Euler Hermes Economic Research

# Weekly Export Risk Outlook

16 October 2019

## In the Headlines

FIGURE OF THE WEEK

8.5%

**Expected U.S. average tariff by year-end**

### U.S.-China mini-deal: Trade policy volatility is here to stay

The so-called "mini-deal" between the U.S. and China is not a game-changer for the global economy. The U.S. average tariff could reach around 8.5% by year-end (taking into account a 10% tariff on EU car imports and the 15 December round of tariffs on Chinese goods). We remain in our intermediate "Trade Feud" scenario; policy volatility is the new norm in trade negotiations, and it goes beyond tariffs (ban lists of companies). We are far from a comprehensive agreement. The hardest part of negotiations still lies ahead: the two parties are switching to "Phase two", which should deal with market access, IP protection, China's industrial subsidies, U.S. sanctions on Huawei and Chinese surveillance firms. We are unlikely to see a comprehensive deal before the 2020 U.S. election. We give 55% probability to the scenario of the U.S. turning its trade policy focus to Europe on 17 November. In the case of a 10% tariff on car imports, aggregate export losses for the EU would be EUR4bn per year, and GDP growth would be hit by an annual -0.1pp.

### Brexit: A technical extension likely, followed by a deal

Prospects for a Brexit deal between the EU and the UK have significantly risen over the past few days, but a technical extension until early 2020 is still likely in our view. A deal should lower the uncertainty both in the UK (-0.3pp of real GDP growth per year since 2018), and should progressively help the UK return to "business as usual". We expect the rise in business confidence to boost domestic investment, which contracted over the past two years. Foreign investment should also gain momentum. Labor shortages should reduce and support corporates' margins. However, the unwinding of contingency stockpiling will shave off -1.5pp from real GDP growth over the next two quarters. Hence, we expect GDP to fall by -0.1% q/q in Q4 2019 and Q1 2020. A recovery is expected thereafter, with growth reaching +0.6% q/q on average in H2 2020. For the EU, the cost of uncertainty (-0.2pp of real GDP growth per year) will slowly fade away but we expect a negative base effect on Eurozone exports due to frontloading of imports from the UK (-EUR2bn in the coming six months).

### Turkey: The tie that binds

The U.S. administration announced sanctions on Turkey after the military intervention in Syria, but the measures are more symbolic than binding. The main measure is a trade tariff of 50% on Turkish steel exports towards the U.S.. These tariffs were already implemented from August 2018 to May 2019 as the U.S. administration hiked them from 25% to 50% after a -50% depreciation of the TRY that was seen as a competitive threat. The impact of the recent trade tariff should be quite limited since the U.S. market is only the 5th export destination of Turkish exports (4.9% of total exports). Should the sanctions be broadened by the U.S. or with Europe joining the retaliation, the impact would increase, but mainly through the financial channel, in our view. Turkish vulnerability to capital flow reversals is still quite high since the level of foreign reserves is still well below the short-term external debt level, which leads us to expect renewed depreciation pressures on the TRY. As a result, growth should remain subdued at +2.3% in 2020.

### France: Industrial recession on the cards?

In France, manufacturing production experienced a one-year low in August (seasonally adjusted data), about -3% below the peak output observed in May. A contraction of the manufacturing output is now likely in Q319 (it will be avoided only if the output grew by +3.5% in September). This slowing industrial momentum came after months of disappointing confidence surveys, with rising inventories and a decreasing backlog of orders in the whole car supply chain. Carmakers (-2.7% y/y), metals (-2.8%) and plastics/rubber (-2.1%) are among the main contractions in a pattern that is mirroring the Q418 industrial output contraction. A broad negative GDP growth figure is unlikely since the service activity did not exhibit any weakness, but the Q3 GDP growth figure should be quite weak, since the construction output went also on the downside in July-August and with the same magnitude than the industrial output. Moreover, the weakening observed in the industrial landscape is quite broad-based in Europe, showing internationally integrated supply chains are exposed to a lower growth momentum.

