Euler Hermes Economic Research

Weekly Export Risk Outlook

28 November 2018

In the Headlines

FIGURE OF THE WEEK

+2.1%

Increase in insolvencies in France from May to October

Ukraine and Russia: Tensions on the rise again

Tensions between the two countries have risen to the highest level since Russia's annexation of Crimea in March 2014. This followed the capture of three Ukrainian naval ships by Russia over the last weekend, accusing them of illegally entering its waters. The ships wanted to pass the Kerch Strait to the Sea of Azov east of Crimea. Both are shared territorial waters under a 2003 treaty but disputed since 2014. So both sides are accusing each other of provocation. As a result, Ukraine has introduced martial law for a period of 30 days, starting today, in 10 regions of the country considered most vulnerable to an attack from Russia. We believe that both sides do not have an interest in a serious escalation of the latest tensions, however, there is always a tail risk of an uncontrolled escalation following such an incident. Meanwhile, the IMF said that introducing martial law would not be an obstacle to continued IMF cooperation with Ukraine, which is still facing a prolonged economic crisis. The currencies of both countries have fallen by -2% or so since last Friday. However, despite the incident, Russia yesterday raised EUR1bn at a yield of 3.0% with the sale of a EUR-denominated seven-year Eurobond.

UK: All eyes on 11 December

The European Council endorsed the Brexit Withdrawal deal on 25 November. The next step is to get the approval of the UK Parliament on 11 December. There is a relatively high chance that it will reject the deal. However, we believe there is still leeway to get the whole ratification process done in time by 29 March 2019 and avoid a no Brexit deal (while we assign a 25% probability to this scenario). In case of rejection, the Parliament has 21 days to bring amendments and trigger a new vote in January. However, the EU seems unwilling to get back to the negotiating table. If approved after a second try, the EU Parliament could ratify the deal by 14 February. If not approved, several options are possible: (1) PM May resigns and there is a leadership contest within the Conservative Party; (2) a referendum on the deal is called by the Parliament; or (3) general elections are called either by PM May or by the Parliament. In either case, an extension of Art. 50 beyond 29 March 2019 is likely. All in all, we estimate the cost of this uncertainty at -0.1pp lower growth in both Q4 2018 and Q1 2019.

France: Bad romance

The French debt bromance documented previously (see WERO 25 April 2018) took its toll on business insolvencies. A high level of corporate debt (above 72% of GDP in 2018), long payment terms (DSO at 74 days in 2017), high oil prices (+20% y/y in Q3 2018) and subdued domestic demand in 2018 (private consumption grew by +0.9% y/y and residential investment exhibited a stagnation in the first three quarters) have put French businesses under pressure. As a result, corporate margins decreased to 31.5% in Q2 (a three-year low) and activity halted suddenly in several sectors (e.g. turnover growth in the construction sector dropped from +10% y/y at end-2017 to +1.4% in July 2018). Household-driven sectors suffered in particular, propelling an increase in business insolvencies by +2.1% from the trough experienced in May until October (12-month cumulated cases). Construction, transportation, retail and wholesale trade exhibited the worst patterns. Household confidence reached a new low at 92 points in November, 8 points below the historical average. As a result, insolvencies are forecast to increase further by +2% next year, to a height +14% above the 2007 level.

South Africa: As time goes by

The risk of a recession is strengthening in South Africa as business confidence deteriorated to 31 points in Q4, down from 34 in Q3 and 40 in Q2 (see also WERO 21 November 2018). Moreover, the policy space has weakened since the South African Central Bank (CB) decided to hike its policy rate by +25bp to 6.75%. This move was expected but appears quite hawkish as headline and core inflation (+5.1% and +4.2% y/y in October, respectively) are still within the CB's inflation target range (the upper bound is 6.5%). We expect the fiscal balance to be the next bad news for South Africa. Last year's fiscal slippage (a deficit of -4.6% of GDP was posted) is likely to continue since deceptive growth in 2018 should be detrimental for any improvement (we expect a deficit of -4.2% of GDP, below consensus). Overall, we now forecast growth to stay below +2% for a sixth consecutive year in 2019 (at +1%), an environment that may put some pressure on the dynamics of public debt (55.5% of GDP in 2018) and the country's sovereign rating.

