Euler Hermes Economic Research

Weekly Export Risk Outlook

18 March 2015

In the Headlines

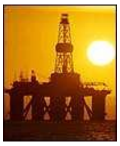
FIGURE OF THE WEEK

20%

UK's rate of corporate tax from 1 April

UK: New cut in corporate tax to stimulate investment

Starting 1 April, the rate of corporate tax will be cut by a further 1pps, to 20%, the lowest level in the G-20. This move will have seen corporate tax reduced by 10pps from 30% in 2009, when the first cut was implemented. This will free some additional cash for companies, while further stimulating domestic and foreign investment through higher rates of return. A down trend in inward FDI was reversed from 2009 and, since then, USD91 bn (3.5% of GDP) of capital has been attracted. The government is also aiming at a broader simplification of the tax system and announced a GBP200 mn investment in introducing fully-digital tax accounts by 2016, which is expected to reduce the burden on business by GBP250 mn each year. The government also reiterated a target to strengthen relationships with emerging markets and announced a near doubling of funding for UK Trade and Investment (UKTI) activities in China. Moreover, the UK will be the first Western economy to be part of the Asian Infrastructure Investment Bank (AIIB) aiming to support projects in Asia in sectors such as transportation, energy, telecoms and agriculture. Food, electronics, vehicles and machinery are likely to remain leading export sectors.



Latin America: Oil price effect will drag down regional growth

Euler Hermes estimates that lower oil prices will negatively impact Latin American trade and fiscal balances and shave -0.4pps from regional real GDP growth (see our Economic Insight February 2015). The effects vary sharply across the region. While net oil importers (including **Chile** and **Central America**) will benefit from the lower prices, oil exporters will be challenged. Among the latter, **Mexico** and **Colombia** appear likely to be able to smooth negative spillovers to the real economy because of their significant reserve accumulation in recent years. The outlook is gloomier for **Venezuela** and weaker oil prices are likely to reduce its growth by -3pps, deepening the recession, with GDP declining by -7.5% in 2015, at least. Overall, the effect of relatively lower oil prices coincides with weakness in other commodity markets while China's slowdown and lingering sluggish demand elsewhere will continue to weigh against export volumes. We expect regional growth will fall to +0.5% in 2015, after an estimated +0.9% in 2014.

Ireland: Peaking, but remaining on a positive trend

In 2014, GDP growth was stronger than expected at +4.8%, mainly driven by net exports. However, GDP growth slowed to +0.2% q/q in Q4 2014, with export growth at +1.2% q/q, the slowest pace since Q3 2013. In contrast, domestic demand is gaining strength, with private consumption up by +1.3% q/q, the strongest growth since Q1 2011, helped by improving consumer confidence and falling unemployment (10% in January 2015, -2pps over one year). Ireland is one of the main winners from the lower EUR through higher exports (particularly as a result of strong demand from the U.S. and the UK, accounting for 40% of Irish exports) but also through higher corporate margins (+1.4pps in 2015 to 56% of value added), coupled with lower oil prices and easier financing conditions resulting from the ECB programme of QE. Going forward, GDP growth is likely to remain driven by the external sector, but assisted by more domestic demand. We expect GDP growth will reach +3.7% and +3.5% in 2015 and 2016, respectively.

Israel: Bibi bounces back

Exit polls after yesterday's parliamentary elections showed the vote was going to be close. It was also the case that whoever won would have to forge a coalition as the political landscape is fragmented under a system of proportional representation, with neither incumbent PM Binyamin (Bibi) Netanyahu's centre-right Likud or Isaac Herzog's centre-left Zionist Union able to achieve an outright majority in the 120-seat legislature. In the event, pre-election polls showing a slight advantage to the Zionist Union were overturned and Likud prevailed, with around 30 seats (the final tally is not yet available) in a relatively high turnout compared with 2013. Now comes the hard part as the state president calls on Netanyahu to form a workable coalition. Security issues featured heavily in Netanyahu's campaigning, particularly the perceived regional threat posed by Iran. Expect forging a coalition to be time consuming and current policies towards Iran and the Palestinians (and somewhat frosty relations with the U.S. administration) to continue. We retain our GDP growth forecasts of around +3.5% in 2015 and 2016.

