Weekly Export Risk Outlook

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In the Headlines

FIGURE OF THE WEEK: EUR10bn >EUROZONE FINANCIAL AID FOR CYPRUS

Eurozone Debt Crisis: Cyprus bail-out

Negotiations with the Troika on a bail-out package—underway since mid-2012—resulted in an agreement on 16 March that unexpectedly included the approval of only EUR10 billion of financial aid from the Eurozone (instead of the requested EUR17 billion) plus a one-off levy on bank deposits, hitting small savers as well as those above the EUR100,000 insured maximum, including large foreign depositors who had taken advantage of Cyprus' position as an offshore banking centre. The levy was required to raise EUR5.8 billion from this source as part of the total financing package. However, Cyprus' parliament overwhelmingly rejected the whole bailout package yesterday (with not a vote in favour). Political leaders are trying to find an alternative plan and the government is also seeking help from Russia. The situation is fluid and the outcome highly uncertain, but the room for sustainable adjustment has dwindled and risks have increased. Even if the worst case is avoided—collapse of the two largest banks, bank runs, sovereign default and possible EZ exit—the Cypriot economy will be affected adversely, including contraction in the banking sector (partly as a result of withdrawal of some overseas deposits) and an increase in public debt, along with increased risk of an eventual debt write-down. Also, the economic adjustment programme will be painful, deepening the recession that brought GDP contraction of -2.4% in 2012, with at least another -3% likely in 2013. Moreover, the characteristics of the Cyprus bail-out, however small in terms of Eurozone GDP (less than 0.2%), have set an unfortunate precedent in relation to how to provide necessary financing needs, spurring concerns throughout the monetary union.

Eurozone: Towards a banking union

Provisional agreement was reached on laws allowing the ECB to create a single supervisory body (effective in mid-2014) for European banks with total assets above EUR30 billion (or 20% of GDP). This represents a significant step forward towards a banking union. The new institution is expected to aid stability across the zone banking system and protect the area from external shocks. In particular, it is hoped to break the vicious circle between sovereigns and banks (through a direct recapitalisation of banks by the ESM, rather than through the government) and to improve confidence in European banks. Next steps consist of finding an agreement on a common deposit insurance scheme (expected by June 2013) and on a common resolution scheme (through a Fund able to save banks from bankruptcies).

Germany: Mixed data

Latest indicators continue to provide a mixed overall picture. On the positive side, the Ifo Business Climate Index continued its improvement, for the fourth consecutive month, increasing by +3% mo/mo in February. Further, the Consumer Climate Index improved slightly in February, still driven by the robust labour market and a brightened economic outlook. Also positively, exports of goods were up by +3.1% y/y in January, mainly a result of higher demand from countries outside the EZ. On a disappointing note, industrial orders declined surprisingly in January, by -1.9% mo/mo, after improving by +1.1% in December 2012 and industrial production fell slightly, by -0.2%, following +1% in the previous month.

India: Interest rate cut

On 19 March, the central bank cut its key policy interest rate by 25bps, to 7.5%, the second cut this year (25bps in January) as officials try to manage a delicate balance between growth (weakening GDP expansion in 2012) and inflation (wholesale prices up 6.84% y/y in February). With inflation remaining above the target range of 4-6% and concerns relating to large current account deficits, the scope for further monetary policy loosening is limited, although signs of moderation in the wholesale price index may allow another small cut in interest rates in H2. Expect GDP growth of +6.5% in 2013 and +7% in 2014.

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Countries in Focus

Mediterranean, Africa & Middle East – *Israel: Coalition*

A six-week post-election deadline was close to expiry when Binyamin Netanyahu (Likud) managed to complete a coalition of parties and form a new government. Likud is joined by Yesh Atid (secular nationalist), Jewish Home (right of centre nationalist) and Hatnua (centrist) and together they hold 68 of 120 parliamentary seats. The political system usually operates with a coalition government and alliances tend to be fluid, so expect a workable government. In terms of policies, a pro-market agenda will continue and there will now be pressure to pass legislation to require most ultra-orthodox citizens to perform military service and, significantly, to seek renewed negotiations with the Palestinians. However, despite this week's visit by US President Obama, do not expect a peace deal to be agreed in the ST.

Americas – *Paraguay: Presidential elections*

The latest opinion polls give Horacio Cartes just over 37% support in the presidential elections to be held on 21 April. Cartes, a businessman, is the candidate of the conservative opposition Colorado Party. Efrain Alegre of the centre-left ruling Authentic Radical Liberal Party (PLRA) is in second place, with just over 30%. No other candidate has more than 10% and 13% of voters are undecided, so Cartes is favourite, although his lead is by no means overwhelming. These elections are important as they will choose the successor to former-president Fernando Lugo (who was removed from office early and controversially after impeachment) and should help normalise international relations. If Cartes wins, it will restore the Colorado Party to office, which it held for an unbroken 61 years prior to 2008.

Asia-Pacific – *Pakistan: A political first*

On 16 March, the government resigned and parliament was dissolved ahead of elections. This marked the first time that a civilian government managed to complete a full five-year term and it provides scope for a peaceful handover of power. Despite periodic calls, including from opposition politicians, the military has kept in the background. However, all this does not necessarily indicate a deepening in democracy. The ruling PPP, led by President Asif Ali Zadari, is not assured of being re-elected, particularly against a background of power shortages, inadequate infrastructure and economic imbalances, as well as periodic bombings and generally weak security. Indeed, to date, a caretaker government to oversee the period to elections has yet to be formed, so expect heightened tensions.

Europe – *Ukraine: Back in recession*

Revised estimates from the State Statistics Service confirm that the economy returned to recession in Q4, with real GDP contracting by -2.5% y/y, after -1.3% in Q3. Full year 2012 growth was only +0.2%, driven by an increase in private consumption of +11.7%. Government consumption increased by +2.2%. Fixed investment expanded by just +0.9% and a sharp decline in gross capital formation, by -12.9%, indicates a large drop in inventories. Exports fell sharply in 2012, by -7.7%, while imports maintained modest growth of +1.9%. Early indicators for 2013 show a continued decline in industrial production in January-February, by -4.8% y/y. Expect real GDP to continue to contract in H1 2013, before recovering gradually in H2 and registering around +1.5% for the year as a whole.

Worth knowing

Other GDP

Sri Lanka: +6.3% y/y in Q4 2012 and +6.3% for the year as a whole (+8.3% in 2011). **Oman**: +4.5% in 2011 (provisional), with government expenditure a key driver (+7.4%). **Namibia:** +4.3% y/y in Q4 2012 (+0.7% in Q3) and +5.5% for 2012 as a whole.

Egypt

Official data show a further fall in net international reserves (to USD13.5 billion at end-February), representing import cover of below three months. Meanwhile, the prospect of an IMF USD4.8 billion lending facility remains uncertain, although a Fund technical team may be in Cairo soon. Formal approval of a facility may yet have to await Egyptian elections (now unscheduled).

Nigeria

All key interest rates and liquidity ratios were left unchanged at this week's MPC meeting. This was largely anticipated, partly because of recent upward pressure on the NGN (weak capital flows). Indeed, monetary policy may be tightened later in the year.