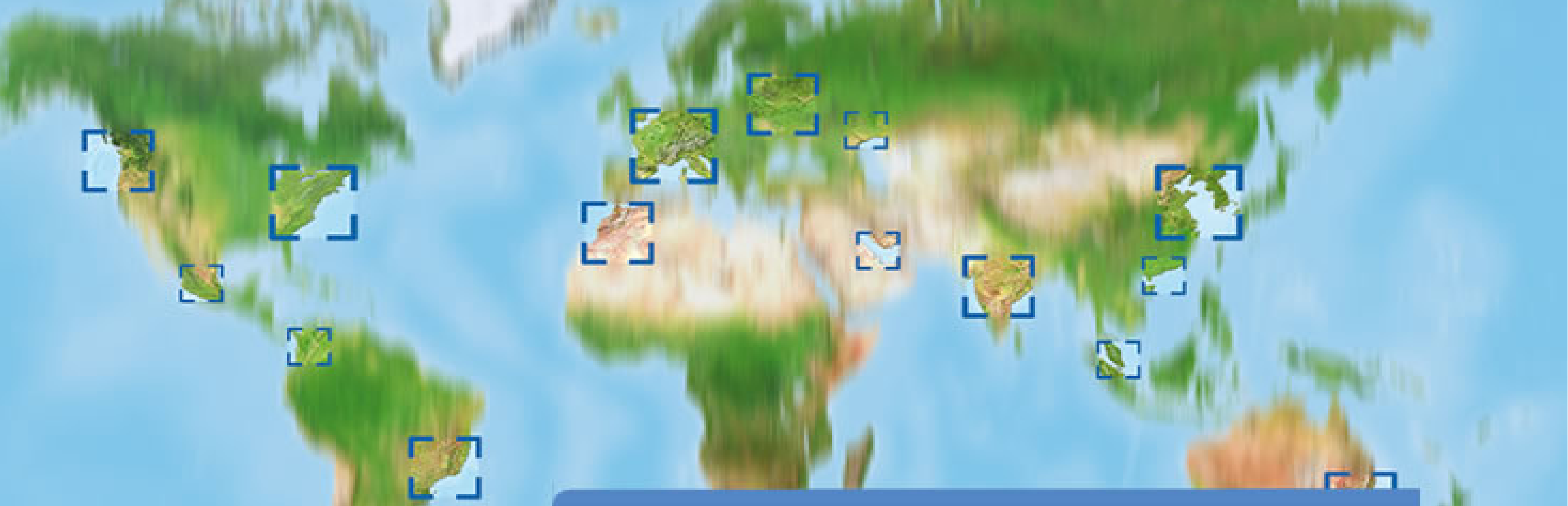

Weekly Export Risk Outlook

EULER HERMES
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15 August 2012

In the Headlines

FIGURE OF THE WEEK: -0.2% >EUROZONE QTR/QTR GDP GROWTH IN Q2

Eurozone/World Economy: Q2 GDP and EH forecasts

Eurostat's flash estimates show that Q2 GDP in the EZ contracted by -0.2% qtr/qtr (0% in Q1 and -0.3% in Q4 2011) and by -0.4% yr/yr (0% in Q1 and +0.7% in Q4). Weakness was widespread. Among economies for which qtr/qtr estimates are available, Italy contracted by -0.7%, Spain -0.4%, Portugal -1.2%, Belgium -0.6% and Finland -1%. Nonetheless, Germany still grew by 0.3%, albeit slower than in Q1 (0.5%) and France was flat (as in the previous two quarters). Austria and Netherlands were also in positive territory. Latest forecasts by EH put EZ growth at -0.4% in 2012 and +0.8% in 2013. EH expects the world economy to grow by 2.5% in 2012 and 2.9% in 2013. Growth in emerging economies will slow but remains relatively resilient, contributing to world trade growth of 4.3% in 2012 and 5.3% in 2013. The EH Global Insolvencies Index is expected to increase by 4% in 2012, in contrast to 2010-2011, when there was a decline.

China: July data

A recovery in activity is expected, but is not yet in place. July industrial production growth slowed to 9.2% yr/yr (9.5% in June) contrary to expectations of a modest acceleration. Growth in nominal retail sales also slowed, to 13.1% yr/yr (13.7%), although growth in real terms edged up. Fixed investment to July was running at a similar pace as in the year to June. However, infrastructure investment by the state sector is picking up, an indication that stimulus measures may be having some effect. Net new bank lending was also below expectations in July, but above July 2010, as was the broader Total Social Financing measure. Trade data were also disappointing, with export growth of just 1% yr/yr, with import growth edging downwards. Inflation, however, fell again in July, to 1.8% yr/yr. Many local governments announced stimulus plans, more will probably follow and further monetary policy action is likely, although an H2 pick up is likely to be gradual.

Russia: Q2 GDP growth and inflation

Flash estimates from the Federal Statistics Service show that real GDP increased by 4% yr/yr in Q2, after 4.9% in Q1. Details of the sub-components of GDP have yet to be released, but high-frequency indicators suggest that domestic demand remained the key growth driver. Retail sales continued to rise, by a robust 10.5% yr/yr in April-May (11.7% in Q1) while industrial output growth slowed to 2.3% (4% in Q1). Exports contracted by 1.7% yr/yr (+16.5% in Q1) and imports fell by 2.2% (+12.1% in Q1), signalling a negligible contribution from net exports in Q2 growth. Expect overall growth to slow further in Q3 as drought and wildfires adversely affected the harvest. Food prices have also been affected, pushing up inflation to 5.6% yr/yr in July from 4.3% in June. The central bank kept its key policy interest rate on hold at 8% last week but has indicated possible increases ahead.

