Euler Hermes Economic Research

Weekly Export Risk Outlook

7 November 2013

FIGURE OF THE WEEK

+2.8%

US q/q annualised Q3 GDP growth

In the headlines

Eurozone: Surprise interest rate cut

In a surprise move, the ECB lowered its key interest rate by 25bps to 0.25%. The deposit rate remained unchanged while the marginal lending facility rate was also reduced by 25bps, to 0.75%. Medium-term refinancing operations (MROs) and 3-months LTROs with full allotment and fixed rate have been conducted at least until July 2015 and Q2 2015, respectively. Financial markets reacted strongly to the news, with the EUR/USD falling from 1.35 to 1.33 while equity indices were up (+1.3% to 4,337points for the CAC-40). ECB President Draghi explained that since September the outlook for inflation has changed with the eurozone likely to experience a 'prolonged period of low inflation'. The review of the forward guidance announced in July concluded that monetary policy should remain 'accommodative for as long as necessary' with interest rates 'at present or lower levels for an extended period of time'. The ECB continues to expect 'continued but modest economic growth in the eurozone in H2 2013', but stated that risks remain skewed on the downside as a result of higher commodity prices and possibly weaker-than-expected domestic demand and export growth. Although its effectiveness is questionable, today's rate cut is a positive move as it reduces the volatility of Eonia and, most importantly, it signals that the ECB is ready to act further to fight deflationary pressures: a rate cut to 0%, a negative deposit rate, one-year maturity or more LTROs, ABS purchases and private loan purchases are among the available instruments in the ECB toolkit.

US: Q3 GDP growth

Real GDP increased by +2.8% q/q annualised in Q3, but the details indicate continuing weakness. The largest inventory increase since Q1 2012 accounted for 0.8pps of the overall growth in GDP in that period. Consumption increased by only +1.5%, the lowest in over two years, and business investment fell for only the second time since the end of the recession, contracting by -3.7%. Unsurprisingly, consumers are still gloomy, reflected in the Bloomberg Consumer Comfort Index, which fell for the fifth consecutive week to the lowest level in over a year. To help counteract the underlying weakness, the Federal Reserve maintained its ultra-loose monetary policies of zero percent interest rates and USD85 billion of Quantitative Easing (QE) per month and EH expects that QE tapering is now delayed until 2014, at the earliest. More positively, the Institute of Supply Management's (ISM) manufacturing and non-manufacturing surveys were both significantly above the 50 level, signalling expansion, and auto sales remain strong.

Central Europe: Accommodative monetary policy

Last week, **Hungary** lowered its key policy interest rate by 20bps to 3.4%, the 15th consecutive cut since August 2012. Headline consumer price inflation has been below the 3%±1pps target range since April (1.4% y/y in September) and the Monetary Council expects inflationary pressures to remain low for some time amid ongoing weak domestic demand. **Romania** reduced its key policy interest rate by 25bps to 4% on 5 November, the fourth rate cut since July 2013. Headline inflation fell from 3.7% y/y in August to 1.9% in September and so is within the central bank's 1.5-3.5% target range, aided by the cut in the VAT rate on bread and bakery products (from 24% to 9%) in September, as well as a good harvest. On 6 November, **Poland**'s Monetary Policy Council decided to keep its key policy interest rate unchanged at the record low of 2.5%. Headline inflation has been below the 2.5%±1pps target range since February (1% y/y in September). For all three countries, EH expects demand and cost pressures to remain subdued and accommodative monetary policies will be maintained in the next two quarters.

Belgium: Continued (modest) recovery in Q3

Preliminary official estimates indicate that Q3 GDP growth was positive for the second quarter in a row (+0.3% q/q after +0.2% in Q2). A GDP breakdown is not yet available but the latest hard data suggest that domestic demand was the main driver of growth, with retail sales increasing by 0.8% q/q in Q3, indicating a moderate increase in private consumption. Indeed, households have one of the lowest levels of private debt and strongest net financial positions within the eurozone. Investment may have stabilised as credit conditions have improved and foreign direct investment remains supportive. Export order books improved strongly over the past three months, suggesting rising external demand. Overall, EH expects GDP growth to reach +0.1% in 2013 and to pick-up to +1% in 2014, reflecting stronger private consumption (+0.8%), moderate recovery in investment (+0.8% after two years of contraction) and a rebound in exports (+3.2%).

