Euler Hermes Economic Research

Weekly Export Risk Outlook

15 January 2015

In the Headlines

FIGURE OF THE WEEK

0.8422

Low reached by EURCHF after SNB removed 1.2000 floor

Germany: Solid growth in 2014

First official estimates indicate that real GDP increased by +1.5% in 2014, following +0.2% in 2013, and above the average of the past 10 years (+1.2%). A recovery in investment and somewhat more dynamic exports (despite an ongoing difficult external environment) drove the rebound. Growth was more balanced between domestic demand, contributing +1.1pps (+0.7pps in 2013), and external demand, which added +0.4pps (-0.5pps in 2013) than in the previous year. Private and government consumption were robust in 2014, with growth picking up moderately to +1.1% and +1%, respectively. Fixed investment increased by +3.1% (-0.4% in 2013), with machinery and equipment up by +3.7% and construction by +3.4%. Export expansion picked up to +3.7% (+1.7% in 2013) while import expansion remained stable at +3.3%. After a dynamic start in Q1 2014, followed by two weak quarters, the economic cycle appears to have stabilised towards the end of the year. Euler Hermes expects this stabilisation to continue and forecasts GDP growth of +1.3% in 2015. Low oil prices for an extended period pose an upside risk to this forecast but deflationary pressures in Europe are a downside risk. A preliminary estimate indicates consumer price inflation at just 0.2% y/y in December 2014, down from 0.6% in November.

Eurozone and UK.: Lower oil prices encourage accommodative policy

In line with the fall in oil prices (-46% since 1 September 2014), **eurozone** consumer prices fell by -0.2% y/y in December from +0.3% in November. However, core inflation (excluding food and energy prices) increased by +0.1pps to +1.3% y/y. Inflation continued to moderate in the four largest economies, reaching the lowest levels since 2009: +0.2% y/y in **Germany**, +0.1% in **France**, 0% in **Italy** and -1.1% in **Spain**. This trend is likely to continue, given Brent oil prices remaining around USD60/barrel in 2015, with weak wage growth (at best) and slow GDP growth. In this context, it is a matter of a few days (22 January) or two months (5 March) until the ECB announces a QE programme that we think will be mainly sovereign bond purchases and possibly followed by private sector bond purchases. Most importantly is the size of this programme. First hints suggest EUR500 billion, which in our view will prove short of reaching the ECB balance sheet expansion target of EUR1000 billion. In the **UK**, low inflation (+0.5% y/y in December 2014, the lowest since the index was created in 1996), and limited upside pressure on core inflation (wages, activity) makes us believe that the BoE tightening cycle will be delayed and we expect it to be announced progressively starting in late Q3, with a risk of drift to Q4.

U.S. Strong job growth brings optimism

The December 2014 employment report was stronger than expected, showing job gains of +252,000 and upward revisions to the previous two releases. As a result, 2014 was the best year for job creation since 1999. Similarly, the Small Business Optimism Index in December increased to 100.4 from 98.1 in November, reaching its highest since October 2006. Eight of the ten components recorded an improvement. The trade deficit in November 2014 declined for the sixth time in seven months, driven by a sharp decrease in petroleum imports, providing a boost to Q4 GDP. Meanwhile, the minutes from the Fed's most recent meeting indicate increased optimism about the economy and with the largest downside risks relating to potential for deterioration in other economies. Seasonal adjustments may explain why retail sales fell sharply in December, since both holiday sales and the Fed's Beige Book indicate robust consumption. One negative note stems from details in the latest labour report as the participation rate fell to a recovery low and the worst since 1978, while hourly wages declined by -0.2% m/m putting the y/y rate at a weak +1.7%, barely above the rate of inflation.

Russia: Heading for a deep recession in 2015

Russia's financial markets experienced a perfect storm in December 2014 as the sharp RUB depreciation in H2 – occurring in line with rapidly falling global oil prices – escalated into a full-blown currency crisis. Exchange rate volatility continues and the RUB stands at 1:66 against the USD, half of its value at end-2013. Downside risks to the exchange rate remain high until the downtrend in oil prices bottoms out. Recently published Q3 real GDP details confirm that seasonally-adjusted q/q growth was flat, as in Q1 and Q2. In light of weak domestic and external demand, private consumption (+1.9% q/q) and building inventories (gross capital formation was up by +14.2% while fixed investment was flat) were the only positive contributors to Q3 growth. Government consumption was down by -0.4% q/q. Exports declined by -0.9% and imports by -1.1%, so that net exports made a negative contribution to Q3 growth. Economic sentiment fell in December, with the manufacturing PMI down to 48.9 (51.7 in November) and the services sector PMI at 45.8 (only slightly up from 44.5 in November). EH expects a deep recession in 2015 (-5.5% of GDP) as the impact of the sharp falls in oil prices and the RUB, as well as existing economic sanctions, take full effect.

