Euler Hermes Economic Research

Weekly Export Risk Outlook

12 November 2014

FIGURE OF THE WEEK

5.8%

U.S. rate of unemployment in October

In the Headlines

Russia & Ukraine: Exchange rate turbulence

In **Russia**, after a week of bold steps aimed at halting the fall of the RUB (see WERO 5 November 2014: Monetary action unlikely to contain the RUB slide) the Central Bank (CBR) announced on10 November the final step in setting the currency free to float by abolishing any trading band and stating that it will only intervene in the FX market in the event of systemic threat to financial stability. Moreover, the CBR limited banking sector RUB liquidity, which should constrain speculation on the currency. In the near term, the float will make the path of the RUB less predictable and create additional volatility in the exchange rate (as observed over the past week). However, given the greater uncertainty created for speculators, the RUB should at some point stabilise at an exchange rate justified by market conditions. The CBR moves should also help to limit the drain of its FX reserves, which have been depleted by USD86 billion since end-2013, although they are still comfortable at USD383 billion (10 months of import cover). In **Ukraine**, the UAH was in free fall over the past week (down -22% against the USD) after the announcement that official FX reserves had fallen by -22% in one month, to USD11.6 billion at end-October (1 month of import cover). External liquidity risk will remain very high.

U.S.: Continued moderate job growth

The employment report for October showed that the economy created a moderate +214,000 jobs, somewhat below expectations of +240,000. However, repeating a now common pattern, the previous two months were revised up significantly, by +31,000. Unfortunately, there has been little wage growth accompanying the jobs, as average weekly earnings have barely outpaced inflation. Unemployment fell to 5.8%, the lowest in 6 ½ years, but much of the decline since the recession ended has been due to a falling participation rate as discouraged workers left the labour force. Nonetheless, job gains have been averaging +230,000 per month this year, the best of the recovery. Similarly, the ISM non-manufacturing index showed a strong gain in the employment component, rising +1.1 to 59.6, the third highest reading on record, and markedly above the 50 level indicating expansion. Overall, the index slipped -0.5 but remains at a strong 57.1. Productivity outpaced expectations and increased at a +2% annualised rate in Q3 and Q2 was revised up +0.6pps to a strong +2.9%.

Eurozone: The door for QE increasingly opens

In line with expectations, the ECB maintained the status quo on interest rates, leaving the refi at 0.05%, deposit rate at -0.2% and marginal lending facility at 0.3%. Of note, the ECB officially introduced the target of an increase in the balance sheet (equivalent to an additional EUR1 trillion in liquidity) and disclosed that if current measures fall short of this target and medium-term inflation expectations deteriorate further (from already record lows), then new measures may be introduced. The ECB acknowledges that risks are skewed on the downside and this is likely to be confirmed by Q3 GDP data this Friday (EH expects GDP will be flat overall). The latest ECB meeting reinforces our view that new measures are likely as soon as Q1 2015, with a risk of a delay into Q2. Indeed, the TLTRO operation on 11 December is expected to disappoint (only 47% of the banks want to participate, similar to September) while covered bonds and ABS purchases would not fill the money gap. The new measures could take the form of corporate bond purchases and/or sovereign bond purchases on the secondary market (OMT type of operation). Potential market for sovereign bonds (EUR6 trillion) and corporate bond purchases (EUR1.3 trillion).

Zambia: No longer copper-bottomed?

President Michael Sata died in office at the end of last month and although the constitution provides contingency plans for this – the deputy president becomes acting leader and elections are to be held within 90 days – it is unclear who will ultimately succeed Sata, given that the caretaker president, Guy Scott, is barred from standing. The ruling Patriotic Front will elect a new party leader and presidential candidate but opposition parties will provide a severe test in the upcoming elections. In the interim period, policy implementation is likely to be largely on hold and there is a risk of violence between rival supporters of political parties and with the security forces. Zambia is Africa's second largest copper producer and mining accounts for around 70% of export earnings. Production is unlikely to be curtailed but investment plans, already disrupted by tax disputes, plans to increase royalty payments and weak commodity prices, are likely to wait for clarity of policy direction. GDP growth, with an annual average of +7.8% in the ten-year period to end-2013, may dip but is likely to remain high.

