Euler Hermes Economic Research

Weekly Export Risk Outlook

25 February 2015

In the Headlines

FIGURE OF THE WEEK

+0.8%

Germany's q/q Q4 2014 consumption growth

Germany: Stage set for moderate recovery

Q4 2014 GDP growth was confirmed at +0.7% q/q, with the main contribution coming from consumption (+0.8% q/q), supported by a one-off benefit from lower oil prices. Construction investment increased strongly in the last quarter (+2.1%) reflecting the impact of a mild early winter and, similarly, growth of equipment investment was positive (+0.4%). Net exports contributed +0.2pps to Q4 2014 GDP growth. After strong growth in Q1 2014 (+0.8%) followed by two stagnant quarters (-0.1% in Q2 and +0.1% in Q3), the pick-up in economic activity in Q4 gives credence to our core scenario of a moderate overall recovery; EH expects full year GDP growth will accelerate to +1.7% in 2015 from +1.6% in 2014. Private consumption is likely to remain the major growth contributor, supported by the introduction of minimum wages in Q1 2015 and positive impetus from QE. With a moderate recovery in global trade, net exports are expected to contribute around 0.5pps to GDP growth. However, private sector investment will be muted because of ongoing uncertainties (including Eurozone growth and geo-political hotspots) and social policies (minimum wages and pension reforms) will weigh on margins.

Greece: Temporary agreement, more time to negotiate

The Eurogroup agreed with the first list of reforms that the government submitted on Monday, a pre-condition of the four-month bailout extension. The current bailout expires on Saturday. The reforms include: action to limit corruption, tax evasion and bureaucracy; delay in introducing a minimum wage; further measures relating to pensions and to privatisation; and pledges to implement stricter control of public spending. Eurogroup approval is a prerequisite for disbursement of the remaining EUR7.2 bn of the bailout, but endorsement by several Eurozone parliaments (including the Bundestag) is required by this weekend. Negotiations with the Troika are scheduled to be finalised by the end of April. Greece now has time to negotiate the conditions of a new programme (a precautionary credit line, ECCL), which we expect in July (around EUR11 bn of financing needs in Q3) accompanied by further debt relief at the end of the year in the form of frozen interest payments on EU and IMF loans, for a limited period of time, and longer loan maturities (see also EH's analysis Economic Insight).

U.S.: Some downbeat data, but Fed upbeat and patient

Producer prices fell a very sharp -0.8% m/m in January (-0.1% y/y), but the decline was driven by a large -10.3% fall in the energy price index, which has fallen for seven consecutive months. Stripping out the volatile energy and food components, producer prices still fell -0.1% m/m, to a +1.7% y/y rate. Consumer confidence fell a sharp -7.4 to 96.4 in February after improving by +10.7 in the previous month. January housing data declined as starts fell -2% m/m, permits fell -0.7% and existing home sales fell a sharp -4.9%, the most in four years. It was the second decrease in three months for all three measures. However, prices as measured by the Case-Shiller index did gain +0.9% m/m in December 2014. Both the headline and manufacturing components of industrial production gained a modest +0.2% m/m in January, putting y/y rates at +4.8% and +5.6%, more than double their historic averages. Fed Chair Janet Yellen gave a more upbeat assessment of the economy but reiterated patience and indicated that the decision to increase interest rates is unlikely for "the next couple" of meetings.

Eurozone: Flash PMI a winning hand for Europe?

February's flash PMI Composite Index beat expectations by +0.5 points to reach 53.5 (52.6 in January) as both services (+1.2) and manufacturing (+0.1) improved, to 53.9 and 51.1, respectively, with all three PMI scores at seven-month highs. This is in line with our euro-area Q1 GDP growth estimate of +0.3%, and the job creation index is at its joint-highest level since the global financial crisis. **France's** services PMI of 53.4 (+4 points) was a major contributor, but the country's manufacturing sector moved deeper into recession territory (a two-month low of 47.7). **Germany's** services PMI increased strongly (+1.5 points to 55.5), compensating for stagnation in manufacturing, with that PMI remaining unchanged (50.9). Although manufacturing gains were unimpressive, February brought the sharpest increase in new orders since August 2014, which also lifted the new orders-to-inventory ratio to a seven-month high, suggesting that manufacturers will increase output in coming months. EH expects the Eurozone's outlook will strengthen through the year, resulting in GDP growth of +1.2% in 2015.