Countries in Focus

Americas

Venezuela: Default pressures mount

The fall in oil prices could be the decisive factor in tipping the economy over the edge towards default. It is already mired in recession, subject to electricity and water cuts, inflation is soaring, price and FX controls are in place, there are shortages of imported goods and state interventionism is pervasive. The risk of sovereign default is increasingly real, with FX reserves halved since 2008, to USD22 billion in November 2014, and covering only three months of imports. The external financing position is of increasing concern as the fall in oil prices will shift the current account from a traditional surplus to a deficit of at least -2% of GDP in 2015. With very limited access to international capital markets, China is the main external source of financing, through a system of oil-for-loan agreements. However, financing is now particularly tight, following President Maduro's visits to China and several OPEC members, which had mixed results.

Europe

Switzerland: Caps off

This morning's surprise move by the Swiss National Bank (SNB) to remove the exchange rate floor of EUR1:CHF1.20 saw the pairing move swiftly below the 0.85 mark before settling around parity. Maintenance of the floor had led the CHF to weaken against the USD as a result of continued EUR weakness, one of the reasons cited by the SNB as determining that the minimum exchange rate was no longer justified. The attractiveness of the CHF has accelerated in recent months as expectations of outright QE by the ECB have increased and because global growth concerns persist. Removal of the cap poses downside risks to our +2% GDP growth forecast for 2015 as it will make exports less competitive, particularly as 35% of Swiss exports is destined for markets in Germany, France and Italy. However, we will wait for some stability in the currency markets before reassessing our GDP growth outlook.

Africa & Middle East

Tunisia: Political transition remains on course

Nidaa Tounes, a centrist and secular organisation, won most seats (but not a majority) in legislative elections in Q4 2014 (see WERO 29 October 2014),Beji Caid Sebsi became the country's first freely elected president in December and, this month, Habib Essid was nominated as prime minister. Unlike elsewhere in North Africa, Tunisia's re-positioning as a functioning democracy is based on acceptance of a consensual approach to governance. Even so, challenges remain evident: there is fragility in the political transition, there is a structural social divide between a generally poor, conservative and Islamist south and a more prosperous north and disruptions to tourism earnings and investment have caused economic damage. Stability and security, allowing time for economic regeneration, require a broad coalition government, including members of the popular al-Nahda Islamist party, particularly as both Sebsi and Essid have connections with the overthrown Ben Ali regime.

Asia Pacific

Sri Lanka: Change at the top

Maithripala Sirisena won presidential elections held on 8 January. His victory was by a significant margin, so that incumbent Mahinda Rajapaksa quickly conceded defeat. Until recently, Rajapaksa had seemed likely to extend his period in office to a third term but the electorate was clearly dissatisfied with governance in recent years. The scale of the victory in the elections suggests that the transition will be peaceful, despite the recent polls being marred by violence, but Sirisena's campaign was supported by around 50 political parties and groups, so allocation of ministerial portfolios in a coalition cabinet is challenging. This suggests that, despite his electoral victory, Sirisena may struggle to satisfy the diverse interests that helped him to power. Euler Hermes expects Sirisena will improve Sri Lanka's relations with the west and, if effective and pro-business governance prevails, GDP growth in 2015 and 2016 will remain buoyant at around the ten-year average to end-2014 of +6.6%.

What to watch

- January 16 – Germany December 2014 CPI
- January 16 – U.S. December 2014 CPI
- January 16 – U.S. December 2014 industrial production
- January 18 – Israel Q3 2014 GDP
- January 19 – Japan November 2014 industrial production
- January 20 – Zambia presidential run-off election
- January 20 – U.S. December 2014 housing market index
- January 20 – South Africa November 2014 mining output
- January 20 – China Q4 2014 GDP
- January 20 – China December 2014 industrial production

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