Euler Hermes Economic Research

Weekly Export Risk Outlook

7 January 2015

FIGURE
OF THE WEEK
+2.8%
EH's forecast of global GDP growth in 2015

In the headlines

World Economy: Slow and steady wins the race?

The world started 2014 with much optimism but it was generally a year of economic disappointment and our expectation is that GDP increased by +2.5%, barely above the +2.4% of 2013. **Global GDP growth** in 2015 should show improvement to +2.8%, the fourth (and hopefully final) consecutive year below +3%, before expanding by around +3% in 2016. We expect growth of the **Advanced Economies** will be +2.1% in 2015, the fastest rate since 2010, with the **U.S.** (+2.9%) outstripping the **Eurozone**, which should finally rise above the +1% mark at +1.1%, the highest in four years. Much divergence remains within the Eurozone core, with **Spain** (+1.8% in 2015) rising at twice the rate of **France** (+0.9%) and **Germany** (+1.3%) a full percentage point above **Italy**, which will finally exit recession (+0.3%). Growth in **Japan** should rebound somewhat from the anaemic +0.1% in 2014, with 2015 bringing further monetary support and corporate tax cuts; we forecast expansion of +1% in 2015. The three main central banks' actions will reflect current economic divergence: U.S. rates are likely to rise, the ECB should begin outright QE and the BoJ to provide continued monetary accommodation. Any change to these actions is likely to be telegraphed and orderly, rather than risking a repeat of the Taper-Tantrum seen in the middle of 2013, although the risk remains of FX volatility to surprise.

Emerging Economies are expected to recover from 2014's subpar GDP growth of +3.8% and expand by +4.1% in 2015. However, there will be two crucial, albeit very different, slowdowns. Firstly **China's** policy-driven slowdown to +7.3% in 2015, compared with +7.4% in 2014, focuses on boosting domestic demand and, crucially, lessening over-investment and excess capacity. By comparison, economic sanctions, capital flight and the near halving of both the RUB and oil prices resulted in **Russian** GDP growth of only +0.2% in 2014, markedly below the 2000-08 average of +7%. We do not see a swift resolution of the current situation and expect the economic issues will be compounded as time passes, resulting in contraction in GDP of -4.5% in 2015 and -4% in 2016. **India's** continued business-friendly focus boosting investment and consumer spending will lift growth to +6.4% in 2015, compared with an average of +7.1% in 2000-07 and +5.8% in 2014. After a flat 2014, **Brazil** is likely to record growth of +0.5% in 2015. Much of Brazil's economic boom during a period of high commodity prices was driven by consumer spending rather than investment in industrial diversification and current low prices give less capacity to address structural weaknesses, while inflationary pressures are likely to result in higher interest rates. In 2015, we expect continuation of existing political minefields, with no resolution in sight in **Ukraine**, continued conflict in the **Middle East** and **Venezuelan** political tensions unaided by lower oil prices. There is also the potential for the elections in the **UK**, **Sri Lanka**, **Turkey**, **Nigeria**, **Burma**, **Argentina** and **Thailand** to throw up some surprises.

U.S.: Consumers driving the economy

The outlook continues to firm as Euler Hermes forecasts +2.9% GDP growth in 2015. Consumer confidence increased by +1.6 to 92.6 in December 2014, above the 90 level indicating a stable economy. It was the third consecutive month above 90 and the fifth in the past six months. The improvement was driven by the present situation component, which reached 98.6, the highest in the recovery. Meanwhile, auto sales recorded their best year since 2006, at 16.5 million units and +5.8% above last year. Pending home sales increased by a strong +0.8% m/m in November 2014 and home prices were +0.8% m/m (+4.5% y/y) in October, the second consecutive monthly gain after four consecutive losses. Both the manufacturing and non-manufacturing ISMs for December 2014 remained in expansionary territory, at 55.5 and 56.2, respectively. However, some details are a cause of concern; manufacturing new orders fell a sharp -8.7 to 57.3, while all 10 of the non-manufacturing components also fell. Producer prices in manufacturing fell steeply in December 2014, to 38.5 (59.5 in October).

Saudi Arabia: What crisis?