Egypt: Leadership changes

President Mohamed Morsi removed from office the two most senior military figures, Field Marshal Mohammed Hussein Tantawi (defence minister) and General Sami Anan (chief of staff). Although allegedly forced to retire, these two received honours and will remain as presidential advisers. Significantly, the military did not object strongly to this reshuffle, suggesting that a deal may have been brokered, perhaps including guarantees of non-prosecution and of the military's control over its own budget, its role in foreign policy and protection of its business interests. On balance, a positive move but the transition remains fragile.

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Countries in Focus

Mediterranean, Africa & Middle East – *Ethiopia: Leadership*

PM Meles Zenawi's absence on health grounds—he has not been seen in public since mid-June and is on "indefinite" leave—raises concerns relating to domestic political stability (uncertain succession) and to regional security. The deputy PM assumed temporary powers but it is uncertain whether a divisive leadership battle will ensue if Meles does not return to office, particularly as the government is a relatively broad coalition, the EPRDF, and the country is ethnically diverse. Ethiopia, with the world's 15th largest population and a large standing army, is strategically important in terms of regional conflict resolution and security—the country borders Sudan, Eritrea and Somalia—and is an ally of the west in its attempts to limit terrorism. Expect heightened risks of deteriorating domestic and regional security.

Americas – *Chile: Strong H1, slower H2?*

The monthly activity indicator increased at a stronger-than-expected pace of 6.2% yr/yr in June, pointing to H1 GDP growth of around 5.5%. However, as FM Larrain noted, the economy should "lose steam" in H2, so expect full year 2012 growth of around 4.5%. In July, the CPI was unchanged, leaving yr/yr inflation at 2.5% (2-4% target range). With this combination of relatively strong growth and modest inflation, the policy interest rate is likely to be left unchanged again at the central bank's rate setting meeting this week. The economy remains highly exposed to global commodity prices, particularly copper, but with a strong fiscal and debt position, the authorities are well placed to make policies more expansionary if GDP growth slows by more than expected.

Asia-Pacific – *Indonesia: Growth retains momentum*

Real GDP growth remained strong in Q2, at 6.4% yr/yr after 6.3% in Q1, but a shift away from relatively balanced growth, as in mid-2011, to (now entirely) domestic demand-driven expansion continued. Private consumption increased by 5% (4.9% in Q1), public consumption 7% (5.9%) and investment 12.3% (10%). Export growth declined to 1.9% yr/yr in Q2 (7.8% in Q1), hit by the global slowdown and lower international commodity prices, while import expansion remained robust at 10.9% (8% in Q1) as a result of very strong domestic demand. Net exports subtracted 3.2pps from overall Q2 growth. Inventories contributed a record 2.3pps to Q2 growth, which suggests that output may fall in coming quarters. Expect full-year growth of around 6% in both 2012 and 2013.

Europe – *Slovenia: Weak banks weigh on sovereign rating*

In early August, all three major rating agencies downgraded Slovenia's LT sovereign rating—Moody's by three notches to Baa2, Fitch one notch to A- and S&P one notch to A—and kept a negative outlook. The underlying reasons for the downgrades are the increasingly vulnerable banking sector, which urgently needs recapitalisation, and the potential adverse effects on fiscal sustainability and the associated impact on the government. Moreover, the unwieldy five-party coalition government has failed, to date, in implementing a clear recapitalisation plan. With already-rising funding costs and high contingent liabilities from the banking sector, public debt is likely to rise rapidly from the relatively moderate 48% of GDP in 2011. An approach to the EU for a bail-out cannot be ruled out entirely.

Worth knowing

Other Q2 GDP growth

Japan: 0.3% qtr/qtr (1.3% Q1). **Hong Kong:** 1.1% yr/yr, but contracted by -0.1% qtr/qtr, sa. **Bulgaria**: 0.5% yr/yr sa and 0.2% qtr/qtr sa. **Cyprus**: -2.3% yr/yr and -0.8% qtr/qtr sa. **Czech Republic**: -1.2% yr/yr sa and -0.2% qtr/qtr sa. **Estonia**: 2% yr/yr and 0.4% qtr/qtr sa. **Hungary**: -1.2% yr/yr and -0.2% qtr/qtr sa. **Latvia**: 5.1% yr/yr and 1% qtr/qtr sa. **Romania**: 1.2% yr/yr and 0.5% qtr/qtr sa. **Slovak Republic**: 2.7% yr/yr and 0.7% qtr/qtr sa.

India

The wholesale price index (the main inflation gauge) increased by 6.87% yr/yr in July (7.25% in June), the slowest rate since November 2009. Industrial production contracted by 1.8% yr/yr in June (+2.5% in May), with manufacturing output—80% of the total—falling 3.2% yr/yr. Despite this adverse data do not expect an imminent cut in interest rates as inflationary pressures are likely to increase as a result of weak monsoon rains and associated higher food prices.