Euler Hermes Economic Research

Weekly Export Risk Outlook

28 August 2019

FIGURE OF THE WEEK

-0.1%

Q2 2019 q/q GDP decline in Germany

In the Headlines

Germany: Flirting with recession

After a relatively good start to the year, the German economy has gone in reverse gear. In the second quarter, seasonally adjusted GDP shrank by -0.1% q/q. A sharp decline in exports (-1.3% q/q) and a setback in construction investment (-1.0% q/q) proved sufficient to bring the German economy to its knees, despite continued positive consumption impulses (+0.2% q/q). In view of the subdued outlook for world trade and the German automotive industry coupled with lingering elevated political uncertainty around trade, Italy and Brexit, at best mini-growth rates can be expected in the coming quarters. It is particularly worrying that the weakness in industry is increasingly affecting domestic demand as suggested by leading indicators and sentiment surveys. After all, the German economy has so far been kept afloat primarily by private consumption and construction investment. Due to the very weak start to the third quarter, the risk of a recession is now at a high level.

U.S.: Data still weak, trade war drags on

Manufacturing picked up in July but still remains in a downtrend. New orders for durable goods gained +2.1% m/m to a tepid +1.0% y/y rate. But critical core orders, a proxy for business investment, gained only +0.4% m/m and are down -0.5% y/y, the most in almost three years. Consumer confidence rose +0.7 point m/m, but the crucial spread between assessments of the present vs. future opened up from -58.5 points to -70.2 points, a level associated with recession. Housing prices in 20 major cities were flat in June falling to +2.2% y/y, the slowest in almost seven years, while volatile sales of new homes fell -12.8% m/m. Fed Chair Powell last Friday indicated that the Fed would be ready to act if uncertainty over a trade war continued to weigh on the economy. The same day the trade war did indeed worsen as China and the U.S. both imposed new tariffs and exchanged heated words. The Fed is quite likely to cut rates in September and perhaps even once more in 2019.

UK: Brexit – A last-minute extension of Article 50 (again)?

A no-confidence vote in PM Boris Johnson's government is very likely to be called in the week of 03 September as the opposition wants to avoid a "no deal" scenario on 31 October. Given his weak majority (one seat if the 10 DUP MPs support him) and in the absence of a change in his Brexit hard stance, we believe he would lose the confidence vote. This would give him 14 days to form another government or try to win another confidence vote. There is a high chance that this process ends up with a cross-party majority and general elections (and potentially also a second referendum). Hence, this would favor an approval of another extension of Article 50 by the EU, probably until Q3 2020. However, we continue to give a 40% probability to a no-deal scenario. The high level of uncertainty disturbs the well-functioning of the UK economy. Looking at declared company intentions, contingency stockpiling should accelerate in Q3 before causing another GDP contraction in Q4 (-0.3% q/q). Consumers are also preparing for a no-deal since Q1. Hence, downside risks to our +1% real GDP growth forecast in 2020 have increased.

France: Defying gravity is off the cards

France should post higher growth than Germany in 2019: +1.2% vs. +0.8%. French growth is partly driven by specific factors such as a strong increase in purchasing power (+3% in 2019), a booming construction sector and an impressive job/business creation. We expect +270,000 new jobs in 2019 and business creation to increase by +100,000 units compared to 2018. However, business conditions deteriorated visibly during the last months, as a result of external shocks. The IHS Markit PMI of the European car sector fell to 35 points, indicating a crisis-like context which was driven by a -15% y/y change in the car production in Germany in Q2 2019. As a result, French exporting sectors of intermediate goods to Germany saw a decrease of their order books and higher inventories. Adding to that, French households continued to save, making the private consumption evolution somewhat disappointing despite a strong fiscal impulse. For all those reasons, France should continue to post about +0.2/0.3% q/q growth per quarter until year-end.

