Euler Hermes Economic Research

Weekly Export Risk Outlook

17 April 2019

FIGURE OF THE WEEK

+6.4% y/y

China Q1 real GDP growth

In the Headlines

China Q1 GDP: Stimulus stabilizes growth

China's real GDP growth stabilized in Q1 (+6.4% y/y like in the previous quarter), helped by expansionary policies. The tertiary sector slowed but remained resilient (+7.0% y/y in Q1 2019 after +7.4% in Q4 2018), industry picked up speed (+6.1% after +5.8%) and the primary industry slowed (+2.7% after +3.5%). Monthly data show that the stabilization came from an improvement of activity in March. Real industrial production rose by +8.5% y/y in March (after +5.3% in Jan-Feb), retail sales were up +8.7% y/y (after +8.2%) and urban investment continued its improvement (+6.3% YTD y/y in Jan-March 2019 after +6.1% in Jan-Feb), driven by SOEs and government spending on infrastructure. Looking ahead, advanced indicators point to an improvement of activity growth: Business surveys in both manufacturing and services point to expansion and financing indicators are improving. M2 growth accelerated to +8.6% y/y in March (after +8% in February). Total social financing outstanding increased by +10.7% y/y in March (after +10.1% in February). Against this background, we maintain our forecasts of +6.4% GDP growth in 2019 (after +6.6% in 2018).

U.S.: Weakness in manufacturing and housing

The manufacturing sector continues to stumble. Overall industrial production slipped -0.1% m/m in March vs. expectations of a +0.3% gain, pushing the y/y rate down to +2.8%. Just six months ago it was +5.4%. The manufacturing component was unchanged on the month but the y/y rate has fallen to +1.0%, the slowest in over two years. The declines have been led by apparel, which has plunged -14.5% in the past year, and motor vehicles, which fell -2.5% m/m to a -4.5% y/y loss. Nine of 19 manufacturing sectors have contracted in the last year. Housing woes continue despite the fact that the Housing Market Index gained one point to 63, indicating expansion. However, the index has yet to recover from a sharp drop in November and is down -5 points in the past year. As usual, the "Traffic of Prospective Buyers" component is lagging at 47, indicating homebuilders are seeing a decline in foot traffic. Economy-wide, many recent reports have been soft, but we maintain our forecast for solid GDP growth of +2.5% for 2019.

Turkey: Gimme shelter

Just as the recession continues to hit the Turkish economy, the credit cycle has tightened markedly and banks face ascending Non-Performing loans (NPLs). The prudential regulator expects NPLs to reach 6% of total loans by year-end, twice the level exhibited before the August 2018 currency crisis and still +2pp above the January figure. This deterioration of payment behavior is fully understandable since corporate debt is high (75% of GDP), in foreign currency (about two-thirds) and the TRY has lost more than -50% last year. But the worst is yet to come, since industrial production was still in contraction for the 6th straight month in February (-5.1% y/y) and the manufacturing PMI is also still in contractionary mode (47.2 in March). The deteriorating payment behavior is translating into higher unemployment (14.7% in January from 11.6% in October) and a likely increase in insolvencies (+5% in 2019). A further deterioration should be prevented through capital injection and loan restructuring, which may entail an upside risk on public debt ratios (33% of GDP in 2018).

Africa: As time goes by

During the last weeks, Zimbabwe, Tunisia, Sudan and Algeria faced significant public demonstrations. In each of these countries, public finance, including subsidy levels, faced scrutiny. As a subset of shocks (from the 2011 Arab Spring to the fall of commodity prices from 2014) cut export revenues, it exposed many countries to an acute rise of their public debt, which now needs to be stabilized. Egypt was a blueprint for this, since subsidy cuts were introduced from November 2016 and successfully helped to revert public debt dynamics. In January 2019, Zimbabwe tripled gasoline prices (public debt is 78% of GDP), then protests turned to Tunisia, where the government intended to progressively cut subsidies. They ended with civil servants wage growth (public debt is expected at 82% of GDP in 2019). The last bout of protests hit Sudan after the decision to cut subsidies on bread prices (public debt should reach 180% of GDP in 2019). As debt sustainability becomes an issue, fiscal consolidation attempts may well have consequences for other African economies.

