Euler Hermes Economic Research

Weekly Export Risk Outlook

19 December 2013

FIGURE OF THE WEEK

52.1

Eurozone December composite PMI (up from 51.7 in November)

In the headlines

US: Tapering to be phased in from January

The Fed will begin tapering its monetary stimulus programme, Quantitative Easing (QE), in January by reducing monthly purchases of Treasuries and Mortgage-Backed Securities by USD5 billion each, to USD40 billion and USD35 billion, respectively. The Fed cited "cumulative progress toward maximum employment and the improvement in the outlook for labor market conditions" as the rationale for tapering, which will continue in "measured steps" if the economy develops as expected. These expectations for the end of 2014 include GDP of 2.8-3.2%, unemployment of 6.3-6.6% and inflation of 1.4-1.6%. While tapering suggests tightening, the Fed also offered more stimulus with new forward guidance on keeping 0% interest rates "well past the time that the unemployment rate declines below [6.5%], especially if projected inflation continues to run below… [2%]." Fifteen of 17 Fed members predicted that this will not happen until 2015, or later. Meanwhile, there was a rebound in the housing market, with the latest Housing Market Index up 4 points and starts in November increased by 30% y/y.

Eurozone: Closer to recovery, but improvement is slow

The composite PMI improved to 52.1 in December from 51.7 the previous month. The manufacturing PMI increased for the sixth consecutive month, to 54.8 (from 53.1), and at the fastest rate since April 2011. This was mainly led by strong growth in order books, particularly exports. The services PMI stabilised at 51.0 as new business growth remained modest because of weak domestic demand. PMI data suggest that GDP could increase by around +0.2% q/q in Q4. Divergence in PMI data at a national level remains evident, with activity in Germany expanding at a rapid rate (the highest since H1 2011) and with the manufacturing PMI increasing to 57.5 (from 54.9) and the services PMI moderately worse at 54.0 from 55.7. In contrast, there was acceleration in the weakening in output in France, with the manufacturing PMI down to 45.3 (from 48.0), a seven-month low, and the services PMI stable at a six-month low (47.4). Data for the rest of the region will be available on 2 January.

Ukraine: Bail-out by Russia provides short-term relief

Anti-government protests that were triggered by a decision on 21 November not to sign an EU Association Agreement continued into a fourth week. The government announced an aid agreement with Russia on 17 December that includes (a) Russia buying USD15 billion of Ukrainian government bonds and (b) reducing import prices for Russian gas by around 33% to USD268.5 per 1,000 cubic metres. Ukraine's commitments are still undisclosed and there is conflicting information on the timeframe of the gas price discount, with Ukraine suggesting "until 2019" and Russia a "temporary deal to be reviewed periodically". The deal reduces substantially the risk of sovereign default before the next presidential election, scheduled for January 2015. However, as the USD15 billion will be used almost entirely to fund the government's financing needs, it will not support FX reserves, which currently cover only two months of imports or one third of all external debt payments falling due in 2014. The current account deficit will narrow in 2014 but remain large at around 6% of GDP. Overall, the deal should also reduce the risk of a disorderly currency crisis in the near term, but a currency depreciation or devaluation at some point in 2014 cannot be ruled out entirely. Pro-European protests are likely to be reinforced by the deal with Russia and may continue for some time, but they are unlikely to lead to a fall of the government.

Turkey: Downside risks remain on the agenda

At its last regularly scheduled meeting of 2013, the central bank left its key policy one-week repo rate unchanged at 4.5%, keeping to PM Erdogan's pledge not to increase interest rates in 2013. Both ends of the overnight interest rates were also kept constant, at 3.5% and 7.75%, respectively. Nonetheless, monetary policy was tightened through reducing the maximum level of funding provided via one-week repo auctions, aimed at limiting rapid credit growth and narrowing the current account deficit. On the political front, media attention is focusing on the arrest of the sons of three cabinet ministers in connection with a high-profile bribery case. There is speculation that the arrests may be linked to a dispute between PM Erdogan and an influential cleric and former supporter of the PM, thus indicating a serious fault-line within the ruling AKP. Downside risks of political tension ahead of municipal and presidential elections in 2014 may weigh against the already high vulnerability of financing flows.

