Euler Hermes Economic Research

Weekly Export Risk Outlook

14 November 2018

FIGURE OF THE WEEK

-0.2%

Q3 2018 q/q GDP decline in Germany

In the Headlines

Eurozone: Temporarily weak growth momentum

The second release of Q3 Eurozone GDP growth confirmed the higher-than-expected slowdown to +0.2% q/q, half the pace seen in H1. Details by component will be published on 7 December, but we expect the car certification delays (due to a new emission test procedure) to be the main driver for the slowdown. Fixed investment is expected to have continued to expand driven by solid consumer demand and accommodative credit conditions. Consumer confidence softened in Q3 as inflation accelerated (2.1% on average vs 1.7% in Q2) on the back of higher oil prices while employment growth slowed down to +0.2% q/q (+0.4% in Q2). Net exports should have contributed negatively to growth on the back of weaker export expansion and strong imports. We expect GDP growth to accelerate to +0.5% q/q in Q4 as the negative effects from the car sector will start to fade, bringing annual growth to +1.9%. Going forward, we expect GDP growth to remain above potential at +1.7% in 2019 (-0.1pp revision compared to our previous forecast). Slowing global growth momentum and elevated political uncertainty (Italy, Brexit, EU elections) remain drags on the Eurozone. The ECB is expected to gradually normalize monetary policy with a first rate hike in Q4 2019 after the end of QE this December.

Germany: Real GDP contracted in the third quarter

The German economy contracted slightly in the third quarter. Seasonally adjusted real GDP declined by -0.2% q/q. While investment and government consumption contributed positively to the economic development, private consumption actually declined. Against the backdrop of the still very positive employment trend this is a bit surprising. Net exports dampened the economic development for the third time in a row. We expect the German economy to pick up again in the current quarter. The automotive sector, which was largely responsible for the decline in industrial production in the third quarter, is already showing first signs of a gradual improvement. We also assume that private consumption will pick up again, driven by a sustained rise in employment and moderate wage growth. How strong the expected rebound will be, however, depends not least on how much, for example, Italy's budget dispute with the EU and the smoldering trade conflict with the U.S. will weigh on economic sentiment. We have revised our growth forecast for 2018 from a calendar-adjusted +2.1% to +1.7%.

UK: Activity is expected to considerably slow down in Q4

The rebound in economic growth in Q3 (+0.6% q/q) was triggered by a number of temporary factors, including contingency planning due to the uncertainty on the Brexit deal by March 2019. With GDP flat in August and September and the Composite PMI falling in October, we expect GDP growth to slow to +0.2% to +0.3% q/q in Q4. Tighter credit conditions, halted investment decisions, weaker consumer confidence and more fragile business profitability will take their toll on the economy. In addition to the higher import costs, the acceleration in annual regular pay growth (+3.2%, a nearly 10-year high) is also a drag on their profitability. We predict annual GDP growth will decelerate to +1.2% in 2019 (from +1.3% in 2018) compared to forecasts of +1.7% by the BoE and +1.6% by the Office for Budget Responsibility. The enduring uncertainty over the UK's future trading relationship with the EU will continue to weigh heavily on corporate investment and the value of the GBP. As a result, we expect the BoE to deliver only one +25bp interest rate increase next year, with Q2 the most likely timeframe.

Central & Eastern Europe: Q3 regional growth remained firm

Flash estimates indicate that real GDP growth in the group of 11 EU members in the CEE region retained momentum in Q3, coming in only just below the +4.3% y/y posted in Q2. Looking at seasonally adjusted, year-on-year (y/y) real GDP growth, **Poland** was the frontrunner with +5.7%, followed by **Latvia** (+5.5%). Q3 GDP growth decelerated in **Bulgaria** (+3%), **Lithuania** (+2.7%) and the **Czech Republic** (+2.3%). The latter suffered in particular from a decline in production and exports (notably to Germany) of the automotive sector. However, **Hungary** and **Slovakia**, both also large automotive producers, did not share that fate and posted accelerating GDP growth of +5% and +4.5%, respectively, in Q3. In **Romania**, growth edged down but remained sound at +4.1%. As the flash estimates are largely based on data from July and August, there may be some downward revisions for Q3 ahead, as well as a slowdown in Q4, since sentiment indicators weakened in September and also in October. We forecast average full-year growth of the 11 EU members in CEE at +4.1% in 2018 (after +4.7% in 2017).

