Euler Hermes Economic Research

Weekly Export Risk Outlook

20 December 2018

FIGURE OF THE WEEK

-0.7%

Q3 2018 q/q GDP decline in Argentina

In the Headlines

U.S.: Fed hikes, becomes more dovish, but not enough

As expected, the Federal Reserve increased the Fed Funds rate by 0.25pp to a range of 2.25% - 2.50%. Materials from the meeting were significantly more dovish. Most importantly, Fed officials now see only two rate hikes in 2019 as opposed to three previously, putting the Fed Funds rate at 2.9% instead of 3.1% by the end of 2019. The Fed's economic projections were virtually unchanged except the 2019 GDP forecast fell from +2.5% to +2.3%. The statement was mostly unchanged, and while it did describe the economy as "strong" there were two significant differences. First it included the word "some" when describing further rate hikes, and in a nod to current turmoil, it said the Fed "will continue to monitor global economic and financial developments…". The financial markets were expecting something even more dovish and were disappointed. Stock markets swung from sharp gains to ugly losses and finished at lows for the year. The yield curve flattened another 7bp. Futures markets, which have been better predictors of Fed hikes than the Fed, are now giving only a 40% chance of any hikes in 2019, suggesting a negative view of the economy.

Eurozone: ECB – starting shot for the great unwind in 2019

With the cessation of QE net purchases at year-end, 2018 will be known as the year when the ECB reached the end of its monetary easing path. Meanwhile 2019 will mark the beginning of monetary tightening. Assuming that the Eurozone economic upswing remains intact, we expect the ECB to raise rates next year for the first time since 2011 starting off with a 15bp deposit rate hike in September followed by a 25bp hike in all rates in December. For the great unwind to proceed without any tantrums, the ECB will put safety nets in place including the reinvestment of maturing bonds to keep long-term yields in check, an extended forward guidance beyond the first rate hike to ensure market expectations do not deviate from ECB intentions and a new round of TLTRO funding to support lending conditions. As the ECB gradually pulls back, the role of market discipline will strengthen again. For countries that are not tackling their macroeconomic imbalances room for policy errors will become ever more limited.

Germany: Political uncertainty weighs on economic activity

In December the ifo business climate index fell to its lowest level for more than two years. Political uncertainty is likely to have contributed to the further decline. Nevertheless, we expect a countermove to the slump in growth in the third quarter for both the current and the coming quarter. By the end of the first quarter of 2019, the problems in the automotive sector associated with the new emission test procedure WLTP, which were primarily responsible for the weak third quarter, should have been largely resolved. The extent of the expected rebound and dynamics of economic development in 2019 will strongly depend on how long political risks such as the trade conflict with the U.S. and the Brexit uncertainty will stay with us. In principle, the domestic economic conditions are still in place for the upswing to continue, albeit at a more moderate pace. However, with real GDP growth of +1.6% this year and +1.7% next year (working-day adjusted), the rate of the previous years will no longer be reached.

UK: Brexit – The vote of last resort on 14 January?

The vote on the Brexit deal in the UK Parliament, initially planned for 11 December has been rescheduled to 14 January. The purpose is to secure a positive outcome on the deal. Based on the results of the confidence vote that PM May survived on 13 December we can conclude that 117 Tory MPs may vote against the deal. The higher and prolonged uncertainty will bring GDP growth down to a meager +0.3% q/q in Q4 and Q1 on the back of "on hold" investment decisions from companies and sluggish consumer spending as the GBP will continue to suffer before rebounding to 1.15-1.20 against the EUR once the deal has passed the EU Parliament (our baseline scenario) and fears of a "Hard Brexit" or another referendum or early elections have vanished. Should the deal be rejected by the Parliament on 14 January, another vote could be planned 21 days later before a vote in the EU Parliament can take place on 11-14 February or 11-14 March. A last resort solution would be the extension of Art. 50 to later than 29 March 2019.

Note: WERO is taking a break. The next issue will be 9 January 2019.

