Euler Hermes Economic Research

Weekly Export Risk Outlook

4 February 2015

FIGURE OF THE WEEK

USD57.6

Barrel price of benchmark Brent crude oil (-45.6% y/y)

In the Headlines

Australia & China: Accommodative stance of Central Banks

Central Banks in **Australia** (RBA) and **China** (PBoC) eased monetary policy this week. The RBA cut its key policy interest rate by -25bps, to 2.25%, the first change in 18 months, in order to boost economic activity. Indeed, this decision was made while the government is engaged in fiscal consolidation and as economic activity is showing signs of weakness. Inflation decelerated to 1.7% in Q4 (from 2.3% in Q3) below the 2-3% Central Bank target. The labour market continues to deteriorate (unemployment reached 6.2% at end 2014, compared with 5.9% in January last year). Business surveys still point to subdued activity. Meanwhile, the PBoC cut the Required Reserves ratio (-50bps) for all commercial banks. Selected municipal and rural banks and the Agricultural Development Bank will benefit from an additional rate cut (-50bps and -400bps, respectively).This will help: (i) reduce liquidity tension in the banking system ahead of the Chinese New Year and (ii) support small and rural company activity. Action by **Australia** and **China** comes just a few weeks after **India** (15 January) and **Singapore** (28 January) also eased monetary policy. We expect monetary policy will ease further and this will keep GDP growth rates in 2015 around our earlier forecasts of +7.3% for **China** and +2.6% for **Australia**.

U.S.: Manufacturing stumbles

The Federal Reserve kept interest rates unchanged at its January meeting, reiterating that it will be "patient" and supporting expectations of a mid-year hike. Q4 2014 GDP increased by only +2.6% q/q annualised, slower than expectations, as government spending fell -2.2%. Net exports also subtracted a full -1pps from growth as the strengthening USD boosted imports. Consumption increased by +4.3% over the quarter, but in December 2014 consumption actually fell -0.1% m/m, perhaps due to shifts in patterns of holiday sales. Meanwhile, the manufacturing sector appears to be stumbling. The ISM manufacturing index slipped -1.6, the fourth loss in five months, driving the index down to 53.5 in January from 58.1 in August. The new orders component fell a sharp -4.9, while export orders fell below the 50 level, indicating contraction for the first time in 27 months. Eight of the ten components fell. Similarly, December 2014 factory orders fell a sharp -3.4% m/m, the fifth consecutive loss, while core goods fell at an annualised rate of -10.6% in Q4.

Switzerland: Deteriorated outlook after removal of CHF:EUR cap

Following the removal of the exchange rate floor of EUR1:CHF1.20 by the Swiss National Bank (SNB) on 15 January, the pairing settled around parity for two weeks but has moved to around EUR1:CHF1.05 this week. Assuming that, on average in 2015, the CHF will be some 15% stronger against the EUR than in 2014, Euler Hermes expects a significant adverse effect on exports and output this year. This is supported by the declines in January of the manufacturing PMI to 48.2 (from 53.6 in December 2014) and of the KOF Economic Barometer to 97.0 (from 98.8 in December). Euler Hermes revised its 2015 real GDP growth forecast to +1% from +2% previously. Real exports are likely to decline by -0.1% (forecast at +4% prior to the SNB move) while import growth, which is strongly related to exports, is now expected to come in at +0.7% (+4% before). As a result, the contribution of net exports to the 2015 growth forecast has shifted to -0.4pps (from +0.5pps previously). Private consumption (+2% instead of +1.6%) is likely to benefit somewhat from the CHF appreciation but investment (+0.7% instead of +1.1%) will also be affected.

Denmark: Challenging times

The economy is facing new challenges in the wake of the ECB QE programme announcement. Over the past month, heavy Central Bank intervention was the remedy of choice for combating the appreciation of the krone (DKK). The DNB cut interest rates to record lows three times in the period 19-29 January - by a total of 45 bps, to -0.5%, and announced suspension of government bond sales on 2 February, aiming to limit the inflow of foreign currencies. It is also estimated that the DNB sold DKK106 billion during the month, taking total FX reserves up to DKK564 billion. Measures aimed at holding down the DKK come in response to further depreciation of the EUR following the ECB QE and determination to defend the peg to the EUR. A strengthening DKK compared with the EUR would act as a drag on GDP growth, heavily supported by export activities, with Germany its main trade partner. The economy was already weak, with GDP still -4% below its pre-crisis peak and expected to expand at only a moderate rate in 2015 (+0.9%).