Countries in Focus

Americas

Argentina: Still in the shadows

The economy continues to deteriorate, with import and FX controls creating a scarcity of imported industrial inputs - output fell by -2.2% y/y in September, the 13th month of contraction - and high inflation (23.8% in September) limiting consumption. In addition, uncertainty regarding the negotiations with the vulture funds continues to weigh on investor confidence, despite recent statements from the Minister of Economy, Axel Kicillof, who reiterated that "it is possible" to reach an agreement by next January when the RUFO clause expires. The stock exchange (MERVAL) has fallen by over -20% since the last peak in late-September, while the relative stability of the peso (at around 8.5 ARS:1USD) is achieved only through the regular intervention of the central bank in the FX markets, which erodes foreign exchange reserves. Against this background, and given ongoing latent political tensions, Euler Hermes expects the risk of non-payment will remain elevated in the short term.

Europe

Baltic States: Growth slows as exports to Russia fall

Q3 real GDP growth decelerated across the Baltic states, to +2.7% y/y (+0.4% q/q) in **Lithuania**, to +2.1% y/y (+0.4% q/q) in **Latvia** and to +2.1% y/y (+0.2% q/q) in **Estonia**. In addition to weak external demand from the EU, reduced trade with Russia is a main contributor to the slowdown in the Baltic region. In **Estonia**, nominal exports of goods to Russia decreased by -12% y/y in Q3 (-9% in Q1-Q3). Exports from **Latvia** to Russia fell by -15.1% y/y in Q2 (-6.5% in H1). Exports of **Lithuanian** goods to Russia decreased by -12.8% y/y in Q1-Q3, although total exports to Russia increased by +9.1% y/y as a result of the large share of re-exports (88%) of non-Lithuanian goods in the total. Sectors showing strong increases of (re-)exports include machinery and equipment, optical and precision instruments and pharmaceuticals. Euler Hermes expects full-year 2014 growth of around +3% in Lithuania, +2.3% in Latvia and +1.5% in Estonia.

Africa & Middle East

South Africa: Policy shift?

The Treasury lowered its GDP growth forecast for 2014 to +1.4% (much in line with our +1.5%). The outcome will be the lowest growth since the recession in 2009. Partly reflecting this, Moody's rating agency downgraded its sovereign assessment by one notch, to Baa2, also citing a deteriorating investor climate and dependence on external capital, although it changed its outlook to stable from negative. However, fiscal management remains prudent, with the medium-term budget projection (MTBP) suggesting that spending cuts and higher taxes will lower the budget deficit from over -4% of GDP to around -2.5% by 2017. The recently announced plans for a privatisation drive will help in this regard and also provide finance for the electricity provider Eskom and thereby assist in limiting power outages. Sales of non-core assets have reportedly already been discussed but whether these will be acceptable to the full ANC tripartite alliance (including labour unions) remains to be seen.

Asia Pacific

China: External trade remains the growth driver

Recent indicators continue to point to a fragile outlook and external trade remains the main driver of growth. Exports and imports increased by +11.6% y/y and +4.6% y/y in September, respectively, and the export surplus remained high (USD45.4 billion). However, as in other recent data, the trade figures may suggest over-invoicing problems as data for exports and imports vary from statistics released by trade partners, particularly Hong Kong, Taiwan (Chinese export figures) and South Korea (imports). Excluding these countries, China's trade data suggest a pickup in exports reflecting rising external demand. On the domestic front, a continuing slowdown in import growth suggests that demand lacks momentum and there is downward pressure on prices, with inflation stabilising at a low level for the second consecutive month, reflecting weak commodities prices. Against this background, we expect the PBOC will implement further monetary easing in the near term.

What to watch

- November 13 – U.S. September JOLTS survey
- November 13 – ECB survey of professional forecasters
- November 13 – China October industrial production
- November 13 – France & Germany October CPI
- November 13 – Japan September capacity utilisation
- November 13 – South Africa September mining output
- November 14 – U.S. October retail sales
- November 14 – EU & Eurozone Q3 GDP (first estimate)
- November 16 – Israel Q3 GDP
- November 17 – Japan Q3 GDP
- November 17 – Eurozone September trade balance
- November 18 – Germany November ZEW survey
- November 19 – Eurozone September current accounts
- November 19 – UK BoE minutes

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