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Countries in Focus

Americas

Argentina: Debt restructuring ahead, if not default

Primary elections, which serve as a barometer for the presidential election, unexpectedly showed that the center-right incumbent Mauricio Macri trailed 15pp behind Alberto Fernández, the Peronist opposition candidate who has recently harshly criticized the deal the IMF struck with the government. This prelude to Macri's defeat in October's elections (now the most likely outcome) has heightened the risk of policy discontinuity in times of painful austerity and rebalancing, hence startling investors. The ARS fell as low as 58.8:1 vs. the USD on 14 August, down -30% from a week earlier, before stabilizing around 55.7:1. Along with the spike in yields, this has markedly worsened public debt dynamics and sovereign risk. Thus, the recession is here to stay as the slow H2 recovery will be averted. In addition, a debt default or restructuring seems likely: it would either be required by the IMF as a condition for the last disbursements of the two-year credit line or triggered by the failure to retain IMF support.

Europe

Russia: Faltering

The economy continues to stumble. First estimates indicate that real GDP grew by a disappointing +0.9% y/y in Q2, only slightly up from +0.5% in Q1. Details are not available as yet. But a deceleration of retail sales growth from +1.9% y/y in Q1 to +1.5% in Q2 and +1% in July suggests that private consumption is a source of weakness. External demand is also weak. USD-denominated, nominal exports of goods and services shrank by -6% y/y in Q2. Meanwhile, the RUB lost half of the strength it had gained in H1 2019 (+10% vs. the USD) in August, after the U.S. announced at the start of the month new sanctions banning U.S. banks from taking part in the primary market for Russian sovereign Eurobonds, though the -9% fall in oil prices in August to date may have also played a role. The RUB weakening may refrain the Central Bank of Russia from further monetary easing at its next meeting in early September, after it cut its policy rate by a cumulative 50bp to 7.25% in June-July. Euler Hermes is likely to revise down its full-year GDP growth forecast to +0.8% for 2019, followed by +1.4% in 2020.

Africa & Middle East

Egypt: Walk like an Egyptian

Egypt joined other Emerging Markets in easing its monetary policy, after a strong disinflation (8.7% in July y/y, down from 14.1% in May). The appreciation of the EGP since early 2019 (+8%) eased the job, as assets in EGP were used by carry traders (high interest rates, low currency volatility). Lower inflation was expected (core inflation was below 10% during the last 15 months) but not that rapidly since subsidy cuts were assumed to have a longer-lasting inflationary impact. Real interest rates are still quite high (5.5%) despite the -150bp easing; hence there is room for further cuts. Lower inflation is also good for private consumption (quite weak during the last three years) and should ease public and corporate debt service (the debt duration is quite short, about two years).The investment cycle in infrastructure is expected to be reinforced, as debt arrears to foreign oil companies were reduced to USD900mn in June. Altogether, these positive evolutions should bring economic growth to +6% in 2020.

Asia Pacific

Hong Kong: A trade hub feeling the pain of trade tensions

The economy expanded by just +0.6% y/y in Q1 and +0.5% in Q2 2019, a marked deceleration from growth of +3% in 2018 as a whole. The slowdown was broad-based. Private consumption increased by a meagre +0.7% in H1 2019 and fixed investment dropped by -9.7%. What's more, external trade activity declined – with exports of goods down by -4.7% and imports by -5.9% – clearly reflecting shrinking demand from mainland China amid escalating U.S.-China trade tensions. However, some relief for the economy may come from two sources: (i) The shift to monetary easing in the U.S. is positive for Hong Kong's financing conditions and should provide a boost to the property market. (ii) Mainland China's fiscal stimulus is set to become stronger in the coming months and this could support a mild recovery of Hong Kong's exports. Overall, we forecast full-year growth of +0.9% in 2019 and +1.4% in 2020. Ongoing social unrest – which so far does not seem to have affected financial markets – poses a downside risk to these forecasts.

What to watch

- August 29 – Brazil Q2 real GDP growth
- August 29 – Eurozone August business and consumer confidence
- August 29 – France July consumer spending
- August 29 – U.S. Q2 GDP preliminary estimate
- August 30 – Canada Q2 and June GDP
- August 30 – Croatia, Estonia Q2 GDP
- August 30 – Eurozone August inflation rate
- August 30 – Spain July retail sales
- August 30 – UK August GfK consumer confidence
- August 30 – U.S. July personal income and consumpt.
- September 2 – Brazil, Mexico August manufact. PMI
- September 2 – Turkey, Serbia Q2 GDP
- September 3 – Nigeria Q2 GDP
- September 3 – U.S. August ISM manufacturing index

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