

Euler Hermes Economic Research

Weekly Export Risk Outlook

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FIGURE OF THE WEEK

62.4%

ANC's share of the votes in South African general elections

In the Headlines

Ukraine & Russia: Exit from crisis appears increasingly difficult

Separatist activists in Ukraine's eastern Donetsk and Luhansk regions declared independence on 12 May, claiming that around 90% of voters backed such a move in referenda held the day before in the cities and towns controlled by the separatists in these regions. The vote was condemned as illegal by the interim government in Kiev and by western governments, but Russia said it respected the outcome and called for the results to be "implemented", despite President Putin's suggestion from last week to postpone the referenda. These developments, as well as escalating violence in east Ukraine, indicate that the situation has taken on a dynamic of its own that neither Kiev nor Moscow can now control. Therefore it has become increasingly unlikely that the presidential election scheduled for 25 May can be held in the whole of Ukraine and if it is not nationwide it would deny the newly-elected president legitimacy. An exit from the crisis appears increasingly difficult to engineer. Meanwhile, western governments alerted the Kremlin that Russian attempts to undermine the election in Ukraine will bring about "phase three" of sanctions, extending penalties beyond individuals and companies to economic sectors.

U.S.: Weak retail sales

Retail sales increased by a weaker-than-expected +0.1% m/m in April, after a sharp +1.5% in March. Winter weather and the Easter holiday period make comparisons difficult but, over the past three months and on an annualised basis, autos sales increased by +13.4%, while sales of all other retail goods increased by only +3.5% (compared with a long-term average of +4.6 %.). Core retail sales contracted by -0.1% in April, suggesting that Q2 GDP will be weak. Winter weather adversely affected productivity in Q1, but on a y/y basis it improved by +1.4% while unit labour costs increased by only 0.9% (below inflation). The inventory/sales ratio in March was down at both the wholesale and retail levels but the Small Business Optimism survey improved to 95.2 in April, the highest since October 2007, although still below the long-term average of 100. Meanwhile, Fed Chair Yellen said it could take 5-8 years for the Fed's balance sheet to return to "normal," reflecting the fact that excess reserves/GDP before the financial crisis averaged +0.03%, compared with +14.8% currently.

Eurozone: All eyes on the ECB in June

During last week's monthly press conference, ECB President Mario Draghi made clear that the bank will loosen monetary policy in June saying that 'the governing council is comfortable with acting next time'. An updated outlook for eurozone inflation will be published in early June and the ECB forecasts for GDP growth in 2014 and 2015 are likely to be lowered somewhat, from +1.1% and +1.4%, respectively (EH expects +0.9% and +1.3%). While few hints about what action the ECB will take in June were given, EH expects further interest rate cuts (refi rate and/or deposit rate to negative) as a first step and deeper unconventional measures such as purchase of private assets in Q3/Q4 (for further analysis see our latest Economic Outlook and our Economic Insight 'FAQ on Deflation Risk in the Eurozone'). Indeed, the ECB is sceptical that quantitative easing as soon as June will lead to increased bank lending to the real economy as banks need to show improved financial strength within the Asset Quality Review (AQR) and Stress Tests, results of which will be published in October/November. However, recent reports suggest that the ECB could announce a package of targeted measures to support SMEs as soon as June – a move that EH sees as very positive.

South Africa: Now comes the hard part

As expected, the ANC won the 7 May general elections, winning 62.4% of the national vote (65.9% in the 2009 poll) and retaining control of eight out of the country's nine provinces. The main opposition party, the Democratic Alliance, increased its share of the vote to 21.9% (17.58% in 2009) and held on to the province of Western Cape. A new opposition party, the radical left-wing Economic Freedom Fighters won 6% of the vote. President Jacob Zuma will therefore be re-elected for a second five-year term and there are hopes that, with a renewed mandate, his new government will be able to implement the National Development Plan, a broad-based 20-year economic strategy that aims to create 11 million new jobs, improve the regulatory environment for businesses (including a lower tax base) and investors, liberalise labour markets and extend transport and energy provision. However, this will be challenging, given current low educational standards, confrontational labour relations, skewed income distribution and fiscal and current account deficits.

