Weekly Export Risk Outlook

EULER HERMES

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In the Headlines

FIGURE OF THE WEEK: 1% > EURO-ZONE Q2 QTR/QTR GDP GROWTH

Euro-zone: Q2 GDP accelerates

Euro-zone Q2 real GDP increased by 1% qtr/qtr sa (1.7% yr/yr) after 0.2% in Q1—the fastest in four years—led by Germany where growth was an unexpectedly strong 2.2% qtr/qtr. France expanded by 0.6%. Nonetheless, the prevailing view remains that growth will slow over the coming quarters as fiscal consolidation takes hold, global demand slows and the positive impact of stock-building fades. EH projects Euro-zone growth of 0.8% in 2010 and 0.9% in 2011. Meanwhile, inflation hit a 20-month high in July of 1.7% yr/yr. Concerns over a growth slowdown, allied to accelerated GDP contraction in Q2 in Greece and the size of bank re-capitalisation in Ireland have weighed heavily on bond markets as risk spreads have diverged again, though Ireland's government bond auction this week was many times over subscribed.

US: Fed concerns

Last week, the Fed decided to leave interest rate policy unchanged and continue quantitative easing by re-investing maturing securities into Treasuries. These actions were expected, but the statement added concern over the weakness of recent data. In June, the Fed stated that the "economic recovery is proceeding and that the labor market is improving" but last week the Fed stated that "the pace of recovery in output and employment has slowed." The change represents a shift from hopes of a slow recovery to fears of a double-dip recession. Similarly, last month Bernanke noted "that the economic outlook remains unusually uncertain." Since then, the yield on the 10-year Treasury has fallen from 3% to about 2.7%, representing investors' perceptions that the probability of a double-dip recession is now a bit higher.

Hong Kong: Q2 GDP slows

Q2 real GDP increased by 1.4% qtr/qtr sa and 6.5% yr/yr. The quarterly pace was slower than Q1 (2.1%) as consumption growth did not fully compensate for an export growth slowdown. Growth should remain solid, though retail sales—which fell in Q2—raise some questions, and following the data release the government has raised it's forecast for 2010 to 5-6% from 4-5%. EH forecasts 6% in 2010 and 4% in 2011. Inflation is not a major concern, reflected in government forecasts of 2.3% for the year, but the authorities are evidently concerned over the rise in residential property prices, as the HK Monetary Authority introduced tighter regulation of mortgage lending at the end of last week.

Commodities: Higher cost of grain imports

Drought and associated fires have cut Russian wheat output, perhaps by 50%, and the world's third largest exporter has banned overseas sales of grains, at least until the end of the year. The immediate impact is on wheat—prices were up almost 50% in July—and barley, but also other grains, and concerns have been raised about a repeat of the 2007-08 food crisis. However, global wheat stocks (especially in the US) are high and the prices of other staple foodstuffs, such as rice, remain subdued. While the global impact of the current grain shortage may be limited, Russia is a significant supplier of wheat to the Middle East and North Africa and seven of the top 15 wheat importers are located in those areas, including Egypt and Algeria. Expect increased economic (fiscal accounts through subsidy provision) and social pressures (potential for bread riots) to be evident in that region.

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Countries in Focus

Mediterranean countries & Africa – *Côte d'Ivoire: Elections?*

Presidential elections could now be scheduled for 31 October, after several postponements. This would be a significant step in rebuilding an effectively-functioning state—civil war, partition of the country and political crises have all taken a toll since 1999. Enhanced stability in one of the largest economies in Sub-Saharan Africa and the world's largest cocoa producer could improve regional development and global commodity supply. However, the main cocoa crop in 2009/10 (October-September) was the lowest in 15 years and an estimated 50% of trees is over 20 years of age and beyond a normal high-yield existence. Reform and resurgence of the cocoa sector are only likely after political consolidation, but recent history suggests that the electoral timetable is far from assured, so expect delays.

Americas – *Colombia: New administration*

The incoming administration of President Juan Manuel Santos has already adopted a more pragmatic tone than its predecessor, with the restoration of diplomatic ties with Venezuela—though this relationship is likely to remain volatile—and an attempt to repair relations with the judiciary. Nonetheless, the new president can also be expected to continue with a vigorous policy against the FARC and other insurgent groups. President Santos is also likely to continue the liberal economic policy framework, which has proved sound as the economy demonstrated its resilience through the global crisis. Real GDP should increase 4.5% this year and 3.5% in 2011. Debt ratios are manageable and the external balance is not a major problem. Moreover, the FCL with the IMF has been renewed for another year.

Asia-Pacific – *Saudi Arabia: Five-year plan*

The 9th Five-Year Development Plan (2010-14) projects expenditure increasing by over 67% from the previous plan to an overall USD385bn, with the highest sector contributions allocated to education and training and to health. Diversification of the economy remains a high priority, with the private sector expected to lead the way in the non-oil sectors. The new plan is based on an annual average GDP growth rate of 5.2% (gross fixed capital formation 10.4%). However, as an average 3% was recorded between 2005 and 2009 and we forecast 3.5-4% in 2010 and 2011, the overall target looks challenging. Nevertheless, with large fiscal and current account surpluses, an import cover of over two years and a sovereign wealth fund of an estimated USD400bn, the economic outlook remains sound.

Europe – *Central Europe: Q2 GDP*

The Czech Republic economy expanded by 0.8% qtr/qtr sa and 2.2% yr/yr according to the "flash" estimate from the central bank at the end of last week, broadly in line with expectations and up from Q1. No detail has been released yet, but industry and exports are likely to have led growth, with construction lagging. The central bank meanwhile has raised its estimate of the fiscal deficit to 5.4% of GDP in 2010 and 6% in 2011, though this has to be set against a relatively low government debt-GDP ratio, which the bank estimates will only increase to 42% in 2011. Industry and exports also drove growth in the Slovak Republic where Q2 real GDP rose by 1.2% qtr/qtr. However, Hungary's "flash" estimate showed quarterly growth barely changed in Q2 at 0.1%, after just 0.6% in Q1.

Worth knowing

India

Industrial output increased by a lower-than-expected 7.1% yr/yr in June, after 11.3% in May, largely reflecting a sharp fall in growth in capital goods. Meanwhile, wholesale price inflation eased to 10% yr/yr in July because of weaker pressures on food prices because of normal monsoon rains. Even so, expect economic growth to remain vibrant and further monetary tightening.

Japan

Q2 real GDP growth was just 0.1% qtr/qtr, sa, weaker than consensus expectations.

South Africa

The Democratic Alliance and the Independent Democrats agreed to merge, but do not expect a significant challenge to the ANC.