Euler Hermes Economic Research

Weekly Export Risk Outlook

5 November 2014

In the Headlines

FIGURE OF THE WEEK

28%

Cumulative fall of the RUB against the USD from mid-2014

Russia: Monetary action unlikely to contain the RUB's slide

The Central Bank (CBR) today limited its daily foreign exchange interventions to USD350 million – markedly below levels recorded in recent weeks – in an attempt to increase exchange rate flexibility and "to hamper prerequisites for speculative strategies against the RUB". This followed continued selling pressure on the RUB even after the CBR increased its key policy interest rate by 150bps to 9.5% at its regularly-scheduled meeting on 31 October, which aimed at stabilising the RUB and dampening inflationary expectations. The depreciation of the RUB accelerated recently as a result of falling global oil prices, which come at the same time as the phase 3 sanctions imposed on Russia by the U.S. and the EU in Q3. The RUB fell by 9% against the USD in October, taking the cumulative fall since mid-2014 to 28% (18% against the EUR). Meanwhile, CPI inflation has continued to pick up, to 8.4% y/y at 27 October (8.1% y/y in September), mainly as a result of rising food prices, which have been fuelled by the weakening RUB and the import ban on most food products by western countries. By the end of the year, Euler Hermes expects the RUB will fall further, by around 10% against the USD, and inflation will reach 9% and, against that background, another increase in interest rates of around 50bps may be felt necessary.

U.S.: End of QE…

As expected, the Federal Reserve ended its QE programme, but took a slightly more-hawkish tone in its policy statement, noting "solid job gains" and "generally diminishing" labour market under-utilisation. Q3 GDP growth was somewhat stronger than expected at a +3.5% q/q annualised rate, but the headline figure is misleading as part of the gain came from what are likely to be temporary factors: a +16% increase in defence spending and the first fall in imports in six quarters. Consumption, which accounts for around two-thirds of GDP was once again anaemic at +1.8% q/q, markedly below the +3.3% long-term average, and the real disposable personal income needed to fuel that consumption was also weak at +2.7% q/q. Other negative news came from the trade deficit, which increased to –USD43 bn in September from -USD40 bn in August, which will pressure the next GDP revision closer to +3%. On a more positive note, the ISM manufacturing index rebounded sharply in October to 59.0, driven by the new orders component, which increased strongly to 65.8 and both measures are now significantly above the 50 level indicating expansion. Meanwhile, Republicans now control both houses of Congress for the first time in this presidency, perhaps providing scope for political compromise.

Japan: … but as one door closes another opens

During its latest monetary policy committee, the Central Bank (BoJ) surprised the markets by announcing further monetary easing. The decision was validated in a tight 5-4 vote by BOJ board members. The main announcements were that the BOJ plans to increase its monetary base at an annual rate of JPY80 tn (from 60-70 tn) and annual government bond purchases will increase to JPY80 tn from 50 tn. The latest policy action demonstrates that the authorities have the firm intention of getting inflation close to the official target (2%) and keeping growth on track. Moreover, this action is likely to compensate partly the effect of the sales tax increase by improving domestic credit conditions and boosting export volumes. However, the extent of the positive stimulus depends on: (i) household confidence as individuals have recorded deterioration in purchasing power with the sales tax increase; (ii) commodity prices as they weigh on trade performance; and (iii) PM Abe's decision regarding the sales tax next October. Against this background, we expect GDP growth will remain limited at +1.1% in 2014.

Brazil: Economic policy challenges

Last week, the Central Bank unexpectedly increased the key interest rate (SELIC) by 25bps to 11.25%, after six months without change. This decision, which was not unanimous within the membership of the Monetary Policy Committee (5 voted in favour of an increase and 3 to maintain rates on hold), is a positive first step towards curbing inflation, which continues to be above the target range (+6.7% y/y in October). Although newly re-elected President Dilma Rousseff pledged to combat inflation in her second term, it remains to be seen whether the government is ready to implement the structural reforms needed to redress underlying rigidities in the economy, including through appropriate fiscal policies. In the first nine months of 2014, the budget deficit was -BRL225 bn (-5.9% of GDP), a 15-year record, while the primary balance went into deficit for the first time. The economic outlook remains weak overall and Euler Hermes expects real GDP will stagnate this year and growth is likely to remain below +1% in 2015, driving business insolvencies higher.