Countries in Focus

Americas

Chile: Economic policies will support growth

Economic activity continues to be subdued. Real retail sales slowed significantly, to +1.2% in 2014, compared with +9.7% in 2013. On the supply side, industrial production contracted by -0.9% in 2014, on average. The mining sector is affected adversely by weakness in the copper industry (20% of GDP). Local copper output fell by -0.4% in 2014 and copper prices declined by -6.4%. Against this background, Euler Hermes estimates real GDP growth of +1.7% in 2014. The economy is likely to recover moderately in 2015 (+2%) because of the fall in oil prices (Chile is a net importer of oil) and the implementation of supportive economic policies. The fiscal budget for 2015 provides for an increase in public investment of more than +25%, while spending on education and infrastructure is projected to increase by over +10% each. The Central Bank also relaxed monetary policy in November 2014, reducing the key policy interest rate to 3%, compared with 5% in September 2013.

Europe

Austria, Belgium & Spain: Q4 GDP points to mixed outlooks

Austria recorded only meagre real GDP growth of +0.1% q/q in Q4 2014, following -0.1% in Q3 and stagnation in Q2 and Q1. Private consumption failed to gain momentum and fixed investment and exports remained a drag on growth, while rising inventories precluded recession. Full-year growth was just +0.3% and Euler Hermes expects only a modest uptick to +0.7% in 2015. In **Belgium**, Q4 GDP growth slowed to +0.1% q/q (+0.3% in Q3). Private consumption is expected to have remained stable, but net exports to have been a drag on growth. Annual GDP growth reached +1% in 2014, the highest since 2011 but still less than half the 2000-07 average. EH expects GDP growth will remain weak in 2015 (+1.1%). **Spain**'s economy gained traction in Q4 2014; GDP increased by +0.7% q/q, bringing full-year 2014 growth to +1.4%, the first positive growth after five years of recession. Economic activity should accelerate further in 2015, to +1.9%, outperforming Germany, France and Italy.

Africa & Middle East

Uganda: Still part of East Africa's regeneration

GDP growth slowed in Q3 2014, to +2.3% y/y compared with +4.1% in Q2, even though the agricultural sector (including cash crops) performed more strongly. Growth in industry (+5.9% after +7.5%) and services weakened. The slowdown in Q3 reflected disruptions caused by the conflict in neighbouring South Sudan and weak momentum in the construction sector (exacerbated by a weak shilling, UGX). These factors are likely to continue in early 2015, at least, and are being compounded by current relatively low oil prices, which will constrain development of the country's hydrocarbons sector. In contrast, and more positively, higher disposable incomes and private consumption because of the lower oil prices will act to support growth, as will low inflationary pressures (CPI of 1.3% y/y in January, markedly below the medium-term target of 5%). Overall, we expect GDP growth of at least +5% in 2015 and in 2016, compared with a ten-year annual average to end-2014 of +6.8%.

Asia Pacific

Philippines: Remaining strong

The economy ended 2014 on a strong note, with Q4 GDP expansion of +6.9% y/y, the strongest rate of growth for five quarters. The marked improvement from +5.3% expansion in Q3 resulted in full year GDP growth of +6.1%. Increasing foreign demand appears to have played the main spur to growth in Q4, with export growth levels remaining positive throughout 2014. Indeed, exports were up +9.9% y/y in Q3 and were even stronger in Q4 at +15.5%, the fastest rate of growth rate since the final quarter of 2010. Government spending increased by +9.8% in Q4 2014, after a contraction of -2.6% in Q3, a positive trend that is expected to continue in 2015. In addition, domestic demand and export growth are forecast to gain strength through this year as a result of a dynamic labour market and improving global demand, leading to our forecast of +6.3% GDP growth in 2015.

What to watch

- February 05 – Egypt January international reserves
- February 05 – UK BoE monetary policy meeting
- February 05 – U.S. December 2014 trade balance
- February 05 – EC winter forecasts
- February 06 – Canada January unemployment
- February 06 – Germany & Hungary Dec. 2014 IP
- February 06 – U.S. January employment report
- February 06 – South Africa January international reserves
- February 06 – Finland pltry. vote of confidence in govt.
- February 09 – Germany December 2014 current account
- February 09 – France BoF January business sentiment
- February 10 – South Africa Dec. 2014 manufacturing
- February 10 – Spain December 2014 trade balance
- February 10 – France & UK December 2014 IP
- February 11 – Estonia Q4 GDP (estimate)

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