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# Countries in Focus

Americas

## Canada: Labor market shows continued strength

The Canadian labor market continued to outperform the rest of the economy, creating +53.7k jobs in September vs. expectations of only +7.5k. Gains were mostly widespread across industries, with major gains in health care and social assistance which added +30k jobs, the most in over 13 years, while accommodation and food services gained +23.3k jobs, the most in over six years. Jobs rose in seven of ten provinces. Year-to-date the economy has created a very strong +358k jobs, the most since 2002. The unemployment rate fell from 5.7% to 5.5%, just off the record low of 5.4% set in May, but part of the decline was due to a -0.1% drop in the labor force participation rate to 65.7%. Hourly wages for full time workers rose +0.4% to a strong y/y rate of +4.3% compared to the post-recession average of +2.3%. One disappointment was a -0.3% decline in the number of hours worked, a key input into monthly GDP.

Europe

## Croatia: Slowdown amid external pressures

In the first half of 2019, economic growth gained strong momentum in Q1 (+3.9% y/y) but lost it in Q2 (+2.4% y/y). A key trigger for the deceleration was a marked slowdown in external demand, mainly from the Eurozone, which lowered real export growth to just +1.3% y/y from +4.6% in Q1. Another trigger was the weakening of consumer spending (+2.7% y/y in Q2, after +4.3% in Q1) as a result of feeble labor market and tight credit conditions. Meanwhile, capital formation was the main growth driver in H1 2019; yet, a slowdown in fixed investment growth (+8.2% y/y in Q2, after +11.5% in Q1) and a build-up of inventories in Q2 suggest that this momentum will gradually fade in the coming quarters. Overall, we expect the economic moderation in Croatia to continue in H2 2019 and in 2020 against the background of ongoing weak external demand, notably from Western Europe. The country's annual real GDP is forecast to increase by +2.5% in 2019 and +2% in 2020.

Africa & Middle East

## South Africa: Not a walk in the park

South Africa is again exposed to the signals that triggered a sharp contraction of its GDP in Q119 (-0.8% q/q): A shrinking manufacturing output and power blackouts. The manufacturing PMI was in free fall during the last two months: At 41.6 in September, this is the lowest level since August 2009. Hard data is consistent, since the manufacturing output was in contraction during the last 3 months (to August), a pattern last seen in 2017. Despite recent Eurobond issuance (USD 5bn), power remains a key problem. A shortage of cash was among the key issues, but too low investment and a depleted output capacity are also key bottlenecks that still await a solution. As a result, a new blackout period is expected during the next weeks. Against this background, the fiscal deficit is deteriorating fast, from -4.2% of GDP in 2018 to an expected -6.5% in 2019. It should help to avoid a negative growth figure in 2019 (+0.5%), but the outlook should again deteriorate in 2020 (+0%).

Asia Pacific

## Singapore: The L word

Singapore just avoided a full-fledged recession, since Q3 GDP growth was +0.6% q/q after a negative figure in Q2. No recession yet, but rather a boom-bust profile that ends in a flat-lining growth cycle: The y/y growth figure was stable in Q3 compared to Q2 (+0.1%). Construction has helped to soften the landing of Singaporean growth, since both the public and private construction output contraction had softened (after strong output losses in Q2) and should now be back to growth, which in turn shows that fiscal buffers that are used in a countercyclical way can smooth the cycle. Otherwise, supply-side indicators remain quite weak: The manufacturing PMI was below 50 for the fifth straight month in September and the electronics PMI also exhibited an index below 50 (49.1 in September), suggesting a weak momentum for both international trade and electronics that is set to persist in the short-run. As a result, GDP growth should follow a stagnation path at +0.4% for both 2019 & 2020, after +3.1% in 2018.

# What to watch

- October 17 – Poland September industrial production
- October 17 – Singapore September electronic exports
- October 18 – China Q3 GDP
- October 18 – China September industrial production
- October 21 – Poland September retail sales
- October 21 – Japan September industrial production
- October 21 – Poland October business confidence
- October 21 – Taiwan September export orders
- October 22 – Hungary monetary policy meeting
- October 22 – Spain August trade balance
- October 23 – Turkey October consumer confidence
- October 23 – Ukraine monetary policy meeting
- October 23 – France October business confidence
- October 24 – Turkey monetary policy meeting

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