Countries in Focus

Americas

Uruguay: Coming up to round two

Former President Tabaré Vázquez (2004-2009), representing the current Frente Amplio (FA) ruling party, won most votes (47%) in the 26 October first round presidential elections. Since the 50% threshold was not reached, Vázquez will enter a run-off vote on 30 November against Luis Alberto Lacalle Pou of the National Party (31% in the first round). The current President José Mújica - despite popularity, having eschewed presidential perks and most of his salary - cannot run because of constitutional limitations. He contrasts strongly with Lacalle Pou who, while perceived as capable of curbing government spending and rising crime levels, is unlikely to succeed because of his background. Vázquez is the favourite to win the runoff, benefitting from a good reputation, having seen strong GDP growth during his previous term. While GDP growth moderated from 2012, inflation remains high at 8.4% y/y in September, above the 3-7% target, a leading policy issue for the incoming president.

Europe

Ukraine: Outlook remains high risk

One week after orderly parliamentary elections were held in most of Ukraine, the separatist-controlled areas of Donetsk and Luhansk conducted their own presidential and parliamentary elections on 2 November. All candidates and parties supported the separatist line. While Russia recognised the results, Kiev and the west denounced the rebel votes as illegitimate. President Poroshenko proposed cancellation of a law granting greater autonomy for the regions. Currently, the fragile peace process that took effect in September appears very much at risk. Meanwhile, flash estimates from the Ukrainian statistical office indicate that Q3 real GDP contracted by -2.1% q/q and -5.1% y/y. This follows -4.7% y/y in Q2 and -1.1% y/y in Q1. Industrial output was affected particularly adversely, declining by -16.7% y/y in Q3, taking the fall in the first nine months to -8.6% y/y. Euler Hermes expects further output deterioration in Q4 and full-year 2014 GDP will contract by around -5.5%.

Africa & Middle East

Burkina Faso: Leadership change with regional lessons

Burkina Faso is considered a relative development success and became a regional peacemaker and security partner of the west, particularly France and the U.S. However, an attempt by President Blaise Compaoré to extend presidential term limits sparked mass protests and forced him to stand down last week. With factions in the military competing for power, continuing demonstrations and condemnation by regional and international agencies of a perceived forced regime change, there is now considerable uncertainty. Neighbouring Mali provides a salutary lesson in the dangers of a power vacuum and of the strength of regional jihadi forces, but Burkina Faso's transition may yet be successful. People power (as in the Arab Spring, as well as Burkina Faso) is now a potent force using modern communication systems and other long-standing African leaders – Compaoré was in power for 27 years – may now reconsider their own positions when it comes to renewing mandates.

Asia Pacific

Indonesia: Q3 GDP growth dampened by exports

GDP growth decelerated to +5% y/y in Q3 and, as expected, exports were the main drag, declining by -0.8%. Consumption proved resilient (household +5.4% and government expenditure +4.4%) but private investment decelerated slightly. On the supply side, the mining sector remains the main drag on growth, affected by downward pressure on commodity prices. The latest indicators point to GDP growth remaining below potential in the short term and with only a gradual recovery. Exports are likely to remain restricted by slowing Chinese demand and weak commodity prices and domestic demand growth is likely to be limited by a cautious policy mix. Monetary policy is set to remain hawkish to limit the current account deficit and preserve financial stability. Moreover, with a new leadership pledging better fiscal management (including subsidy rationalisation), a large fiscal stimulus is unlikely. We expect GDP growth of +5.1% in 2014 and +5.6% in 2015.

What to watch

- November 6 – Eurozone ECB deposit and refi rates
- November 6 – UK September industrial production
- November 6 – Egypt October international reserves
- November 7 – U.S. October employment report
- November 7 – Canada October unemployment
- November 7 – France & Germany Sept ind production
- November 7 – Spain September industrial production
- November 7 – Brazil, Mexico & Chile October CPI
- November 7 – Germany September external trade
- November 10 – Romania Sept industrial production
- November 11 – South Africa Sept manufacturing output
- November 11 – Romania & Hungary October CPI
- November 12 – Hungary September industrial production

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