Current relatively low oil prices did not prevent this year's (1436/1437, 2015) state budget projecting spending at record levels (SAR860 billion, USD229 billion), with government continuing its expansionary policy, particularly investments in education and health services. With an underlying assumption of an oil price of USD56/barrel, such spending projects a deficit of SAR145 billion (approximately -5% of GDP and easily financed through borrowing or asset utilisation; net foreign assets are over USD720 billion). At the political level, however, King Abdullah's health is again a concern and domestic financial markets are edgy, given succession concerns. EH does not expect a marked policy re-direction in the event of a new head of state, including in terms of oil output.

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Countries in Focus

Americas

Brazil: 2014, a year to forget

Economic indicators continue to disappoint. The industrial production index continues its downward trend (-3.2% y/y in October 2014 and -6.5% since mid-2013) while capacity utilisation fell to a record low of 81% in December, compared with 85% at the beginning of 2014. Inflationary pressures persist (+6.6% y/y in November) and weigh on consumer confidence, which fell close to 2008-2009 lows in December. The external sector is also weak, with 2014 recording the first trade deficit since 2000. Indeed, exports are expected to contract more rapidly than imports, reflecting falling commodity prices (particularly food and agriculture). We estimate the trade deficit reached -USD4 billion in 2014 (compared with a surplus of +USD2.4 billion in 2013), which will widen the current account deficit to around -4% of GDP. Against this background, 2015 looks challenging. Euler Hermes expects real GDP growth of only +0.5% this year, after stagnating in 2014.

Europe

France: Deflationary expectations

In December 2014, household confidence again increased by two points, to 90, the highest level since June 2012 and the first consecutive monthly rise since October 2013. Despite the improvement in their financial situation (past: +6 points; future: +2), households remained reluctant to make major purchases (–2 points). Furthermore, unemployment remains a key concern as the corresponding balance increased by 3 points to 68, markedly above the long-term average (32). Household expectations of rising prices continue to fall: -4 points after -7 points in November 2014, reaching their lowest level since February 2010, again well below the long-term average. Accordingly, even though disinflationary pressures continue to provide a short-term boost to purchasing power, it appears that deflationary expectations are becoming entrenched. Recent data are consistent with our forecast of slightly stronger private consumption in 2015 (+1.1%) and GDP growth of +0.9%.

Africa & Middle East

Sub-Saharan Africa: 2015 roller coaster?

As in 2014, this year will be a busy one for regional presidential and/or legislative elections. **Côte d'Ivoire, Ethiopia, Guinea, Mauritius, Niger, Nigeria, South Sudan, Sudan, Tanzania, Togo** and **Zambia,** among others, are all scheduled to go to the polls, although some elections are yet to be confirmed. Electoral practices in Africa have made progress in recent years but 2014 indicated that political stability is not a given and that recourse to non-ballot box actions persists; events in **Mali**, **Burkina Faso** and, latterly, **The Gambia** suggest that there are continuing risks of political/social disturbances that may limit economic development and disrupt some commercial transactions. Government and electoral systems vary across the region but polls in **Nigeria** (February), the largest economy, will be particularly significant as a sign of regional political maturity; a change in leadership may ensue but how the elections are conducted and the result is received will be the critical factors.

Asia Pacific

India: Still improving

In contrast to some parts of Asia, recent data suggest that industrial output and overall economic growth are strengthening. The manufacturing PMI improved in December 2014 and ended the year at 54.5 (from 53.3 in November), with both domestic and external orders showing strength and, in particular, new orders up to 58.0 and the highest since end-2012. Meanwhile, an index of eight core industries – accounting for approximately 38% of overall industrial output – increased by +6.7% y/y in November 2014, compared with +6.3% in October, reflecting positive developments in infrastructure projects. EH expects further improvement in the short term as business retains confidence in PM Narendra Modi's reform credentials and lower oil prices will moderate inflationary pressures and may promote monetary policy easing. However, if economic reforms are not pursued, confidence in economic management may wane and the rate of recovery slow later in 2015.

What to watch

- January 8 – Brazil November 2014 industrial production
- January 8 – Germany November 2014 factory orders
- January 8 – Eurozone December 2014 sentiment index
- January 8 – Eurozone November 2014 retail trade
- January 9 – Canada December 2014 unemployment
- January 9 – China December 2014 CPI and PPI
- January 9 – Germany November 2014 IP
- January 9 – France November 2014 IP
- January 9 – Spain November 2014 industrial output
- January 9 – U.S. December 2014 employment report
- January 9 – UK November 2014 industrial output
- January 13 – U.S. Nov. 2014 job openings & labour turnover
- January 14 – U.S. December 2014 retail sales