



Weekly Export Risk Outlook



EULER HERMES

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In the Headlines

FIGURE OF THE WEEK: 10.1% TO 1.1% > UK PUBLIC SECTOR NET BORROWING TARGET REDUCTION 2010/11 TO 2015/16 (AS % GDP)

▶ Euro-zone: Fragility still signposted

The level of composite PMIs flash estimate for activity in the Euro-zone in June was well above the 50-mark, still consistent with a positive GDP growth in Q2 2010, and even a slight acceleration after the relatively poor performance in Q1 (+0.2% qtr/qtr). However, the composite PMI was also down for the second consecutive month, after a peak in April, providing a reminder of the fragility of the recovery, with confidence down in manufacturing and in services sectors. Several sub-indicators that give a more forward-looking outlook—such as orders in manufacturing or new business in services—also suggest that the pace of economic activity could moderate in coming months. This survey is in line with Germany's IFO for June, with an expectation index down for the second time in a row, albeit including a slight increase in the current situation index.

▶ China: Exchange rate flexibility

The central bank indicated over the weekend that it will increase exchange rate reform flexibility. This appears to mark the end of the hard peg against the USD and—although the bank's statement lacked specifics—a resumption of the managed crawl that was followed in 2005-08, the previous period of flexibility. However, the bank also re-affirmed that the currency will be managed with reference to a basket of currencies, indicating that the USD will not be the only factor. A fairly modest rate of appreciation can be expected by the end of 2010 (1-3%) with a similar relatively slow pace to continue in 2011. This move comes ahead of the G-20 summit meeting and should help defuse some of the tensions over this issue.

▶ UK: Deficit reduction

The emergency budget introduced this week by the new coalition government proposes aggressive action to cut the fiscal deficit and lower the public debt/GDP ratio. Reduction falls mainly on spending (74% rising to 77% of the total). The aim is to reduce public sector net borrowing from 10.1% of GDP in 2010/11 to 1.1% in 2015/16 and to eliminate the structural (cyclically adjusted) current budget deficit by 2014/15, two years earlier than targeted by the outgoing government. The budget envisages the net public debt/GDP ratio peaking at 70.3% in 2013/14. (General government debt/GDP will peak at 84.9%.) The budget is designed to maintain market credibility and low interest rates and "crowd-in" the private sector. The risk is that actual growth falls below official projections as fiscal support is removed.

▶ Belarus: Gas row highlights financial difficulties

Russia's state-controlled gas monopoly Gazprom cut gas supplies to Belarus by 60% earlier this week, claiming that Belarus had failed to pay increased prices in 2010 and thus accumulated arrears of around USD200bn. In turn, Belarus claimed that Gazprom owes it a similar amount in fees for transiting gas via its territory to western Europe. Belarusian and Gazprom officials subsequently announced that outstanding debts have now been cleared. However, there is also tension between Belarus and Russia over the latter's imposition of higher oil export duties, which are set to have a strong negative impact on Belarus' fiscal and current accounts. These events suggest that Belarus has serious financial difficulties. The country has expressed an interest in a new IMF programme, following the successful conclusion of a 15-month, USD3.4bn Stand-By Arrangement in March.

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► **Mediterranean countries & Africa – *Egypt: Economic outlook***

Consumer price inflation in May, at 10.5% yr/yr (11.4% in April), was down for the fifth consecutive month. With weightings for food and drink and housing accounting for almost 44% and 13.5% in the CPI index, respectively, living costs and some associated social pressures are easing. The economy expanded by 5.8% yr/yr in Q3 2009/10 (FY ending in June) but net exports were a driving force, even with key European markets slowing, and the implied weakness in imports suggests that both GDP growth and inflation—notwithstanding further reductions in energy subsidies—will have been subdued in Q4 and this is likely to continue into H1 2010/11. As a result, monetary policy is unlikely to be tightened in the ST. Expect sound economic policies and GDP growth of around 5% in 2010 and 5.5% in 2011.



► **Americas – *Colombia: Election win for Santos***

Conservative candidate Juan Manuel Santos (Partido de la U), a former defence minister and the chosen successor of outgoing President Alvaro Uribe, won the presidential election run-off last weekend by a wide margin with 69% of the vote, compared with just 28% for his opponent, Antanas Mockus (Green Party, centrist). The result gives the president-elect a strong mandate, even though voter turnout was relatively low at less than 50%, and he is likely to continue the strong security measures of the Uribe presidency, which was probably the key factor behind his comfortable win in the end. Santos is seen as a pragmatist in economic policies and will start with an economy that grew marginally in 2009 and should have solid growth in 2010.



► **Asia-Pacific – *Saudi Arabia: Gold reserves re-assessed***

Recent reports suggest that national gold reserves may have more than doubled to over 320 tonnes, compared with previously released official data suggesting that holdings were around 143 tonnes. This does not reflect new purchases and is thought to represent a different accounting approach, with previously held gold now being classified as official national reserves. Additionally, this follows a strong upward revision in data on foreign exchange reserves, with the IMF indicating that the latter amounted to over USD416bn at end-April 2010. The message to markets, investors and traders is clearly that SAMA (the central bank) has control over substantial reserves, which provide an import cover of around 25 months, and external liquidity should not be a constraint on general business activity.



► **Europe – *Russia: Gradual recovery***

The preliminary estimate of 2.9% yr/yr real GDP growth in Q1 2010 points to a fairly modest recovery so far, especially as inventory restocking and base effects supported the outcome. The acceleration of industrial production growth to 11.5% yr/yr in April-May from 5.1% in Q1 indicates that the recovery will gain momentum in Q2. The outlook thereafter is somewhat subdued by potential downside risks, in particular uncertainties about the oil price trend and weaknesses in the Euro-zone, which accounts for around 40% of Russian exports. Expect about 3.2% growth in calendar 2010. Inflation has gradually eased over the past year to 6% yr/yr in April, encouraging the central bank to cut its key policy interest rate by another 25bps to a historic low of 7.75% in June.

Worth knowing

► **Australia**

Kevin Rudd, head of the ruling Labor Party and PM, did not stand in this week's leadership vote within the party. Julia Gillard, his deputy, was duly elected and became premier on 24 June. Elections are scheduled to take place by April 2011.

► **Commodity prices**

Oil: Benchmark Brent USD76/barrel (average year to date USD78.5/b, average full 2009 USD63/b); **Gold:** USD1,226/oz (average year to date USD1,155/oz, average full 2009 USD973/oz).

► **Ethiopia**

Official results from elections held in May show that the ruling EPRDF of PM Meles Zenawi won 545 out of 547 seats. Despite some opposition and international concerns, the poll was relatively peaceful and credible and policy continuity can be expected.

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