Countries in Focus

Americas

Mexico: A cautious central bank… for valid reasons

The recently released minutes of the March central bank meeting – in which the policy rate was held steady at 8.25% – show that a majority of board members believe core inflation remains a concern (it is stuck at +3.6%). The balance of risks for inflation appears tilted to the upside. Under the current environment of uncertainty, Banxico will follow: (i) the potential pass-through of exchange rate fluctuations to prices, (ii) Mexico's monetary policy stance relative to that of the US and (iii) domestic slack conditions. The latter two developments are positive for inflation, with slightly higher unemployment (+0.2pp to +3.5% in the last three months). Yet the risk of exchange rate volatility from AMLO's policy fluctuations remains: On April 16 he ordered ministers to ignore his predecessor's education reform, bypassing its constitutional validity. There is also potential volatility due to trade and migration policy in the US and Pemex's financial situation. Hence, we do not see an interest rate cut on the agenda until the fall.

Europe

Bulgaria: A good start to the year

Seasonally adjusted industrial production grew by +1.5% m/m in February, following a +3.6% m/m increase in January (which however benefited from a low base after -2.1% m/m in December 2018). In working-day adjusted y/y terms, industrial output growth accelerated to +6.6% in February from +2.6% in the previous month, driven by a +9.1% y/y rise in manufacturing. Noteworthy, the recovery in the automotive industry continued in February, with output up by +12.8% y/y (after +4.5% in January). These figures point to a good start into the year and support our full-year 2019 GDP growth forecast of +2.8%. The latter will be a moderate slowdown from the +3.1% GDP expansion in 2018 which was entirely driven by domestic demand. Consumer spending rose by +6.4% last year, public spending by +4.7% and fixed investment +6.5%. Meanwhile, exports contracted by -0.8% while imports grew by +3.7% so that net exports made a negative contribution of -2.9pp to 2018 growth.

Africa & Middle East

South Africa: Power-strapped economy

Just 3 weeks before the next general elections, the ANC dominance is expected to remain - and economic stagnation as well. The mother of all the bottlenecks is access to power (electricity output was cut by -4.4% since 2011). Affordability is structurally poor and deteriorated even further since 64% of the production capacity was available in Q1 (75% is the long-term average). Eskom will need fresh cash in order to improve access to power, a burden that will be at least partially met by public finance. The fiscal deficit should deteriorate to -5% of GDP in 2019 and public debt is expected to reach 60% of GDP by year-end. Moreover, low power supply is also cutting growth prospects, particularly in power-intensive mining and manufacturing sectors (with likely output q/q decreases by -2.5% and -1.5% in Q1 respectively). As a result, the Q1 GDP is expected to post another negative figure to about -0.5% (18H1 was already a recession) and 2019 growth to be capped at +1% (-0.5% per capita).

Asia Pacific

India: Turning up?

It is election season in India. The 2019 Lok Sabha elections started on April 11th and by the end of May, the country will have a new government. Opinion polls put Prime Minister Modi as the favorite, but he faces tough opposition from Rahul Gandhi, president of the opposition Indian National Congress party. These elections come in at a crucial time for India. January and February 2019 data were not encouraging yet it seems that economic conditions have improved slightly in March. Exports increased in March (+11.0% y/y after +2.4%). Disinflationary pressures have receded with wholesale prices rising +3.2% y/y in March (after +2.9% y/y). Credit conditions have improved with two policy rate cuts since the start of the year. Fiscal policy has turned accommodative as the government announced measures such as direct cast transfers and tax relief for households ahead of the election. In this context, we expect economic growth to be robust in FY2019-20 at +7.1%.

What to watch

- April 19 – Japan March inflation figures
- April 22 – Lithuania March industrial production
- April 22 – Turkey April consumer confidence
- April 22 – Brazil April Business confidence
- April 22 – Taiwan March export orders
- April 22 – Colombia February monthly activity index
- April 23 – Poland March retail sales
- April 23 – Mexico March unemployment rate
- April 24 – Poland April business confidence
- April 23 – Ukraine March industrial production
- April 24 – Germany April ifo business climate index
- April 24 – France April business confidence
- April 24 – South Africa Q1 consumer confidence
- April 24 – Argentina March trade balance

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