Countries in Focus

Americas

Mexico: Growth gained traction in Q4 2014

GDP growth gained traction in Q4 2014 (+0.7% q/q, +0.5% in Q3), bringing overall 2014 growth to +2.1% (+1.7% in 2013). Positive contributions from manufacturing (+0.7pps) and services (+1.7pps) more than offset contraction in gas and oil extraction activities (-0.3pps). The hydrocarbons sector is negatively affected by weak oil prices and declining oil output (2.4 mn barrels/day in 2014, compared with 2.5 mn in 2013 and 3.5 mn in 2006). Lower oil prices will be particularly challenging for public finances as oil receipts account for 35% of total revenues. Accordingly, the government decided to cut the 2015 budget by nearly 3%, which will impair progress of infrastructure projects. However, foreign exchange reserves are comfortable (covering five months of imports) and will limit the impact of lower oil prices. The manufacturing sector will continue to benefit from a recovery in the U.S. economy in 2015. Overall, Euler Hermes expects real economic activity will accelerate moderately in 2015.

Europe

Turkey: Further policy easing should be viewed with caution

OnTuesday, the Monetary Policy Committee (MPC) lowered its key policy one-week repo interest rate by 25bps to 7.5%, following a 50bps cut in January, and also cut the overnight borrowing rate (by 25bps to 7.25%) and lending rate (by 50bps to 10.75%). The easing was explained by credit growth at reasonable levels, expectation of further declining inflation and improvement in the current account balance. Indeed, private sector credit growth slowed to +18.5% at end-2014 and inflation decreased to 7.2% y/y in January. However, after moderating for most of the year, the current account deficit widened again sharply in the last two months of 2014, taking the full-year shortfall to -USD46 bn (around -5.7% of GDP). Moreover, since the January interest rate cut, the TRY has lost -6% against the USD and reached a new record low of 1:2.50 in mid-February. There is a risk that too quick monetary policy easing will undermine exchange rate stability and the disinflation process.

Africa & Middle East

Morocco: Roc on!

In its latest assessment, the IMF acknowledges that macro-economic stability has been maintained, despite a challenging environment, but the Fund also notes that fiscal and external vulnerabilities (fiscal and current account deficits of -4.9% and -5.8% of GDP in 2014, respectively) need to be addressed to strengthen growth and job creation. GDP growth slowed in 2014 (+3% following +4.4% in 2013), reflecting relatively weak agricultural output after an exceptional harvest the previous year, and weak demand in key markets in Europe. The Fund forecasts growth of +4.4% in 2015, in line with EH's expectation of +4.5%. As external demand improves, output increases from newly developing sectors (including aeronautics and autos) and import costs are limited by weak oil prices, growth should be maintained at such levels (ten-year annual average to end-2014 of +4.2%) in to the medium term, subject to regional stability issues, thereby generating commercial opportunities.

Asia Pacific

Singapore: A forward thinking Robin Hood?

This week, changes to the 2015 budget were announced that largely focus on reducing income inequalities, but also suggest a fundamental economic shift. The government intends to raise taxes on the rich (+2% income tax for the top 5% earners) and support the middle class and most disadvantaged within the population, particularly those in retirement on low incomes. Benefits for the latter groups will accrue from improvements to public transport, lower education costs, decreasing the tax burden and providing further direct financial support to pensioners. In addition, the government has toned down policies that limit hiring of foreign workers and will add to funding for (and access to) R&D grants. This suggests that Singapore is seeking to build a more innovative economy through supporting domestic demand, improving productivity growth and building resilience against China's slowdown. EH expects GDP growth will accelerate moderately to +3.4% in 2015 (from +2.9% in 2014).

What to watch

- February 26 – Germany February unemployment
- February 26 – Japan January CPI
- February 26 – Japan January unemployment
- February 26 – U.S. & Canada January CPI
- February 26 – U.S. January durable goods orders
- February 27 – Germany February CPI
- February 27 – Austria & Czech Rep. Q4 2014 GDP
- February 27 – UK Q4 2014 GDP (2nd estimate)
- February 27 – Croatia Q4 2014 GDP (preliminary)
- February 27 – U.S. Q4 GDP (2nd estimate)
- February 26 – U.S. January pending home sales
- March 02 – U.S. January personal incomes
- March 02 – U.S. February ISM manufacturing

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