Countries in Focus

Americas

Brazil: Confidence up, but still fragile

The manufacturing PMI improved to 50.2 in October (49.9 in September), suggesting increased activity in Q4. Moreover, the services PMI gained 1.4 points in October, to 52.1, and the composite PMI index increased to 52 (from 50.7 in September), reaching its highest level in eight months. Data show that new business increased moderately in the private sector, with a stronger rise in services, and job creation accelerated at the strongest rate in seven months. EH expects Brazil's GDP growth to reach +2.2% in 2013, with both internal and external demand sustaining economic activity. However, EH also expects GDP growth to decelerate to +2% in 2014, reflecting persistent economic imbalances and volatilities, inflationary pressures, high labour costs and structural weaknesses (including infrastructure and education). EH also expects that insolvencies will continue to increase, by +12.4 in 2013 % and +1% in 2014, but at a reduced rate from the +26% recorded in 2012.

Europe

Central & Eastern Europe: Flash estimates of GDP growth

In **Lithuania**, Q3 real GDP growth decelerated more than expected, to +2% y/y (+3.7% in Q2) and +0.1% q/q (+0.6% in Q2), mainly as a result of slowing export demand and some base effects. Assuming some recovery in Q4, EH forecasts full year growth of +3% in 2013. **Serbia**'s Q3 GDP growth surprised on the upside, at +3.2% y/y (+0.2% in Q2), reflecting a good harvest (after a poor one in 2012) and strong automobile production. EH expects +1.5% growth in full year 2013. **Ukraine** remains firmly in recession as GDP contracted by -1.5% y/y in Q3 (-1.3% in Q2), marking the fifth consecutive quarter of decline. A lack of crucial economic policy decisions, as emphasised by an IMF mission last week, will continue to hamper recovery. EH expects that real GDP will contract by -1.2% in 2013 as a whole. In **Georgia**, GDP growth continued to moderate in Q3, to +1.3% y/y (+1.5% in Q2) and EH revised its full year 2013 growth forecast to +1.7% (+6.5% in 2012).

Africa & Middle East

Lebanon: Neighbourhood watch

Recent official data releases show GDP growth of +2% in 2011 and a preliminary estimate of +2.5% in 2012. These rates of growth compare unfavourably with an annual average of over +9% in 2007-10 and are the lowest since 2006 (+1.6%), which was a year of significant disruption as a result of an Israel-Hezbollah conflict. The downturn reflects a weaker global environment but also contagion from events in neighbouring Syria, a leading trade partner, and reduced tourist flows because of heightened security concerns in the wider region. Localised internal sectarian fighting (most recently in the seaport of Tripoli) acts to limit investor and consumer confidence, with negative repercussions on the overall economy. EH does not expect a swift resolution of the civil war in Syria (refugees in Lebanon from that country are estimated at over one million) and GDP growth is likely to remain weak and below-potential, at +1.5% in 2013 and +1.8% in 2014.

Asia Pacific

Asia-Pacific: Confidence increasing

Confidence within industry is strengthening in the Asia-Pacific region as a whole. With the exception of **India**, all Asian manufacturing PMI improved in October, reflecting acceleration in global demand. Marked improvements were recorded in **Japan** (+1.7 points to 54.2), **Australia** (+1.5 points to 53.2) and **Taiwan** (+1 point to 53), with benefits stemming from rising new orders and general strengthening in overall economic conditions. Surveys in **China**, including the official PMI data and that from HSBC, continue to signal an improvement in activity, but at a slower pace (+0.3 points to 51.4 and +0.7 points to 50.9, respectively). **South Korea** improved to above the no-change mark (above 50) from 49.7 to 50.2 after a four-month period below. Currently, only **India** remains in contraction territory, with the index unchanged at 49.6, reflecting weak output and new orders. Overall, EH expects regional activity will strengthen by +0.1pps to +4.7% in 2014.

What to watch

- November 7 – Malaysia monetary policy decision
- November 7 – UK BoE November base rate
- November 7 – Egypt October international reserves
- November 8 – Canada October unemployment
- November 8 – China October trade balance
- November 8 – France September ind. production
- November 8 – US October unemployment
- November 9 – China October CPI, IP & retail sales
- November 11 – Estonia & Latvia Q3 GDP
- November 11 – Czech Republic October CPI
- November 12 – Germany & Hungary October CPI

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