Euler Hermes Economic Research

Weekly Export Risk Outlook

4 December 2014

In the Headlines

FIGURE OF THE WEEK

-45%

Fall of Russian RUB against EUR since end-June

Russia: Oil price slide takes its toll on the RUB and growth

This week, the RUB fell to new record lows against the USD (about 1:54) and the EUR (about 1:67), down by around -60% since end-June against the USD and -45% against the EUR. This came after almost three weeks of relative stability following floating of the currency on 10 November. The renewed fall was triggered by last week's OPEC announcement that it did not intend to cut production to stabilise oil prices. The fall in the global oil price (Brent at USD70/barrel on 4 December, down -38% since end-June) is the main reason for the sharp RUB depreciation since mid-year. Output growth has been more resilient than expected, so far. A flash estimate puts real GDP growth at +0.7% y/y in Q3 (to date, no details and no q/q data are available), only slightly down from +0.8% in Q2 and +0.9% in Q1. Industrial production increased by +2.9% y/y in October (+1.7% y/y in 2014, to date) and the manufacturing PMI edged up to a 13-month high of 51.7 in November (50.3 in October). However, the service sector PMI declined to 47.4 in October (50.9 in September), indicating that the economic slowdown is so far most critical in services that do not benefit from the RUB decline. However, going forward, the currency's slide and lower oil prices, combined with the lagged impact of stepped-up Western sanctions, will have an impact on overall growth. Euler Hermes revised its full-year GDP growth forecasts to +0.2% in 2014 and -1% in 2015.

Greece & the ECB: Pockets of hope

In **Greece**, GDP increased by +0.7% q/q in Q3, up for the third consecutive quarter after falling for 18 consecutive periods. The GDP breakdown shows that private consumption was up by +1.1% q/q and total investment by +1.6% q/q. External trade contributed positively (+1.3pps) with exports increasing by +1.7% q/q and imports contracting by -2.5%. In contrast, public consumption fell by -2.6% q/q and stocks subtracted -0.9pps from overall growth. GDP remains -26% below the Q1 2008 peak. Private consumption is still -25% below the pre-crisis level and companies invest only EUR5 billion (EUR15 billion pre-crisis). The positive economic momentum could be altered by the current tough negotiations of the government and the Troika about the bailout exit and the increased political uncertainty (presidential elections will be held in March 2015). We continue to view a new precautionary credit line (ECCL) the most likely scenario, possibly accompanied by further interest rate reductions/maturity push back on the current bailouts. Indeed, Greece will require a new programme in order to benefit from the ECB ABS purchases. As we expected, the **ECB** did not announce any new measures but explicitly stated that it will look into 'various options of QE' and pursue 'technical preparations' for the implementation of further measures, if necessary. We maintain our call of a QE programme to be announced in Q1 2015 in the form of sovereign bond purchases, but we do not exclude other asset purchases (including corporate bonds).

Brazil: Setting restrictive economic policies

The economy expanded by a meagre +0.1% q/q in Q3, ending the technical recession in H1. Activity in Q3 was driven by a rebound in both investment (+1.3% q/q, after four consecutive quarters of decline) and, in particular, expansion in public consumption (+1.3%) following the presidential elections in late-October. Household spending contracted again (-0.3%), held back by steady high inflation (+6.6% y/y in October) that continues to be above the target range (4.5% +/-1pps). Consequently, the Central Bank decided to increase further the key policy interest rate (SELIC), by +0.5pps to 11.75% (after +0.25pps in October). While re-elected President Dilma Rousseff pledged to combat inflation in her second term, the new Finance Minister, Joaquim Levy, committed to address fiscal accounts. The target is to reach a primary surplus of +1.3% of GDP in 2015 and +2% in 2016-2017, compared with a deficit of -0.3% of GDP recorded in the first 10 months of 2014. While these policies are a first step to address macro-economic imbalances, they will also weigh on overall activity levels. Euler Hermes expects real GDP will stagnate this year and growth will remain below +1% in 2015.

U.S: Recent data point to a firming economy

Real personal consumption increased by +0.2% m/m and a modest +2.2% y/y in October, while disposable income was up +0.1% m/m (+2.5% y/y). Volatile new home sales increased by +0.7% m/m in October, the third consecutive gain, while prices increased strongly, by +16.5% after a -9% drop in September. The ISM manufacturing index fell -0.3 in November but remained at a robust 58.7, while the new orders component improved by +0.2 to a very strong 66.0. The non-manufacturing index was also strong, gaining +2.2 to 59.3 while new orders improved +2.3 to 61.4. Meanwhile, auto sales increased to a 17.2 million annualised rate in November, the second highest since January 2006. Productivity was up in Q3 for the sixth time in seven quarters, gaining +2.3% q/q annualised, while unit labour costs fell for the fourth time in five quarters, by -1%. High productivity helped boost corporate profit margins to 12.7% of GDP in Q3, which is the second highest ratio on record (from Q1 1947).