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Countries in Focus

Americas

Argentina: Companies start paying the crisis bill

After a severe currency crisis, emergency interest rate hikes by the Central Bank and a USD57bn IMF funding arrangement, we argued earlier this fall that the worst was yet to come for companies. We now see that they are starting to pay the bill of the financial shock through the resulting spike in inflation (hindering demand prospects) and high interest rates (raising borrowing costs). September data show the largest year-on-year (y/y) drop in industrial production since 2012, at -11.5%. The contraction was broad-based. Some of the decline owes to this year's historical drought which affected the production of agricultural machinery. More generally, the production of companies has been suffering from lower current and expected demand. For instance, car sales over twelve months dropped in September (-3% y/y) and October (-9.4%). Besides, the monthly construction index registered a -4.1% y/y fall in September, the sharpest decrease since early 2017. Going forward, the recession will make the life of corporations increasingly harder.

Europe

Portugal: Still cruising above +2%, but not for much longer

The Q3 2018 GDP flash estimate indicates Portugal grew +0.3% in Q3 compared to last quarter (q/q), after growing +0.6% in Q2. It registered its lowest q/q growth in more than two years. After stagnating in Q2, partly due to higher inflation dynamics, private consumption is expected to have picked up a bit. Compared to the same quarter last year (Q3 2017), GDP growth continued cruising above +2% (+2.1% y/y) as it has done in the last two years. The National Statistics institute indicated that domestic demand added less to y/y GDP growth while the contribution of net exports was again negative. Indeed, private consumption decelerated y/y despite the pick-up from Q2 2018. The unemployment rate is at its lowest level since 2002 (6.8%) and employment growth has been decelerating y/y for three straight quarters. Against this backdrop and with export demand projected to weaken going forward, we still expect Portugal to grow above +2% this year before decelerating to +1.9% next year.

Africa & Middle East

GCC: Oil production down or up?

Last weekend, oil producers led by Saudi Arabia expressed discontent with the latest oil price development and suggested that a 1mn bbl/day decline in oil supplies from October levels was required to balance the market and avoid a build-up of oil stocks. On 9 November, the oil price had retreated almost -20% since hitting a four-year high in early October, in part because the U.S. granted last-minute waivers with regard to its re-imposed sanctions on Iran on 5 November to eight big buyers of Iranian oil (including India, Japan, South Korea). Initially, oil prices climbed on Monday. But they swung back and fell further after U.S. President Trump put pressure on the OPEC, saying "oil prices should be much lower". Also, investors got alarm that supply has started to outpace consumption. At the time of writing, benchmark Brent stood at USD67/bbl, another -5% down from 9 November. Expect continued oil price volatility in the near term until more clarity about future production levels is disclosed.

Asia Pacific

Japan: Q3 GDP hit by natural disasters

Real GDP contracted by -0.3% q/q in Q3 2018 (from an upwardly revised +0.8% q/q in Q2) as natural disasters and bad weather disrupted domestic spending and exports. Apart from government consumption (+0.2% q/q) and private residential investment (+0.6% q/q), most major GDP components contracted. In particular, exports of goods and services dropped by -1.8% q/q, while private consumption declined by -0.1% q/q. Looking ahead, advanced indicators suggest that growth has bounced back in October. The Manufacturing PMI improved to 52.9 points (from 52.5 in September) with the output and new orders sub-components indicating stronger growth. The Services PMI increased too (to 52.4 from 50.2) as corporates point to stronger growth in new business and output. In that context, we expect growth to register a mechanic recovery in Q4 (i.e. due to base effects as Q3 was distorted by natural disasters). Overall, we forecast full-year 2018 growth at +1% (after +1.7% in 2017).

What to watch

- November 15 – Canada October home sales
- November 15 – Canada October Teranet home prices
- November 15 – Argentina October inflation
- November 15 – Colombia Q3 GDP
- November 15 – EU September trade of goods
- November 15 – UK October retail sales
- November 15 – U.S. October retail sales
- November 16 – Brazil Sept. economic activity index
- November 16 – Eurozone October inflation
- November 16 – Turkey September industrial production
- November 16 – U.S. October industrial production
- November 19 – Chile Q3 GDP
- November 19 – Eurogroup meeting
- November 19 – Japan October trade figures
- November 20 – Hungary Central Bank meeting

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