

FIGURE
OF THE WEEK

+5.1%

November 2019
y/y inflation in
Ukraine
(68-month low)

In the Headlines



U.S.: Fed leaves rates unchanged

As expected the Federal Reserve left interest rates unchanged at Wednesday's meeting and signaled that further cuts in 2020 are less likely than previously thought. The tone of the accompanying statement suggested more confidence about the future, particularly with the addition of the words "is appropriate". The phrase which specifically suggested that the Fed would be biased towards leaving rates unchanged reads "the Committee judges that the current stance of monetary policy is appropriate to support sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective." The statement from the previous meetings had characterized those outcomes as "the most likely...", but uncertainties about this outlook remain." The dot-plot showing individual Fed member's projections of the Fed Funds rate suggested no change in 2020. However financial markets are still pricing in one cut in 2020, and we agree, particularly as the economy in H1 may be weaker than consensus views. The dot-plot also suggests that two hikes are likely in 2021, and we would also agree with that since the economy should rebound by then.



Eurozone: More easing likely in 2020

At its December monetary policy meeting – the first under new President Christine Lagarde – the ECB kept all policy rates unchanged with the deposit rate at -0.5% and confirmed the pace of monthly QE purchases at EUR20bn. While the ECB maintained its view that the balance of risks around the growth outlook remains tilted to the downside, Lagarde also highlighted that these had become less pronounced and that the growth slowdown shows some signs of stabilization. Nevertheless the ECB's macroeconomic projections – which are largely aligned with ours – are far from pointing towards a swift rebound in economic momentum any time soon. In fact, until 2022 the ECB expects GDP growth to strengthen to only +1.4% while inflation will rise to 1.6% – a level that is still somewhat below the inflation target of close to 2% over the medium-term. This confirms our view that in 2020 the lackluster inflation outlook will push the ECB to further ease policy. With political considerations around divisions in the Governing Council making an increase in monthly asset purchases less feasible, we expect a further -0.1% cut in the deposit rate in H1 2020 while QE continues at the current pace until end-2020.



France: Hold the (flat) Line?

The latest output and external trade data indicated a relatively flat growth profile in the last months. Notwithstanding a sizeable fiscal stimulus, growth has not accelerated owing to several shocks (German stagnation, car sector problems, strikes...) that weighed down on demand. And despite some industrial output cuts already implemented, inventories are still significant and further output curbs are now needed, in particular in the car, metals, plastics/rubber, agrifood and textile sectors. Moreover, export gains are now plateauing after being the main growth driver in H1. At the same time, growth is still vibrant in key French strongholds such as pharmaceuticals and aeronautics where both industrial output and exports continue to surprise on the upside. Against this background, wage growth is at the same time a positive factor since it fuels purchasing power gains for households, and a threatening one since corporates now see their margins constrained by real wage increases. All in all, economic growth should remain quite resilient in 2020 compared to 2019 (+1.2%).



Turkey: Continued monetary easing – is it too rapid?

The Monetary Policy Committee today continued its rapid monetary easing path, lowering its key policy one-week repo rate by 200bp to 12%, arguing that the inflation outlook continued to improve and the economic recovery goes on, while investment demand remains weak (which would argue for lower interest rates). This was the fourth rate cut since July 2019, halving the policy rate from 24% in June. However, the size of today's rate cut appears a bit large, considering that headline inflation jumped back to 10.6% y/y in November (from 8.6% in October) and is forecast to rise further, largely due to base effects, so that it may soon be higher than the new policy rate. Meanwhile, the current account posted another surplus of +USD1.5bn in October, but this was lower than a year ago. Hence, the rolling 12-month surplus narrowed to +USD4.3bn. More worrisome, net portfolio investment turned outward again in October (-USD3.6bn), even though current global financial conditions support the demand for emerging market assets. We expect the vulnerability of capital inflows to Turkey to continue throughout 2020, given current Turkish economic policies.

Countries in Focus

Americas



Brazil: Encouraging start of Q4, time for cautious optimism

Three encouraging news came in from Brazil this week and bode well for the modest acceleration we forecast for next year. First, retail sales grew +0.1% m/m in October which brings the y/y growth to +4.2%, up from +2.2% in September. Overall, the outlook is improving for consumers, amid a low inflation environment (boosting real wages) and declining interest rates as monetary policy eases, helping the credit cycle. Yet, there remain some hindrances to a full-fledged ramping up of consumers: the unemployment rate remains high (11.6%) and consumer confidence still has to recover. The second news is the fourth consecutive policy interest rate cut of Banco do Brasil by 50bps to 4.50%, the lowest rate on record. It did not close the door to further cuts in 2020, but signaled a more cautious data-dependent approach; and it could start hiking only in 2021. The third news is the decision of ratings agency S&P to revise the country's outlook to positive from stable, which could signal a future sovereign rating upgrade.