NOTE: WERO is taking a break. The next issue will be 8 January 2014.

Countries in focus

Americas

Mexico: Energy sector opens to private and foreign investment

On 11 December, Senate approval of an energy sector reform bill (ratified by the House of Representatives the next day) opened the hydrocarbon industry to private and foreign investment. The law allows the entry of private equity firms into the industry and ends 73 years of nationalisation in the sector. A broad range of contracts for extraction of hydrocarbons now specifies allocation details for profits, output and licensing. The law also includes the creation of an oil savings sovereign fund (Mexican Petroleum Fund for Stabilization and Development) to manage oil earnings, which will be used to finance current expenses, the budget, pension liabilities and science investment projects. The bill allows private generation of electricity, but not its distribution. The overall reforms are expected to attract significant levels of investment in the country and to improve the efficiency of Pemex (the state-owned petroleum company), which has recorded significant losses in the past five years.

Europe

Hungary: Moderate economic recovery to continue

Q3 real GDP growth accelerated to +0.9% q/q from +0.4% in Q2 and to +1.8% y/y from +0.5% in Q2, largely as a result of recovering investment and exports. Following six quarters of y/y contraction, private consumption was flat in Q3, while government consumption continued to expand, by a robust +4.4% y/y (+5.5% in Q2). Fixed investment increased by +8.2% y/y (+5.4% in Q2). Export expansion picked up to +6% y/y (+3.5% in Q2), outpacing imports, which increased by +5.8% y/y (+5.5% in Q2), so that net exports contributed +0.7pps to Q3 growth (-1.4pps in Q2). EH expects the gradual recovery to continue in the next few quarters, resulting in full year growth of around +0.6% in 2013 and +1.5% in 2014. As inflation remained at a record low 0.9% y/y in November, well below the 3%±1pps target range of the central bank, the latter lowered its key policy interest rate by another 20bps to 3% this week, the 17th consecutive cut since August 2012.

Africa & Middle East

Tunisia: Transition update

On 14 December, opposing political forces agreed jointly to the selection and appointment of Mehdi Jomaa, formerly the industry minister, as the new caretaker PM, with a mandate to oversee a period that will ratify a new constitution and then lead to parliamentary and presidential elections in 2014. In effect, an Islamist-based administration has agreed to stand down so that the electorate can have another opportunity to express its preference through the ballot box. Political transition is proving difficult but, unlike elsewhere in the region, there appears to be a greater willingness to compromise and seek consensus. Even so, stability and security, particularly in the country's hinterland and along the Algerian border, remain fragile. EH expects GDP growth of around +3% this year and +4% in 2014, with clear downside risks if the transition fails to move forward, which could potentially lead to disruption to financial and other assistance from the IMF and the GCC.

Asia Pacific

Japan: 17th month of trade deficits

The trade balance in November widened to –JPY1.29 billion, registering the 17th consecutive monthly shortfall. Indeed, nominal exports increased more slowly (18.4% y/y) than imports (35.1%), reflecting sharp increases in imported mineral fuels (30.6% y/y) and electrical machinery (22.2%). The trade balance continues to remain negative with (i) all the main commodity exporters, particularly in the Middle East (-JPY1,151 billion) and Oceania (-JPY263 billion) and (ii) also with Western Europe (-JPY127 billion). In addition to exchange rate factors, adverse economic effects also stem from the shutdown of the nuclear industry after the 2011 disasters. EH expects the trade balance to remain negative in H1 2014, reflecting a temporary boost in domestic demand before the rise in the sales tax, as well as a continuing high energy import bill. From mid-year, the trade deficit should start to narrow benefitting from a slowdown in domestic demand. EH expects GDP growth will ease to +1.6% in 2014 from +1.9% this year.

What to watch

- December 19 – Ireland Q3 GDP (1st estimate)
- December 20 – Madagascar presidential election
- December 20 – Canada November CPI
- December 20 – UK Q3 current account
- December 20 – UK Q3 GDP (final)
- December 20 – US Q3 GDP annualised (3rd estimate)
- December 21 – Mauritania parliamentary elections
- December 24 – Saudi Arabia Nov. foreign assets
- December 31 – Latvia to adopt the EUR
- December 31 – Israel Q3 GDP
- December 31 – Egypt Q3 GDP

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