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Americas



Argentina: GDP revision (conveniently) cut economic growth

On 9 May and in response to last year's censure by the IMF for misreporting economic data, the National Institute of Statistics released a new series of GDP statistics, using a base year of 2004 to replace the previous one of 1993. According to this revision, annual GDP growth averaged +5.1% between 2005 and 2013, which is around one percentage point below the previous data. GDP growth in the first three quarters of 2013 was cut to +3.5% y/y (previously +5.3%). Also, preliminary data for Q4 2013 suggest that economic activity grew by +1.4% y/y, which allowed the government to maintain its estimate of +3% GDP growth for 2013 as a whole, making it more credible. Indeed, a few weeks earlier, the authorities cut 2013 growth estimates from +4.9% to +3%, which conveniently allowed them to avoid paying around USD3 billion in GDP Warrants (payments that are to be made if GDP growth surpasses a threshold, which was set at +3.22% for 2013).

Europe



Baltics: Flash estimates of Q1 GDP growth point to loss of momentum

In **Latvia**, Q1 real GDP growth was stable at +0.7% q/q but slowed to +2.8% y/y (+3.6% in Q4 2013). On the production side, Q1 growth was driven by a surge in construction (+25% y/y) and moderate increases in retail trade (+2.6%), other services (+3%) and manufacturing (+1%), although total industry declined by -2% y/y. **Lithuania**'s Q1 GDP growth eased to +0.6% q/q (+1.2% in Q4) and +2.9% y/y (+3.4% in Q4), mainly reflecting a -6.8% y/y decline in industrial output stemming from a sharp -28.7% fall in energy production at the country's sole refinery (Orlen Lietuva). That fall is assumed to be unrelated to the Ukrainian-Russian crisis but rather to be caused by large corporate losses in 2013. In **Estonia**, Q1 real GDP contracted by -1.2% q/q (+0.2% in Q4) and -1.9% y/y (+0.3% in Q4), pulled down by declines in the transport, real estate, energy, electronics and chemicals sectors. EH reduced its 2014 growth forecasts to +3% for both Latvia and Lithuania and +0.5% for Estonia.

Africa & Middle East



Ethiopia: A rising star?

Recently announced sovereign credit ratings by global agencies may indicate that international capital markets will be tapped, possibly for infrastructure financing. At the very least, the ratings draw attention to Ethiopia, a country with a domestic market of around 98 million people, GDP of almost USD50 billion and with an economy that recorded annual average growth of +9.7% in the period 2003-12. However, the country remains poor in annual per capita terms (USD500), records a structural current account deficit, foreign exchange reserves remain low and there are geo-political risks arising from neighbouring Eritrea, Somalia, Sudan and South Sudan. Accordingly, Ethiopia is a frontier market in a challenging region but foreign direct investment is likely to increase, particularly now that the ratings are in place. EH expects GDP growth of around +8% in 2014 and in 2015 (+7.7% in 2013).

Asia Pacific



China: Towards stabilisation

Trade data show encouraging signs. The trade surplus increased to USD18.5 billion in April (USD7.7 billion in March), with exports up by +0.9 y/y (-6.6% in March). Excluding exports to Taiwan and Hong Kong, which introduce distortions because of a strong base, the data are even better as exports were up by +10.2 y/y. Domestic activity indicators are less upbeat, showing stabilisation in industrial production and retail growth (+8.7% y/y and +11.9% in April, respectively). Moreover, credit figures suggest that attempts to curtail shadow banking need to be ongoing. Total social financing (a broad measure of credit), decreased in the first four month of 2014 (- 9.8% y/y) driven by a fall in non-bank credit components, especially trust loans. New bank loans remain resilient (+6.8% y/y). Economic activity is set to remain in low-growth mode in the short-term, before a modest pickup in H2 supported by rising external demand and a favourable policy mix, bringing overall growth to +7.5%.



What to watch

- May 15 – EU & Eurozone Q1 GDP first estimates
- May 15 – US April industrial production
- May 15 – Croatia April CPI
- May 15 – Japan Q1 GDP preliminary
- May 16 – Eurozone March trade balance
- May 16 – Japan March industrial production
- May 16 – US April housing starts & permits
- May 18 – Israel Q1 GDP annualised
- May 20 – Japan monetary policy statement
- May 20 – UK April inflation data
- May 21 – UK April retail sales
- May 21 – Eurozone May consumer confidence indicators
- May 21 – South Africa April CPI

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