

FIGURE  
OF THE WEEK

47.8

September 2019  
ISM manufactur-  
ing index  
in the U.S.

## In the Headlines



### Trade: The door opens for more tariffs on the EU

The World Trade Organization (WTO) authorized today the U.S. to impose tariffs on EU-imported goods to cover an estimated annual loss of USD7.5bn in compensation for illegal state aid provided to aircraft maker Airbus. The U.S. additional duties target a total of EUR60bn of EU goods, or close to 15% of total EU exports to the US. The goods taxed are mainly planes and aircraft parts, as well as luxury products – such as wine and spirits – and leather goods. The average tariff increase is estimated at +15pp from the current 2% for these goods. Aircraft parts would be taxed at 15%, beverages at 80% and specialized machinery at more than 100%. However, as this represents only close to 3% of total U.S. imports, the impact on the total U.S. import tariff is deemed negligible (around +0.1pp to the current 8%). We estimate an annual exports loss for the EU of -USD9.7bn. The countries that are expected to lose most are France (-USD2.4bn), Italy (-USD2.1bn) and Germany (-USD1.9bn). In GDP growth terms, this would mean around -0.1pp for France and Italy. Additionally, we expect the U.S. to announce a tariff hike on EU car imports in mid-November.



### U.S.: Manufacturing in contraction

The manufacturing sector is clearly in decline. The ISM manufacturing index fell for the seventh consecutive month and has now been below 50 points for two straight months, thus indicating contraction. At 47.8 it's the weakest in over 10 years. Tariffs are taking a toll, driving new export orders down to 41.0, also the lowest in over 10 years. Only one of the 10 components of the survey is above 50, and only three of 18 industries showed expansion. In a separate manufacturing report, new orders for (core) durable goods fell by -0.3% y/y, they rose +7.6% a year ago. Shipments of core durables, which are a direct input into GDP, grew a tepid +1.7% y/y, down sharply from +6.2% a year ago. Consumption is also sliding, as real personal consumption expenditures gained only +0.1% m/m in July, putting the y/y rate to a decent +2.3%, but again it was +3.7% a year ago. And consumer confidence took a hit in September, dropping from 134 to 125 points. But in one piece of good news, the beleaguered housing market has been boosted by falling mortgage rates and has recently shown improvements in sales, starts, and permits.



### Italy: 2020 Budget unlikely to trigger renewed EU tensions

This week the government presented its 2020 budget plan which targets a deficit of -2.2% of GDP – up from -2.1% in 2019. Thanks to finding savings to the tune of EUR23bn, the government was able to avert an automatic sales tax hike from next year onwards. While a renewed escalation in relations with its EU partners à la 2018 – when the EU Commission flat-out rejected Italy's 2019 draft budget – is unlikely, given also the Italian government's intentions to exchange over the budget targets in a constructive manner, full EU approval is not a given. Critic from Brussels is likely to focus on the expected rise in the structural deficit to -1.4% next year up from -1.2% in 2019, whereas in July the EU Commission had argued for a reduction by -0.6pp in 2020. In addition the budget targets rest on rather ambitious assumptions concerning proceeds from the fight against tax evasion (EUR7bn) and GDP growth accelerating to +0.6% in 2020 (we forecast +0.4%). Markets meanwhile have already thrown lingering debt sustainability concerns overboard, buying 10-yr Italian government debt at a record-low yield of 0.88%.



### Morocco: Growth is heading south

Trade openness is not the best bargain in 2019, since world trade in goods already experienced three quarters of contraction and Morocco is no exception. GDP growth came in at +2.5% in Q2 and net exports made a -0.9pp contribution, since export growth came to a sudden stop. This growth performance was also the weakest since Q4 2016. At the same time, agricultural output was impacted by lower crops (-2.8% y/y in Q2). In contrast, non-agricultural output grew by +3.3% y/y, mainly driven by water and electricity output (+20.9% y/y in Q2). Without the exceptional performance in that sector, the latest GDP growth rate would rather have been about +2% y/y; and this is also our growth forecast for H2 2019, since short-term indicators such as car sales are still oriented to the downside (about -10% y/y in August). Low economic growth combined with the increase in days sales outstanding just before the growth slowdown (+3 days to 84 days in 2018) suggests that corporate insolvencies are likely to rise (we forecast +7% in 2019).

