

Euler Hermes Economic Research

Weekly Export Risk Outlook

18 June 2014

FIGURE OF THE WEEK

USD113.5

Barrel price of benchmark Brent oil (+7.6% y/y)

In the Headlines

France: Fiscal targets challenging but labour costs finally falling

The '*Cour des Comptes*' (national auditors) issued a report warning that the government's fiscal deficit target of -3.8% of GDP in 2014 will be challenging to reach and that it may even exceed the -4% mark if GDP growth disappoints. Furthermore, the '*Cour des comptes*' also stressed that the target of EUR50 billion spending cuts for 2015 looks ambitious, given that some of the planned cuts will be difficult to implement. The report also notes that, since 2003, the government has regularly overestimated the growth rate in income tax revenues and underestimated the rise in public spending. All in all, this report confirms that France will probably miss its fiscal targets in forthcoming years. EH expects -3.9% of GDP in 2014 and -3.3% in 2015. It is also worth noting that EH's GDP growth forecasts are lower than those of the government: +0.7% in 2014 (compared with +1%) and +1.2% (+1.7%). Meanwhile, the labour cost index (including social charges) fell -0.5% q/q in Q1, which is only the fifth quarterly fall since 1998 and reflects lower social charges associated with the implementation of the 'CICE'.

Argentina: Default risk

On 16 June, the U.S. Supreme Court refused Argentina's appeal against the ruling that it is required to reimburse around USD1.33 billion to some of its creditors. When Argentina defaulted in 2001 on almost USD100 billion in bonds, the country reached agreement with most bond-holders to restructure 93% of its debt, representing a 70% loss on the debt's face value. However, the "vulture" funds contested the agreement and demanded full reimbursement of the debt (plus interest) and, in 2013, the New York Court found in their favour. Argentina must pay the holdouts in full before it can make repayments to other bondholders, whose next instalment is due on 30 June. Although Argentina warned about a new risk of default if it had to submit to the reimbursement to these hedge funds, President Kirchner tried to reassure markets that the country would not default and that a negotiated solution would be found. The authorities are currently trying to swap their overseas bonds into local jurisdiction to ensure holders of restructured bonds keep getting paid. The U.S. Supreme Court decision could have even more consequences as it could incite other investors to go back on agreed restructurings and claim full reimbursement. Furthermore, the IMF expressed concern about consequences for other countries struggling to service their debts, as investors will have more restricted incentives to participate in any debt restructuring.

Japan: Abe's third arrow – getting clearer

The government unveiled a 120-page "Strategy for Reviving Japan" in which it presents key policy steps to provide sustainable growth. This follows the first and second policy "arrows" (fiscal stimulus and ultra-loose monetary policy) with the overall aim of moving Japan out of deflation and increasing GDP growth. Abe's third arrow (structural reforms) is also intended to address demographic challenges, as well as foster economic recovery. The strategy, which will soon be presented formally, includes reforms that will favour female participation in the labour force through establishment of after-school programmes for an additional 10,000 school-age children and modification of the tax and pension systems, which are currently less favourable to working women than to those that stay at home. Moreover, to further boost the labour force, the Abe government is considering easing (i) rules on foreign workers and (ii) working rules for white-collar employees. In addition, the authorities announced that the current government pension investment fund will be reorganised to be more competitive. Overall, if effective, these changes will assist in augmenting growth, with a medium-term target of annual GDP expansion of +2%.

Greece: Entering a positive trend after six years of crisis

The rate of GDP contraction is easing, reaching -0.9% y/y in Q1. Private consumption was up by +0.7% y/y in Q1, the first increase since the start of 2010, while exports accelerated strongly (+5.4% y/y) with a fourth consecutive quarter in positive territory. EH expects this positive trend to continue as domestic activity starts to show visible signs of a pick-up. However, "mind the gap" in the short-term: (i) high deflationary pressures are visible (since March 2013) and prices are expected to continue to fall in 2014 (-0.6% after -0.9% in 2013) and to stabilise in 2015 (+0.1%); (ii) the governing coalition appears weak; and (iii) with the end of the IMF/EU programme will new debt relief/a third bailout be required? All in all, EH expects GDP growth will stabilise in 2014 (0%), after six years of recession, and grow moderately in 2015 (+0.8%). The improvement in business sentiment and progressive pick-up in economic activity should lead to a fall in the number of business insolvencies in 2015 (-4%) after a moderate rise in 2014 (+3%). Even so, business insolvencies will remain three times higher than in 2007.

