



Weekly Export Risk Outlook



EULER HERMES

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In the Headlines

FIGURE OF THE WEEK: **+2.4%** > US Q2 GDP GROWTH

▶ US: Q2 GDP and employment report

Real GDP grew at a tepid but positive 2.4% quarterly annualised rate in Q2, showing that the recovery is not dead, merely slow. Investment was strong but net exports were a drag. Most importantly, personal consumption expenditures grew, but at a disappointing rate of only 1.6%. Meanwhile, personal savings in June rose to 6.4%, a positive in the long run, but in the short run (now) the economy needs consumer spending to drive growth. This is the same dilemma that the federal government confronts, trying to manage a deficit while continuing to spend and trying to avoid unpopular tax increases. Friday's employment report is expected to show headline job losses of up to 100,000 as a result of further temporary Census workers being laid off, with private payrolls growing around 100,000. Even this sluggish number would be welcome.

▶ Global: PMIs uneven but point to slower growth

A raft of manufacturing PMIs for July released this week, although uneven, on balance point to slowing growth. The Euro-zone was up and is firmly in positive territory, although the rise in July was mainly influenced by Germany. The UK remained relatively strong, although the services PMI was down. In the US, the Institute of Supply Management's index fell, although it still signalled growth for the 12th successive month. Asia was mixed, with India and Australia up and Taiwan, Hong Kong and Korea down. In China, the various PMIs weakened to relatively low levels, but were still well above the lows of Q4 2008 and Q1 2009. Moreover, one service sector PMI for China was also up and there is scope for further stimulus, if needed.

▶ Mexico: Strong rebound maintained

The economic activity indicator (GDP proxy) increased by a rapid 8.8% yr/yr in May and 0.2% s.a. mo/mo, with a broad expansion of industrial, services and agricultural output, confirming the rebound from deep recession (GDP contracted by 6.6% on an annual basis in 2009). The May data followed a 7.4% yr/yr increase in April, which adds up to a likely strong growth of Q2 GDP. However, expect annual growth of around 4.5% in 2010—which implies a slowdown in H2 and output at end-year still well below the peak level prior to the recession—followed by 3.5% in 2011. However, with inflation still at the upper end of the target range and the fiscal deficit projected to narrow, much depends on the durability of the US recovery.

▶ Ukraine: Renewal of IMF lending

The IMF Board last week approved a 29-month USD15bn Stand-By Arrangement (SBA) to support fiscal, energy, monetary policy and financial sector reforms. The previous 24-month SBA, which started in November 2008 but was suspended in late 2009 because of failure to implement crucial reforms, was cancelled. Fiscal and energy reforms are especially ambitious. The fiscal deficit has to be cut to 3.5% of GDP in 2011 and 2.5% in 2012. The quasi-fiscal deficit of Naftogaz, the state oil and gas utility, has to be eliminated from 2011—to this end, the government raised household gas prices by 30% in July. However, substantial implementation risk remains, especially as the economic recovery is already losing momentum. Given Ukraine's weak track record in relation to reforms, renewed suspension of IMF funding cannot be ruled out in the next 12 months.

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► Mediterranean countries & Africa – *Nigeria: Oil reforms*

Parliament may be extended to ensure that new oil and gas sector reforms are pushed through. A Petroleum Industries Bill could lead to the break up of the state oil company (NNPC) into smaller commercial units and oversee large increases in the amount that oil majors pay in royalties and taxes for their operations in deep offshore oilfields. The intention is to revitalise the oil and gas sector by eliminating mismanagement and by increasing transparency of investment. Recent Nigerian oil output has recorded shortfalls of up to 40% of potential production. However, while a tighter regulatory environment and increased private sector involvement may be welcomed, higher taxes will not, and may further limit foreign investment, which is also deterred by the on-off insurgency in the Niger Delta.



► Americas – *Ecuador: Oil contract revision*

A new law was introduced by President Correa last week, which effectively nationalises the oil sector. Henceforth, the state will own all oil and gas production, which means that private sector oil companies will have to renegotiate contracts, turning them into service agreements. Any that do not, will have their assets taken over, although they will be compensated fairly, according to government statements. Oil production has been declining in recent years and this move could continue to deter investment. The law was promulgated by the president under his direct powers, after congress could not reach agreement by the deadline set, indicative of the opposition's ability to frustrate legislation and the president's radical agenda.



► Asia-Pacific – *Indonesia: Monetary and fiscal policies*

Inflation accelerated to a 15-month high of 6.2% yr/yr in July, up from 5% in June and 2.8% at end-2009, largely driven by surging food prices, which rose by 14.1%. A 10% increase in electricity tariffs in July is estimated to have added around 0.4pps to inflation. Nonetheless, the central bank kept its key policy interest rate at 6.5% today as it continues to expect inflation to meet its end-2010 target range of 4-6%. The increase in electricity tariffs is aimed at containing total fuel subsidies, which, after falling from 5.6% of GDP in 2008 to 2.8% in 2009, are projected to increase to around 3.2% this year as a result of higher oil prices. In June, the authorities introduced some measures to reduce the volatility of ST capital flows to curtail extreme currency swings, but these measures will not affect LT economic trends.



► Europe – *Kazakhstan: Strong growth, despite weak banks*

According to the economy ministry, real GDP grew 8% yr/yr in H1 2010, up from 1.2% in calendar 2009, largely driven by hydrocarbons and mining. These sectors have also caused a sharp rise in exports, returning the current account to surplus in 2010 year-to-date. However, other sectors are still struggling because of a continuing credit squeeze. Following the systemic banking crisis in 2009 (four major banks had to restructure their external debt), bank lending is still contracting (6.9% yr/yr in May) while non-performing loans have remained high at around 36% of total loans. Excluding the NFRK (the sovereign oil wealth fund), the fiscal deficit deteriorated sharply year-to-date, but transfers from the NFRK and a USD1bn World Bank loan will help to cover the 2010 deficit.

Worth knowing

► Kenya

A constitutional referendum today may herald significant changes to the political system, including a clearer separation of powers. However, do not expect vested interests to relinquish power easily, no matter the outcome.

► Lithuania

Advance estimates show that Q2 real GDP grew 1.1% yr/yr (-2.8% in Q1), the first increase after six quarters of decline, and 2.9% qtr/qtr (seasonally and working-day adjusted) after -4% qtr/qtr in Q1.

► Pakistan

The central bank increased its key interest rate by 50bps to 13% (30 July). Floods in the NW are reportedly the worst in 80 years and provide humanitarian and health concerns in a region beset with adverse security issues.

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