# Countries in Focus

## Americas



### Brazil: Manufacturing in a better direction

Two recent data releases are pointing towards a manufacturing recovery in Brazil. Industrial production grew +0.8% m/m in August, higher than expected. This reflects higher mining activity, while the production in consumer and capital goods fell. Secondly, the September Purchasing Managers Index (PMI) signaled the highest manufacturing production growth in one and a half years, standing at 53.4 points (a reading above 50 signals growth). The upturn in order books seems to have been driven by the domestic market, as exports were down. This is in line with the fact that [the least open emerging economies are faring better](#) than the most open ones amid high trade policy uncertainty and escalating trade tensions. The good job performance suggests that businesses expect growth momentum to be sustained in the near term. A gradual return of confidence and domestic monetary easing could help the economy accelerate from growth of +1% this year to +1.8% next year.

## Europe



### Emerging Europe: Deteriorating sentiment

Economic sentiment in the industrial sector of large eastern European economies has continued to worsen, by and large. In September, the manufacturing PMI deteriorated further or stayed stable at a weak level in **Poland** (47.8 points, down from 48.8 in August; a reading below 50 signals contraction), **Czechia** (44.9, unchanged), **Hungary** (51.8 from 52.6) and **Russia** (46.3 from 49.1). This took the quarterly averages in Q3 2019 to the weakest levels since Q4 2012 in **Poland** and **Hungary** and even since Q2 2009 in **Czechia** and **Russia**. A common feature in these economies was that new export orders fell strongly, reflecting rising fears surrounding ongoing trade conflicts. In **Russia**, the steep fall in the overall index also reveals declines in new domestic orders and production, signaling that the economy may drop into recession in Q3. Meanwhile, **Turkey's** overall PMI improved to a neutral 50.0 (from 48.0) supporting the view that the recession there has bottomed out. Yet, risks remain on the agenda in [Turkey](#).

## Africa & Middle East



### Kenya: Growth is here to stay

GDP growth was stable at +5.6% y/y in Q2 (unchanged from Q1). Drought conditions had an impact on agricultural output growth (+4.1% y/y in Q2 after +5.2% in Q1). Growth continued to be diversified, with a balanced contribution of manufacturing, construction, trade, education and digital (telecoms, mobile payment services) of +0.5pp each to overall GDP growth. The manufacturing PMI suggests that growth is here to stay (52.9 points in August) since new orders showed an increasing level. The macroeconomic environment is growth-supportive, particularly as inflation posted a moderate 3.8% y/y in September. Foreign reserves have grown to eight months of import cover, easing liquidity risk in the economy. The current environment is also allowing fiscal consolidation (the fiscal deficit should decrease to -5.5% of GDP in 2019 from -7% in 2018) and public debt stabilization below 60% of GDP. As a result the KES exchange rate is stable and KES borrowing costs have decreased by -100bp this year. GDP growth should remain stable at +5.7% in 2019 and 2020.

## Asia Pacific



### APAC: Accommodative monetary policies

The Reserve Bank of **Australia** (the central bank) lowered its key policy interest rate again by 25bp this week (after similar moves in June and July) to a record low of 0.75%, in a bid to boost the faltering economy. Real GDP had posted the [weakest annual growth in a decade](#) in Q2 2019 while inflation expectations have remained low. Last week, the central bank of the **Philippines** (BSP) had cut its main policy interest rate also for the third time this year, by 25bp to 4%. That cut was prompted by rapidly easing inflation (1.7% y/y in August) and disappointing growth momentum. Annual real GDP growth hit a four-year low of +5.5% y/y in Q2 and the manufacturing PMI edged down to 51.8 points in September (compared to an average 53.4 since the survey began in January 2016). Meanwhile, the Bank of **Thailand** (BoT) kept its policy rate unchanged at 1.5% last week, after it had cut by 25bp to 1.5% in August. Inflation in Thailand fell to 0.5% y/y in August, below the BoT's target range of 1%-4%. We expect further monetary easing to be likely in Australia and the Philippines but less likely in Thailand.



## What to watch

- October 3 – Kazakhstan Q2 GDP
- October 3 – Romania Central Bank meeting
- October 3 – Russia September services PMI
- October 3 – Turkey September inflation
- October 3 – U.S. Sept. ISM non-manufacturing index
- October 4 – Eurozone Q2 corporate profitability data
- October 4 – Latvia August industrial production
- October 4 – Russia Q3 consumer confidence
- October 4 – U.S. September employment report
- October 6 – Portugal parliamentary elections
- October 7 – Czechia August industrial production
- October 7 – Hungary August industrial production
- October 8 – France August trade balance
- October 8 – Hungary September inflation
- October 9 – Bulgaria August industrial production

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