EULER HERMES
Our knowledge serving your success

Countries in Focus

Americas



U.S.: Mixed data

In May and for the second consecutive month, consumer price inflation was stronger than expected, up by 0.4% m/m, the highest rate in 21 months, and 2.1% y/y. Over the past three months, food prices increased by a sharp 5.1% annualised rate and energy prices by a strong 4.4%. Even without food and energy, inflation was 1.9% y/y. May retail sales were slightly disappointing, up 0.3% m/m and only 0.1% ex-auto, while core sales were flat. In real terms, auto sales increased by a very strong 8.3% y/y rate but sales ex-auto were up only 0.7%. Meanwhile, after hopeful signs in April, the housing market disappointed in May, with starts down -6.5% m/m and permits by -6.4%. The NAHB homebuilders' confidence index increased to 49 in June (up 4, the most in a year), but still signifying weak conditions. Industrial output was strong in May, with the overall index up 4.3% y/y (compared with a long-term average of 2.3%) and the manufacturing component up 3.6% (2.5%).

Europe



UK: Weak inflation suggests an accomodative monetary policy to 2015

Inflation fell to 1.5% y/y in May (from 1.8% in April) and reached its lowest point since October 2009. Indeed, inflationary pressures are expected to remain low in the coming quarters reflecting several factors: (i) weak external price pressures, notably from the eurozone where inflation is expected to remain below or close to 1% until 2015; (ii) sterling appreciation; and (iii) moderate wage growth in the short-term in line with the state of the labour market. Corporate margins remain low (32% of value added, the lowest level since 2007), but they should start to recover progressively in line with the rise in productivity. Inflation is expected to remain below 2% until 2015 (EH expects 1.7% in 2014 and 1.9% in 2015). Interest rates should therefore remain at record low levels until Q1-Q2 2015, at least, although risks of an earlier-than-expected upward move cannot be excluded, given recent developments in the housing market.

Africa & Middle East



Iraq: Regional quagmire

The current crisis is not specifically and exclusively a sectarian conflict as the militant extremist group ISIS does not receive undisputed support among Sunni communities. However, sectarian tensions do play an important role in the unfolding problems. While the Shia-led government in Baghdad requires assistance and potential talks about the crisis between the U.S. and (Shia) Iran may assist some wider issues, direct involvement (troops on the ground) of either would probably heighten sectarian tensions across the region. The latter is open to competing hegemonic claims of regional powers, including Iran, Saudi Arabia and Turkey, but also of armed militias and other groupings (including the Kurds, who seek more autonomy). Against this background of rapidly changing regional dynamics, the borders of existing Iraq (and Syria) are not guaranteed. Expect serious disruption to local commercial activity and upward pressures on international oil prices.

Asia Pacific



China: Gaining traction?

Latest data indicate a slight improvement in the economy. Domestic activity indicators show a continuing stabilisation process in industrial production growth (8.8% y/y in May after 8.7% in April) and a limited acceleration in retail sales (12.5% y/y in May from 11.9% in April), suggesting a slight rebound in private demand. The trade surplus increased to USD35.9 billion in May (compared with USD18.5 billion in March), with exports up by 7% y/y (0.7% in March). In order to support economic activity, the government boosted fiscal spending (+25% y/y in May, according to official statements). Moreover, attempts to curb shadow banking are ongoing, with a decrease in non-formal and off-balance sheet components and moderate increase in formal lending (10.5% ytd). Overall, after a low-growth mode in H1, economic activity is set to pick up gradually in H2 supported by rising external demand and a favourable policy mix, bringing 2014 GDP growth to +7.5%.



What to watch

- June 19 – Japan April leading indicator
- June 19 – UK May retail sales
- June 19 – Colombia Q1 GDP
- June 19 – Eurogroup meeting
- June 19 – U.S. May leading indicator
- June 20 – Eurozone April current account
- June 20 – Colombia interest rate decision
- June 20 – Mexico April retail sales
- June 23 – U.S. May existing home sales
- June 23 – Japan June manufacturing PMI
- June 23 – China June manufacturing PMI
- June 23 – Eurozone June manufacturing PMI (prelim.)
- June 23 – Ireland Q1 GDP
- June 23 – Mexico May unemployment
- June 24 – U.S. May new home sales
- June 24 – U.S. April Case-Shiller home price index
- June 24 – U.S. June consumer confidence index
- June 24 – Portugal April current account
- June 25 – U.S. Q1 GDP annualised q/q
- June 25 – U.S. May durable goods orders

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 authorised and regulated by the Financial Markets Authority of France.
© Copyright 2014 Euler Hermes. All rights reserved.

View all Euler Hermes Economic Research online
http://www.eulerhermes.com/economic-research

Contact Euler Hermes Economic Research Team
research@eulerhermes.com

Publication Director
Ludovic Subran, Chief Economist
ludovic.subran@eulerhermes.com