Euler Hermes Economic Research

Weekly Export Risk Outlook

20 November 2013

FIGURE OF THE WEEK

0.7%

Eurozone's y/y inflation rate in October

In the headlines

China: Reform agenda unveiled

Following the recent general communiqué, the authorities issued a more detailed document, setting out a comprehensive reform agenda, perhaps the most significant since the beginning of 1990. A range of major social reforms will be implemented, including an easing in the one-child family policy, simplification of the current procedure for the rural population to get residency permits in large cities and abolition of the "re-education through labour" camp system. The role of the private sector in the financial system will be enhanced as markets are expected to get "a decisive" role in resource allocation. Moreover, the financial sector will be further opened to include acceleration in interest rate liberalisation and the convertibility of the RMB capital account. Some fiscal reforms have been proposed, including improvements in budget transparency and changes in the tax system (involving VAT and simplification in the rates of taxation). Overall, the outlined reforms, if timely implemented, could strength growth prospects in the medium term, probably at a lower level of GDP growth than in recent years, but more sustainable.

Eurozone: Growing fears of deflation

The rate of inflation fell to 0.7% y/y in October from 1.1% in September and 2% in January. Greece has been experiencing deflation since March, when its rate of inflation turned negative, and price increases are moderating rapidly in Italy and Spain, in particular. Indeed, between January and October, inflation in these two countries fell from 2.2% y/y to 0.7% and from 2.7% to -0.1%, respectively, largely reflecting significantly weaker domestic demand as a result of austerity measures that triggered import compression, cuts in wages and deteriorating consumer confidence. Inflationary pressures are also moderating elsewhere, although less rapidly, to 1.2% y/y in Germany (1.7% in January) and 0.6% in France (1.2%). The situation is not as severe as in 2009 and intensification of deflationary pressures could result in the ECB: (1) cutting the refi rate to 0% from 0.25% and the deposit rate to negative from 0% (2) announcing a three-year, or more, LTRO (3) buying sovereign debt on the secondary bond market (SMP, OMT) and (4) buying private sector securities (ABS and private loan purchases). Moreover, deflationary pressures should be offset by increases in commodity prices, higher inflation in emerging markets, a moderate pick-up in economic activity and some temporary effects, including wage increases in Germany and a VAT increase in France.

US: Data support the Fed's stance

The Housing Market Index, a gauge of homebuilder sentiment, was unchanged in November at 54. The index peaked in August at 58, suggesting that potential buyers are temporarily on hold as prices have been falling for three months and mortgage rates for two. Productivity gained 1.9% in Q3 but was flat in y/y terms. Unit Labor Costs (ULC) fell in Q3, by 0.6% annualised, while the Employment Cost Index (ECI) increased by an annualised 1.7%, with the wages component rising only 1.4%. On a y/y basis, ULC and ECI were both up only 1.9%, while the ECI wages component was up only 1.6%, the lowest since Q2 2011. These reports show there is little inflationary pressure and provide the Fed with more breathing space for continued QE. Industrial production fell 0.1% in October, driven in part by a spike in utilities because of an unseasonably cold September. More positively, industrial production was up 3.2% y/y and manufacturing 3.3% y/y, having risen for three consecutive months.

Norway: GDP growth lost momentum in Q3

GDP growth slowed in Q3, to +0.7% q/q (slightly above consensus expectations and compared with +1.2% in Q2), reflecting weaker private consumption (+0.1% in Q3 after +0.2% in Q2) and contraction in investment (-0.5%, after +4.8% in Q2, mainly as a result of deterioration in equipment investment). Net exports provided a strong negative contribution to growth, with weak exports (+0.1% after +1% in Q2) and a strong increase in imports (+2.6% q/q). The main growth driver in Q3 was inventory building (+1.4pps). Given the weakness in domestic demand, this could prove a drag on investment in coming quarters. Mainland GDP growth (excluding the volatile oil and shipping sectors) accelerated slightly in Q3, to +0.5% q/q after +0.3% in Q2, but remained weak compared with previous levels. EH expects GDP growth to remain subdued in 2013 (+1% after +2.8% in 2012) and, given recent improvements in business confidence (especially in order books), economic activity will gain momentum in 2014 (+2.7%), also reflecting a rebound in exports.

