 2009) from 49.2 in October. Overall, EM are still exhibiting elevated weaknesses. Political turmoil in a growing number of countries is binding. This evolution is threatening growth and deteriorating financial conditions. In Latin America, 59% of the banks said that political risk will have an impact on their future supply of credit. However, we know that an economic pickup in China can engineer a recovery in EM. But can we expect it? Not yet. In March-April, the Chinese PMI had already improved but it reversed in May. The landscape has not changed for now, and EM still face key vulnerabilities: foreign exchange reserves and capital flows should remain fickle.

Countries in Focus

Americas

Brazil: Economy accelerating, but window for reforms narrowing

Q3 GDP grew +0.6% q/q (+1.2% y/y), accelerating from +0.5% in Q2, driven by private consumption which grew +0.8% q/q and investment which grew +2% q/q. Public consumption contracted -0.4% q/q, along with exports (-2.8%) due to subdued global trade and the Argentina recession. Yet, without the buildup in inventories which added +0.6pp to growth, the Q3 figure would have been close to zero. This could show two things: expectations of higher internal demand; a frontloading of imports (+2.9% q/q growth in Q3, highest pace in a year) as the currency lost ground against the USD. For 2020, we expect an acceleration of growth to around +2% on the back of the cyclical consumption recovery and a positive investment boost following the pension reform, helped by accommodative monetary policy and one-off stimulus measures in Q4. Yet, the sustainability of the momentum is at risk: First, the window of opportunity for reforms has narrowed as public sector reform was postponed to avoid stirring social protests, and municipal elections are scheduled for next fall. Second, companies could lose their bet on higher demand if the tax reform is delayed.

Europe

Poland: Slowdown is set to continue

Second estimates confirmed that Q3 real GDP growth slowed to +3.9% y/y (from +4.6% in Q2), the first reading below +4% since Q4 2016. Q3 growth was boosted by strengthening public spending thanks to fiscal stimulus ahead of the elections in October, while the expansion in consumer spending (+3.9% y/y) and fixed investment (+4.7%) moderated. A decline in inventories pushed Q3 growth down further by -0.7pp. Slowing capital spending is in line with continued weak sentiment in the manufacturing sector. Although the manufacturing PMI edged up to 46.7 points in November (from 45.6 in October), it nevertheless recorded its second-lowest reading since July 2009 and has now been below the 50.0 mark for 13 months in a row, indicating deteriorating conditions in the sector. Anemic new domestic and external orders are key drivers of the weak PMI. As a result, we expect the Polish GDP growth to decelerate further and forecast +4.2% in 2019 as a whole and +3.1% in 2020.

Africa & Middle East

South Africa: The cycle is the trend

The South African economy entered anew a contraction in Q3 (-0.6% q/q annualized growth rate). This is not a recession per se, as Q2 growth was positive after Q1 was negative. South Africa is experiencing short-lived boom bust cycles, a pattern that we expect to continue. The power issue is the main trigger of this profile since the output capacity constraint is increasingly binding and played again on the downside in Q3 (after an already very negative figure in Q1). Along with lower access to power, energy-intensive sectors (mining, manufacturing, construction, transport) went again into contraction. As a result, GDP growth should remain very low for long, since a solution to the overall power issue has not been found yet (financing needs has been the key topic to be addressed, but not output capacity). We expect +0.5% GDP growth in 2019 and 0% in 2020. This also entails that the fiscal deficit is likely to widen to -7% of GDP and public debt to rise to 64% of GDP in 2020.

Asia Pacific

India: GDP disappoints in Q3 2019

The Indian economy continued to slow in the July-September quarter of 2019. GDP growth reached the weakest rate in more than six years, declining to +4.5% y/y from +5.0% in the previous quarter. The breakdown shows weaknesses in particular in investment and exports. Conversely, public spending accelerated (to +15.6% y/y in Q3 2019, from +8.8% in Q2). Private consumption growth also picked up somewhat (to +5.1% y/y from +3.1%) although it remains well below the pace in previous years. Euler Hermes currently expects India's GDP to grow by +5.3% in 2019 and +5.8% in 2020. However, the weaker-than-expected GDP released for the latest quarter puts downside risks on these numbers. Stimulus measures are in place, but should take a little time to filter through. The Reserve Bank of India has been easing the monetary policy this year, and is likely to implement further rate cuts. New fiscal policy measures have also been announced to boost private sector investment.

What to watch

- December 5 – Germany October factory orders
- December 5 – India RBI interest rate decision
- December 5 – Philippines November inflation
- December 6 – Canada November employment report
- December 6 – Germany October industrial production
- December 6 – U.S. November employment report
- December 8 – China November trade
- December 9 – Czechia October industrial production
- December 9 – Japan Q3 GDP (final)
- December 10 – China November inflation
- December 10 – Philippines October trade
- December 11 – Brazil central bank interest rate decision
- December 11 – Romania November inflation
- December 11 – Turkey October balance of payments
- December 11 – U.S. Federal Reserve meeting
- December 12 – Eurozone ECB monetary policy meeting
- December 12 – UK general elections

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