Euler Hermes Economic Research

Weekly Export Risk Outlook

24 May 2017

In the Headlines

FIGURE OF THE WEEK

+0.6%

Q1 2017 q/q GDP growth in Germany

France: Sunny afternoon

The French business climate indicator provided by INSEE edged up to 105 points in May, from 104 in April. The two main cyclical components (construction and manufacturing) were up or at cyclical peaks, increasing the likelihood that output growth will follow. Manufacturing confidence was stable at 109, remaining well above its long-term average of 100. Moreover, building construction increased to 102, being above 100 for the first time in the current construction cycle. This supports our expectations of a full-blown growth cycle led by a broad recovery in investment. We expect corporate investment to rise by +2.9% in 2017 and household investment growth to accelerate from +2.4% in 2016 to +3.6% in 2017. Moreover, the Euler Hermes Investment Barometer (a survey of a sample of 1,000 corporates) shows that 68% of firms will either maintain or increase their investment level in 2017. Furthermore, order books of French companies increased to 6.4 months on average, up from 5 months registered two years ago in the 2015 Barometer. Overall, we expect real GDP growth to accelerate from +1.1% in 2016 to +1.5% in 2017.

Greece: The hard deadline for a deal is 15 June

Last Monday, the Eurogroup failed to agree on the release of the EUR7.5bn tranche needed for Greece to avoid default in July. Yet the second review is very close to finalization as the Greek parliament adopted new austerity measures demanded by creditors. No agreement was reached on further debt relief which the IMF requests as a condition for its participation in the bailout. Given the hard deadline in terms of debt maturing in July, a deal should be struck at the next Eurogroup meeting on 15 June. Still, we cannot exclude a lack of alignment regarding further debt relief in which case the IMF is likely to limit itself to an advisory role. That being said, the financing needs of Greece are at least EUR20bn below the initial bailout package. A gradual improvement in confidence should follow, allowing private sector deposits to strengthen after 3 months of stability. Hence, a further relief of capital controls is expected in Q3 (close to a full lifting) which should support trade. Q1 GDP fell by -0.1% q/q, dragged down by the uncertainty surrounding negotiations. We expect GDP growth in 2017 to be below +1%.

Brazil: New chaos ahead?

Just starting to emerge from recession, Brazil has sunk back into a severe political crisis. A year after former President Roussef's impeachment, her successor, President Temer, is now involved in a major scandal. A local newspaper asserted on 18 May the existence of a secret recording allegedly proving he bribed Eduardo Cunha – the mastermind behind Rousseff's impeachment – to "keep him quiet". Several scenarios could arise. Firstly, an impeachment of Temer could lead to new indirect elections which might take several months. Secondly, the Superior Electoral Court could end Temer's mandate as early as on 6 June for having financed his 2014 campaign with corruption money. Thirdly, Temer might simply resign. Fourthly, direct elections could be organized after the impeachment as a signal to the people already disaffected by the Lava Jato scandal. Lastly, the president could manage to calm things down until the next general elections planned in October 2018. Whatever the outcome, a new period of high uncertainty is likely and market reactions to the crisis could be hefty (the BRL already lost -6% against the USD) while the reform agenda has already been put on hold.

Canada: A well-oiled machine

The machine that is the Canadian economy is producing strong growth in a frictionless, inflation-free environment. Retail sales rose +0.7% m/m in March to a very strong +6.9% y/y rate vs. a longer term +4.6% rate. On an annualized quarterly basis sales grew at a very rapid +10.8% pace, or +8% after inflation, more evidence that Q1 GDP growth is likely to exceed +4%. Autos led the way in March with a +3% m/m gain to +10.2% y/y. Sales rose in seven of the ten provinces, and all ten are positive on a y/y basis. Yet the strong pace of real economic activity has done little to stoke inflation, as April consumer prices were running at only +1.6% y/y. By comparison that is the same average rate for all of the recovery, it is down from +2.1% in January, and it is less than half the post WW-II average of +3.6%. Auto price inflation fell for the second consecutive month to only +0.9% y/y despite the rapid sales noted above, and the Bank of Canada's core inflation measure was only +1.3% y/y.