Countries in Focus

Americas

U.S.: Weakness all around

Retail sales in February fell for the third consecutive month, by -0.6% m/m (compared with expectations of +0.3%) and increased by only +1.7% y/y. Even after stripping out volatile auto and gasoline trades, retail sales fell -0.2% m/m. Consumer sentiment fell a sharp 4.2 to 91.2 in February as both the current conditions and future expectations components declined. March industrial production increased by only +0.1% m/m, dragged down by a third consecutive contraction in manufacturing (-0.2%). Capacity utilisation fell to 78.9% in February, the lowest since February 2014. Meanwhile, the housing market index fell -2 to 53 in March, affected by a lack of foot traffic and housing starts fell a sharp -17% in January, although driven down by a -57% decline in the north-east as a result of record snowfalls. Also disconcerting is the impact of weaker energy prices, which helped drive headline producer prices down to -0.7% y/y, while the core rate of only +1% was the weakest since May 2013.

Europe

Russia & Ukraine: Monetary policy adjustments

The Central Bank of **Russia** (CBR) lowered its key policy interest rate by 100bps to 14% last week, following a 200bps cut in February, even though inflation continued to rise to a 13-year high of 16.7% y/y in February. This suggests that the CBR shifted its focus from inflation targeting to address concerns about the banking sector and economic growth. The RUB improved to around 1:61 against the USD from a 2015 low of 1:70 at end-January, but renewed oil price weakness could revive downward pressure. The National Bank of **Ukraine** hiked the key policy rate by 1050bps to 30% in early March as inflation surged to 34.5% at end-February. Moreover, the UAH fell to an all-time low of 1:30 against the USD as FX reserves dropped to just USD4.7 bn. Meanwhile, USD:UAH recovered to 1:22 (still down -60% y/y), perhaps as a result of the IMF approval last week of a new USD17.5 bn funding facility. Euler Hermes expects deep recessions in **Russia** (-5.5%) and **Ukraine** (-8%) in 2015.

Africa & Middle East

Egypt: Summit happening?

The economic summit at Sharm el-Sheikh on 13-15 March achieved some of its aims. USD60 bn was pledged in investment and loan facilities and a further USD12.5 bn was promised in aid from the GCC. Care needs to be used in relation to these headline numbers as the pledges include non-binding memos of understanding, some previously-announced projects and, as with many pledges, actual inflows are likely to be somewhat below expectations. However, hosting the summit was intended to show that Egypt is back in business and seeking commercial partners and investments. To that extent, the pledges are partly a vote of confidence in the current regime. We expect GDP will increase by +4% in 2015 and +4.5% in 2016, compared with only an annual +2% in 2011-14, but much depends on maintenance of domestic stability and further improved security, particularly in the Sinai. The risk outlook has improved but fragilities remain evident.

Asia Pacific

Japan: Need for further monetary easing?

Despite lower oil prices, the trade deficit increased in February, to –JPY638 bn from -JPY412 bn in January. In volume terms, total exports decreased by -2.1% y/y (from +11.1% in January) as a result of a fall in exports to other Asian countries (-3.4% y/y), while imports increased by +4.6%, with an increase in shipments from other Asian economies (+11.4% y/y). In value terms, the product breakdown reveals that imports excluding energy accelerated in February (electronic products +13.9% y/y). The trade data come at a time of still sluggish inflation. Excluding the effect of last year's increase in sales tax, core inflation (the BoJ's key measure) only increased by 0.2% y/y in January (far less than the 2% inflation target of the BoJ) and deflation in coming months cannot be excluded. Against this background and only slow recovery in domestic demand, we expect the BoJ will ease policy further in Q2 to bring inflation close to 1% in FY2015/16.

What to watch

- March 19 – U.S. Q4 2014 current account
- March 19 – EU leaders summit meeting begins
- March 20 – Canada February CPI
- March 23 – U.S. February existing home sales
- March 23 – Qatar & Jordan Q4 2014 GDP
- March 24 – U.S. February new home sales
- March 24 – Hungary monetary policy meeting
- March 24 – U.S. February CPI
- March 25 – South Korea Q4 2014 GDP

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