Countries in Focus

Americas

Uruguay: Inflationary pressures and external weaknesses

Repeating results in 2004 elections, former President Tabaré Vázquez (2004-09) was declared the winner of the runoff presidential election, with 53% of the vote. The Frente Amplio (FA) leftist party retains power but, under President Vázquez, policy is likely to be re-oriented to focus on education and crime. However, there are other pressing issues. On the domestic front, inflation (8.1% y/y in October) continues above the Central Bank's target range of 5% +/-2pps for 2014, despite a tightening in monetary policy. Persistent inflationary pressures are driven by the indexation of wages and pensions based on CPI growth. On the external front, the poor economic performance of top trade partners (Brazil, Venezuela, Argentina and Russia) coincides with fluctuations in key raw material prices (cereal and dairy prices are down, although meat prices are strong). Euler Hermes expects real GDP growth of below +3% in 2014 and 2015, after +3.7% in 2012 and +4.4% in 2013.

Europe

Italy: The laggard of the region, until when?

Italy and Cyprus were the two EU countries to register a second consecutive contraction in GDP in Q3 (Italy -0.1% q/q). GDP now stands -10% below the Q1 2008 peak. Domestic demand continued to contribute negatively (-0.2pps) reflecting almost stagnant household consumption (+0.1% q/q) and contraction in public spending (-0.3%) and total investment (-1.1%), with the latter in decline continuously for 15 quarters. The fall in investment was more pronounced in equipment (-1.1% q/q after -0.8% in Q2) but softened somewhat in construction (-0.9% after -1.1%). Overall, companies now invest EUR18 billion less compared with the pre-crisis period, given very weak demand prospects and continuing tight credit conditions. Net exports contributed positively to GDP growth (+0.1pps) reflecting a moderate expansion in exports (+0.2% q/q) and falling imports (-0.3%). We expect the economy will not return to positive (but weak) growth until 2015 (+0.3%).

Africa & Middle East

Israel: Coalition collapses, elections scheduled

A snap election is scheduled for 17 March 2015, following the implosion of the coalition government of PM Binyamin Netanyahu who sacked two key cabinet ministers (finance and justice portfolios) after accusing them of "acting against the government from within" and alleging that they plotted to overthrow his administration. Israel has a history of fragile coalition governments within an overall stable domestic political system. EH expects that elections will result in a government led by Netanyahu's Likud party with the support of right-wing and ultra-orthodox religious groups. This is likely to keep the broad governance stance as hardline and nationalist – proposed legislation makes Israel the nation state of the Jewish people – at a time of conflict on the streets of Jerusalem and when the international community appears increasingly uneasy with the perceived intransigence of Israel in relation to negotiations with Palestinian authorities.

Asia Pacific

Australia: Sub-trend Q3 growth, but a boost to come

In Q3, the economy continued to record sub-trend growth, with GDP decelerating to +0.3% q/q (from +0.5% in Q2 and compared with a long-term average of +0.8%). Net exports contributed positively to growth (0.8pps) reflecting rising exports and decreasing imports. However, private consumption slowed to +0.5% from +0.8%. Investment, both public and private, contracted (-2.7% q/q). On the supply side, the main contributors to GDP growth were financial services (+0.2pps) and mining (+0.1pps) but construction acted as a drag (-0.2pps). GDP growth is set to improve in the short run supported by improving external demand and gradual increase in non-mining investment growth. The latter will probably be boosted by a more supportive monetary policy in H1 2015 as a result of lower inflation and weak domestic demand and will then contribute to keep growth above +2.5% in 2015 (this is the assumption underlying the budget for FY2014/15).

What to watch

- December 5 – Brazil November CPI & monetary policy
- December 5 – Spain October industrial production
- December 5 – Mexico Nov. consumer confidence index
- December 5 – U.S. November employment report
- December 5 – U.S. October international trade
- December 5 – U.S. October factory orders
- December 8 – Germany & Czech Republic October IP
- December 8 – Japan October current account data
- December 8 – China November merchandise trade data
- December 9 – Mexico November CPI
- December 9 – Czech Republic November CPI
- December 9 – Estonia Q3 GDP details
- December 10 – France & the Netherlands October IP
- December 11 – EU November CPI
- December 11 – Italy October industrial production
- December 11 – Greece September unemployment

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