Countries in Focus

Americas

Peru: Floods weighed on Q1 GDP

Real GDP grew by +2.1% y/y in Q1 (+0.1% q/q), the slowest y/y pace in two years and below our expectations. Activity was dragged down by severe floods related to the El Niño phenomenon in the country's northern region. Construction activity fell by -5.3% y/y. Fixed investment contracted by -7.1% y/y, marking the 13th month of continuous decline. Investment was affected in the past months by the fall in mining investment and the weakening of international metals prices as well as the postponement of several major infrastructure projects, for example the Line 2 of the Metro de Lima and Callao. Private consumption remained robust at +2.2% y/y, supported by employment growth (+2% y/y). Real exports gained momentum (+12% y/y, the fastest rate since early 2012) on the back of traditional products such as copper and fisheries. Imports finally got out of their one-year slump but only just, expanding by a meager +0.2% y/y, reflecting the still tepid investment cycle.

Europe

Germany: Strong Q1 growth and favorable outlook

Q1 real GDP growth was confirmed at +0.6% q/q, up from +0.4% in Q4 2016. Both consumer spending (+0.3%) and public spending (+0.4%) edged up in Q1 while fixed investment surged by +1.7% (up from +0.4% in Q4), driven by a rebound in investment in equipment (+1.2%) and a construction boom (+2.3%). However, inventories subtracted -0.4pp from Q1 q/q growth. Net exports added +0.4pp to Q1 growth (-0.2pp in Q4) as exports grew by +1.3% while import growth eased to +0.4%. Meanwhile, the latest business surveys suggest that the economy is well on course for a boom. The Ifo Business Climate Index rose to 114.6 in May (from 113.1), reaching its highest level since 1991. Businesses corrected their view of both the current situation and expectations up sharply. The flash PMI Composite Output Index is similarly euphoric, rising from 56.7 to 57.3 in May. For now, we maintain our full-year GDP growth forecast of +1.7% in 2017, but the balance of risks is now more tilted to the upside.

Africa & Middle East

Iran: Policy continuity? Perhaps

Incumbent centrist and pro-reform Hassan Rouhani was re-elected president on 20 May, gaining 57% of the vote, a wide margin over his main challenger Ebrahim Raisi, the hard-line revolutionary unity candidate, who got 38%. This outcome reduces the risk of the collapse of the JCPOA, known commonly as the Iran nuclear deal, and the re-imposition of UN sanctions by the U.S. in the near term. The JCPOA was the main achievement of President Rouhani’s first term. It led to the easing of UN sanctions on Iran in early 2016 which has helped to increase oil production by about +30%, boosting real GDP growth to +6.5% in fiscal year 2016/17 (ending 20 March). Further, during Rouhani’s first term annual average inflation fell from 31% in 2012 to 9% in 2016, however, unemployment has remained stubbornly high at around 15%. The election outcome provides the opportunity for some progress on economic reforms while social and political reforms will come up against strong opposition from “hardliners”.

Asia Pacific

Japan: Strong start into the year

Following steady growth in 2016, the Japanese economy accelerated in the first quarter of 2017. According to preliminary estimates, real GDP increased by +0.5% q/q (up from +0.3% in Q4 2016). Export growth remained fairly strong (+2.1% q/q). Domestic demand growth was driven by private consumption (+0.4 % q/q in Q1), which had been subdued in late 2016. Private non-residential investment was more or less flat while the decline in public investment virtually ceased. Going forward, there is limited scope for further acceleration of private consumption in the short run as wages continue to disappoint. Regarding investment, supportive fiscal measures and firm manufacturing survey results (Manufacturing PMI at 52.0 in May) signal an improvement in the near term. Against this backdrop, the Japanese economy appears on track for average annual growth of at least +1.2%.

What to watch

- May 25 – UK and Spain Q1 GDP (second estimates)
- May 25 – Ukraine Central Bank meeting
- May 26 – U.S. Q1 GDP (second estimate)
- May 26 – U.S. April durable goods orders
- May 29 – U.S. April personal income and expenditures
- May 30 – Eurozone confidence indexes
- May 30 – Germany and Spain May CPI (flash est.)
- May 31 – Belgium Q1 GDP (second estimate)
- May 31 – Canada Q1 GDP
- May 31 – Estonia and Slovenia Q1 GDP (first estimates)
- May 31 – Eurozone May CPI (flash estimate)
- May 31 – Germany April retail sales
- May 31 – India Q1 GDP
- May 31 – Portugal Q1 GDP (second estimate)
- May 31 – UK May Business Barometer
- May 31 – UK May Consumer Confidence

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