Europe



Ukraine: Speeding up monetary easing

Today, the National Bank of Ukraine (NBU) cut its key policy interest rate by 200bp to 13.50%. The cut including its size appears appropriate and the overall monetary policy stance remains cautious as consumer price inflation fell to 5.1% y/y in November, stronger and faster than expected from a recent high of 9.6% in May 2019. The rapid disinflation has been supported by lower energy prices and a significant appreciation of the UAH (+15% YTD vs. the USD). Another positive news this week was that Ukrainian authorities reached agreement with the IMF staff on a new three-year, USD5.5bn funding arrangement (subject to IMF Board approval). This provides for the opportunity to enhance structural reforms further. However, substantial risks remain on the agenda for Ukraine. The NBU notes that "...the risk of rising threats to macrofinancial stability persists because of court rulings and pressure on the NBU." External risks include an escalation of the (military) conflict with Russia, including a halt of the Russian gas transit through Ukraine as well as deepening global trade tensions and turmoil on global financial markets.

Africa & Middle East



Morocco: Missed expectations matter

There is a growing disconnect between Moroccan growth forecasts vs. global and European ones. Global growth is expected to disappoint again at +2.4% in 2020, down from +2.5% in 2019 and +3.1% in 2018, as a result of trade and political uncertainties on the path to the U.S. presidential elections. World trade growth should stay weak and Eurozone growth should stall at about +1% in 2020. Against this background, official expectations (in Morocco or from international institutions) point towards a steady recovery in Morocco, with about +3.5% growth in 2020 (after a likely +2.4% in 2019). However, we expect only +2% in 2020. A subdued international environment is one aspect, and the domestic environment should also not be that conducive since insolvencies are growing again after a pause in 2018: +7% is expected in 2019 and +5% in 2020. It means that Moroccan reforms (up +15 positions in the Doing Business survey over the past two years) are not comprehensive enough: it's easier to start a business now, but bad payment terms make cash needs high enough to nurture rising insolvencies and lost growth opportunities.

Asia Pacific



Japan: Fiscal stimulus package to support growth into 2020

The government announced last week a fiscal stimulus, amounting to JPY13.2tn (2.4% of GDP). Out of this headline number, JPY9.4tn (1.7% of GDP) will take the form of actual government spending. The stimulus was described as a "15-month budget", and the government said it will boost growth by +1.4pp over time. While we expect the stimulus to support growth (we are revising our 2020 forecast upwards), the government's estimate may be assuming an excessively high fiscal multiplier. We also think that GDP growth may still disappoint in Q4. The negative impact of the sales tax hike will be reflected, the stimulus will not have kicked in yet, and the upwards revision in Q3 GDP provides an unfavorable base. Indeed, Q3 GDP growth was revised up on Monday to +0.4% q/q from +0.1%, likely reflecting frontloading of spending ahead of the tax hike (implemented on 1 October). Overall, we expect GDP growth at +1.1% in 2019 and +0.8% in 2020.

What to watch

- December 12 – UK general elections
- December 13 – Brazil October activity index
- December 13 – France Q3 wage growth
- December 13 – Russia monetary policy meeting
- December 13 – Turkey October industrial production
- December 13 – U.S. November retail sales
- December 15 – Tariffs between the U.S. and China scheduled to hike
- December 15 – Hong Kong interest rate decision
- December 16 – Japan December PMIs (flash)
- December 16 – China November industrial production, investment, retail sales, housing prices
- December 17 – Argentina Q3 GDP growth
- December 17 – Hungary monetary policy meeting
- December 17 – U.S. Nov. housing starts and permits
- December 17 – U.S. November industrial production
- December 18 – Thailand interest rate decision

DISCLAIMER

These assessments are, as always, subject to the disclaimer provided below.

This material is published by Euler Hermes SA, a Company of Allianz, for information purposes only and should not be regarded as providing any specific advice. Recipients should make their own independent evaluation of this information and no action should be taken, solely relying on it. This material should not be reproduced or disclosed without our consent. It is not intended for distribution in any jurisdiction in which this would be prohibited. Whilst this information is believed to be reliable, it has not been independently verified by Euler Hermes and Euler Hermes makes no representation or warranty (express or implied) of any kind, as regards the accuracy or completeness of this information, nor does it accept any responsibility or liability for any loss or damage arising in any way from any use made of or reliance placed on, this information. Unless otherwise stated, any views, forecasts, or estimates are solely those of the Euler Hermes Economics Department, as of this date and are subject to change without notice. Euler Hermes SA is authorized and regulated by the Financial Markets Authority of France.

© Copyright 2019 Euler Hermes. All rights reserved.