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Countries in Focus

Americas

U.S.: Holiday sales solid but unexciting

Retail sales for the holiday season are expected to grow by a modest +4% to +5% from 2017. According to the National Retail Federation, that's not as fast as last year's +5.3% but better than the five year average of +3.9%. Of course traditional retail will grow more slowly than online sales. Indeed over the Black Friday weekend, ShopperTrak reported that foot traffic in traditional stores fell -1%, the fifth straight decline. Online sales however surged +26.4% to USD12.3bn, and Cyber Monday sales rose +19.3% to USD7.9bn according to Adobe Systems. Consumers are clearly in a positive mood as measured by the Consumer Confidence Index which remains near the highest level in 18 years, despite slipping -2.2 points in November. But all retailers are facing margin pressures as wages rise, tariffs increase costs, and pricing pressures remain relentless.

Europe

Italy: Economic sentiment on a downward trend

In November both Italian consumer and business confidence declined. The composite business confidence climate index weakened from 102.5 points to 101.0 with all sectors but retail showing a decrease in sentiment. Meanwhile the consumer confidence index fell from 116.5 to 114.8, driven by declines in the economic, current and future components of the survey. However, sentiment increased in the personal component which includes an assessment of saving intentions and the family budget. While businesses have become decidedly less optimistic in recent months, consumer confidence still registers close to an all-time high. This optimism may reflect the expected impact of the fiscal measures put forward in the 2019 budget draft. However, the Italian consumer is in for a rude awakening: We expect GDP growth to slow to +0.6% in 2019 after +1% this year. As the favorable labor market trend comes to a halt and elevated yields on government debt increasingly feed through to the private sector, confidence and in turn support for the government's imprudent fiscal agenda may well fall sharply.

Africa & Middle East

Israel: Cooling a bit

Seasonally adjusted real GDP growth accelerated to +0.6% q/q in Q3 from +0.3% in Q2. But in unadjusted y/y terms, GDP growth slowed down to +3.1% in Q3 from +3.7% in Q2. Private consumption grew more moderately by +2.9% y/y in Q3 (+3.5% in Q2) while government consumption surged by +5.8% (+3.5% in Q2). Meanwhile, fixed investment dropped by -1.2% (+4.9% in Q2) due to a slump in residential construction. External trade activity weakened markedly, with exports up by +3.4% y/y (+7.8% in Q2) and imports by +2.4% (+9.7% in Q2) so that net exports added +0.3pp to Q3 growth (-0.5pp in Q2). We expect growth of around +3% y/y in Q4, taking the full-year expansion to +3.5% in 2018. The tentative forecast for 2019 is +3.3%. Meanwhile, the Bank of Israel (BoI) raised its key policy rate by 15bp to 0.25% this week, the first rate hike since June 2011. The move was a small surprise as headline inflation had stabilized at 1.2% y/y in October, just above the lower bound of the BoI's 1-3% target range. In 2019, we expect average inflation of 1.4% and two more rate hikes.

Asia Pacific

China: The G-20 test

Industrial profit growth continued to ease in October, posting +13.6% y/y in January-October after +14.7% in January-September. This follows a mixed batch of activity indicators. Retail sales expansion slowed to +8.6% y/y in October (from +9.2% in September). Investment and industrial production growth improved slightly but remained low by historical standards. Looking ahead, all eyes will be on the G-20 meeting at the end of this week as President Xi and President Trump are expected to meet to discuss about trade. Risks to the outlook have risen this week after Trump's statement about proceeding on implementing the next wave of tariffs, especially 25% on USD200bn of imports from China. Note that if such measures were implemented, global trade growth could be reduced by -2pp and China's economic growth by -0.3pp over a two-year horizon.

What to watch

- November 29 – France October consumer spending
- November 29 – US Oct. personal income and outlays
- November 30 – Canada Q3 GDP
- November 30 – Estonia, Slovenia Q3 GDP
- November 30 – Eurozone Nov. inflation (1st estimate)
- November 30 – Poland Q3 GDP (with details)
- November 30 – South Africa October fiscal balance
- December 3 – China Nov. Caixin Manufacturing PMI
- December 3 – Czechia, Poland, Russia, Turkey November Manufacturing PMI
- December 3 – Turkey November inflation
- December 3 – U.S. Nov. ISM Manufacturing Index
- December 4 – South Africa Q3 GDP
- December 5 – Poland monetary policy decision
- December 5 – Russia November Services PMI

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