Countries in Focus

Americas

Chile: Bachelet (almost) certain to win presidential elections

On Sunday, Michelle Bachelet (centre-left) won the first round in presidential elections, although a second round will be necessary as she won 46.7 % of the vote. Her opponent will be the rightwing candidate Evelyn Matthei, who only received 25% of the vote and now appears unlikely to win the second round vote, which is scheduled for 15 December. Given the results of the congressional elections, in which the New Majority coalition controls 68 out of 120 seats in the house of deputies and 21 out of 38 seats in the Senate, Bachelet should be able to implement most of the promised reforms, especially tax changes. The latter include an increase in corporate taxes, designed as a way to raise revenues to establish a high-quality public education system and to improve the health system and other public services. However, she may struggle to implement changes to the constitution (dating from the Pinochet era), as a two-thirds majority is required.

Europe

Austria: Momentum builds slowly

Advance estimates from the Institute of Economic Research indicate that Q3 real GDP growth picked up to +0.7 y/y (flat in Q2) and +0.2% q/q (from a revised 0% in Q2). Growth was broad-based as domestic demand improved after a weak start to the year. Only a reduction in inventories provided a negative impact on Q3 growth, with gross investment (which includes inventories) contracting by -0.3% q/q, while fixed investment returned to growth of +0.1% q/q. Private consumption increased by +0.1% q/q (the same as in Q2) and public consumption by +0.4% (+0.2% in Q2). Export growth eased to +0.2% q/q in Q3 (+0.3% in Q2) and imports increased by +0.1% q/q, so that net exports contributed +0.1pps to overall Q3 growth. PMI data suggest a positive momentum in coming quarters, with October's PMI up to 52.7 after moving above the 50 mark in August. EH expects full year GDP growth of +0.4% in 2013 and +1.7% in 2014.

Africa & Middle East

Nigeria: Rapid growth in the regional heavyweight

Nigeria may be close to becoming the largest economy in Africa. It is in the process (with IMF and World Bank assistance) of rebasing GDP data, which will now include greater weightings for some of the more rapidly growing sectors, including mobile telecommunications, the film industry and financial services. When Ghana undertook a similar rebasing in 2010 the economy was shown to be 60% larger than previously estimated. Over the period 2003-12, Nigeria's annual average GDP growth was +7.5%, compared with +3.5% for South Africa. At some stage next year it may be assessed that both countries have a nominal GDP of around USD400 billion. Meanwhile, and despite lingering regional security issues, the Nigerian economy continues to grow rapidly, with Q3 GDP expanding by +6.8% q/q (+6.2% in Q2). EH expects GDP growth of +6.8% in 2013 and +6.5% in 2014, although it could be even higher next year if oil output returns to around 2.52mbpd (2.26 in Q3).

Asia Pacific

Asia: Positive GDP growth, but below potential

GDP growth in **China** remained strong in Q3 (+7.8% y/y after +7.5% in Q2) but expansion in **Japan** was only +0.5% q/q (+2.6% y/y) compared with +0.9% (+1.2%) in Q2, dampened by weak exports. In **Singapore**, GDP growth was + 5.1% y/y, with a recovery in manufacturing, and in **Malaysia** GDP increased by +5% y/y, driven by strong domestic demand. **Taiwan's** performance in Q3 was disappointing, with growth slowing to +1.6% y/y because of a lacklustre export sector that was affected negatively by reduced demand from China. In contrast, **Thailand's** economy, on a q/q basis, expanded for the first time in three periods, by +1.3%, but it only grew by +2.7% y/y, which was below market expectations and reflected a decline in domestic consumption and private investment. The overall outlook is for the regional economy to strengthen in the short term, reflecting favourable signs from China. EH expects the Asia-Pacific region to grow by +4.5% in 2013 and +4.7% in 2014.

What to watch

- November 21 – South Africa interest rate decision
- November 21 – Mexico Q3 GDP
- November 21 – Brazil October unemployment
- November 22 – Brazil October current account
- November 22 – Canada October CPI
- November 22 – Germany Q3 GDP
- November 24 – Saudi Arabia October foreign assets
- November 26 – South Africa Q3 GDP
- November 27 – Brazil Selic decision
- November 27 – Philippines Q3 GDP

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Contact Euler Hermes Economic Research Team
research@eulerhermes.com

Publication Director
Ludovic Subran, Chief Economist
ludovic.subran@eulerhermes.com