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Countries in Focus

Americas

Argentina: Officially in recession (again)

As expected, Argentina fell into recession in Q3, for the second time in three years. After dropping by -4.2% q/q in Q2, GDP contracted by -0.7% q/q in Q3. In y/y terms, GDP declined -3.5% in Q3. The contraction in private and government consumption, investment and imports accelerated. It was partially offset by the recovery in exports thanks to competitiveness gains after the -50% currency depreciation this year. Compared to Q3 2017, private consumption was the main drag on activity (-3.0pp) followed by investment (-2.3pp) as inflation averaged +35% in Q3 and policy interest rates spiked to 65%. From the supply side, retail suffered the most (-8.9% y/y), followed by manufacturing and agriculture. The economy should continue to contract as consumer confidence remains weak and inflation close to +50%. Two positive notes could slightly mitigate the contraction: policy rates have started to decline (currently around 60%) and the Q3 unemployment rate remained close to the level in Q1 (9.0%).

Europe

France: Addicted to debt

Corporate debt rose markedly in 2018. We estimate that it reached 74% of GDP in Q4, +2.3pp y/y and +14pp above the 2010 level (while it stabilized elsewhere in the Eurozone). The +2.3pp increase in 2018 came after some stabilization in the debt ratio in 2017. Lower economic growth in 2018 (+1.5%, after +2.3% in 2017) was the main trigger of the new debt accumulation, since corporate margins decreased from 32% in Q4 2017 to 31.5% in Q2 2018 (our expectation is 31% in Q4 2018) and at the same time corporates continued to increase their investment for digitalization purposes. As the government took a part of the SNCF debt and decided to introduce a stimulus in 2019 (mainly tax cuts), public debt should also be on the rise. As a result, total (corporate + household + public) debt is expected at 232.5% of GDP at end-2018 (a record level, +30pp above the 2010 level). We expect corporate debt to rise further in 2019 (+2pp) and total debt to reach 235% of GDP by the end of next year. Such an increase should come along with a higher number of insolvencies (+2% forecast in 2019).

Africa & Middle East

Angola: No debt truce despite the IMF

The IMF announced last week a 3-year USD3.5bn lending program to Angola. This is good news in some way as it shows the country's willingness to stricter conditionality. In our view, the size of the program will not be enough to cope with Angola's high financing needs since the proceedings from the USD3bn Eurobond issuance made in May have already been spent. It came along with conflicting signals about Angolan reliance on Chinese loans. Angola represents 30% of the total loans granted by China to African economies and a new USD2bn credit was secured in October. There is evidence that Angola is servicing its debt to China through oil shipments, a risky situation especially when the value of this collateral falls (the Brent oil price dropped from 85 to 60 USD/bbl during the last weeks). Since public debt is at 80% of GDP and external debt increased to 65% of GDP in 2018, a lower oil price should weigh on the 2019 outlook. We expect a fourth year of recession (-1% growth, after -3% in 2018).

Asia Pacific

China: Preparing for next year

Activity growth continued to slow in November. Industrial production (+5.4% y/y from +5.9% in October) and retail sales (+8.1% y/y from +8.6%) growth moderated. The only good news was a continued recovery of investment (+5.9% y/y in Jan-Nov) which suggests that previous supportive measures have begun to have an impact. Currently, China is having its Central Economic Work Conference. We expect policymakers to come out with new measures to stabilize the domestic economy. Fiscal policy will likely be the main tool, with supportive measures for households (tax cuts and deductions) in order to boost private consumption, and a rise in infrastructure spending to reinforce investment. Meanwhile, the accommodative monetary policy stance should be maintained – with specific measures to support fragile agents (e.g. SMEs). Yet we do not expect a cut in the key policy rate as long as trade tensions do no escalate. Economic growth is forecast to slow to +6.3% in 2019 from +6.6% in 2018.

What to watch

- December 21 – France Q3 corporate margins
- December 21 – France Dec. business confidence
- December 21 – Japan November inflation
- December 21 – U.S. personal income and spending
- December 28 – Russia December Manufacturing PMI
- December 29 – Russia December Services PMI
- December 31 – Mexico Congress to vote on budget
- January 2 – EU December Manufacturing PMIs
- January 2 – Turkey December Manufacturing PMI
- January 3 – Argentina November industrial production
- January 3 – Turkey December inflation
- January 4 – EU December Services PMIs
- January 4 – Eurozone December inflation
- January 4 – France December CPI inflation
- January 7 – Eurozone November retail sales

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