

FIGURE  
OF THE WEEK

-0.2%

Q1 2019 q/q  
GDP decline  
in Argentina

## In the Headlines



### U.S.: Fed holds, but hints strongly that cuts are coming

As expected, the Federal Reserve held the Fed Funds interest rate unchanged but hinted at rate cuts in the near future. Euler Hermes believes that there will be two cuts this year with the first one coming at the July meeting if no agreement takes place between China and the US during the G20 summit in Japan at the end of June 2019. The accompanying statement dropped the word "patient" which had been used for some time to describe the Fed's approach to deciding on interest rate moves. It also downgraded the outlook for the economy from "solid" to "moderate", said that there were now "uncertainties" for the outlook, and that inflationary expectations had "declined". Projections for inflation for 2019 were downgraded from 1.8% to 1.5%. More importantly, the "dot plot" indicated that 8 of 17 Fed members now see at least one cut this year, and 7 see two cuts. In March none of them had expected a cut. Finally, there was a dissent on the vote for the first time in the Powell era. St. Louis Fed President James Bullard wanted to cut rates immediately. Overall the decision and the accompanying materials suggest an imminent rate cut as the Fed faces a slowing economy, below-target inflation, and trade concerns.



### Russia: Rate cut as economy falters

The Central Bank of Russia (CBR) cut its key policy interest rate by 25bp to 7.50% last week, ending the monetary tightening cycle that began in September 2018. The CBR cited slowing inflation (5.1% y/y in May, down from a recent high of 5.3% in March) and weak economic growth in H1 2019 for its move. This week, a second estimate by Rosstat confirmed that real GDP grew by just +0.5% y/y in Q1, down from +2.7% posted in Q4 2019. The supply-side breakdown reveals sharp output declines in Q1 for real estate activities (-3.5% vs. +0.3% in Q4), administrative & support services (-2.8% vs. +2.9%) and wholesale and retail sales (-3% vs. +2.2%). The latter is mainly due to the wholesale cluster as large traders increased stocks ahead of the VAT hike at the start of this year. Retail sales grew by +1.6% y/y in Q1 though it slowed to +1.2% y/y in April. Meanwhile, industrial production growth experienced a rollercoaster ride. After surging from +2.1% y/y in Q1 to +4.6% in April, it fell back to +0.9% in May. Overall, we forecast full-year growth to slow from +2.3% in 2018 to +1.3% in 2019 and +1.5% in 2020.



### Spain: Acceleration of labor cost growth

Spain's cost competitiveness normalization continues as predicted in [our article on the end of the Spanish miracle](#). This is consistent with the +22.3% hike in the minimum wage as of January 2019 and with the unemployment rate reaching a ten-year low. In Q1, companies' labor costs increased +2.1% compared to Q1 2018, the fastest pace in more than five years. This acceleration was driven by both wages (+1.7% y/y) and other costs (+3.1%). When looking at sectors, services registered the fastest rise in labor costs in Q1, posting the highest growth (+2.3% y/y) since 2013. This is in line with our conclusions about the consequences of the minimum wage hike. As many sub-sectors in services have a high labor intensity (ratio of compensation to sector gross value added) and low average compensation by worker, they have been the most sensitive to the increase. Going forward, we see higher labor costs indenting corporate margins: we expect the profit share of gross value added to fall from 43% to 41.5%, its lowest level since 2011, converging to the average Eurozone level (about 40.5%).



### Africa: One size does not fit all

Despite the lowest global FDI flows in the last 10 years (USD1.3tn in 2018), Africa benefitted from an increase to USD46bn (+11%) in 2018; yet debt remained the main financing scheme. According to Unctad, the main destinations of FDI flows were Egypt (USD6.8bn), South Africa (USD5.3bn), Congo Rep. (USD4.3bn), Morocco (USD3.6bn) and Ethiopia (USD3.3bn). However, FDI is not always equity; and intracompany loans were dominant in Congo Rep. and South Africa. Moreover, USD4.6bn of FDI outflows from South Africa also means that net FDI covers only a negligible 8% of the current account deficit (still heavily financed through portfolio flows). In other regions, FDI flows remained quite weak, particularly to West Africa (USD9.6bn, lowest level since 2006) and Central Africa (USD4.5bn, excl. Congo Rep.). Overall, according to our estimate net equity FDI inflows financed only about one third of the combined -USD80bn current account deficit observed in Africa in 2018; so debt accounted for two thirds. As we expect the current account gap to widen to -USD110bn in 2019, debt will likely remain the main financing scheme.

# Countries in Focus

## Americas

### Argentina: Finally bottoming out?

In line with expectations, the economy contracted for the fifth consecutive quarter, posting a -0.2% q/q decline (-6.4% y/y). Growth in government consumption was positive for the first time in more than a year (+2% q/q but -1.1% y/y) and net exports supported overall GDP growth as imports contracted and exports grew slightly. Private consumption continued to contract (-2.5% q/q and -12.5% y/y) along with investment. On the supply side, agriculture and livestock came to the rescue (+5.3% q/q) and the manufacturing sector halted its one-year long contraction (+0.6% q/q). While the growth carry-over is at -2.5%, GDP contracted less than in the past three quarters (-2.1% q/q on average). The worst of the recession could be behind us; we expect the economy to slowly emerge from it this year, posting an annual contraction of -1.8% in 2019 and +2% growth next year. Yet as elections loom, the risk of a policy mistake increases; and defeat of President Macri would be a threat to debt sustainability.

### Turkey: Weak start into Q2 ahead of Istanbul election rerun

Industrial production fell by -1% m/m in April, the first m/m decline after three months of increases. In y/y terms, the contraction in industrial output accelerated to -4% from -2% y/y in March. The production of intermediate goods (-8.5% y/y) and capital goods (-7.6% y/y) dropped particularly sharply. Likewise, real retail sales declined by -1.8% m/m in April, the first such fall after three months of increases. In y/y terms, the decrease in retail sales accelerated as well, to -6.9% from -3.4% y/y in March. In all, these developments do not bode well for investment and consumer spending at the start of Q2. It appears that the political and financial turmoil in the aftermath of the local elections has not only led to a [renewed drop in sentiment](#) but also in real economic activity. Expect renewed turmoil after the [Istanbul election rerun](#) on Sunday, 23 June. Meanwhile, the current account deficit widened to -USD1.3bn in April from -USD0.6bn in March, though the 12-month cumulative deficit continued to narrow, to -USD8.6bn in April from -USD12.9bn in March. For 2019 as a whole we forecast a shortfall of -2.2% of GDP.

### Ghana: Growth innuendo

Ghana is changing fast: Its nominal GDP more than doubled in the last five years. High growth (+5.4% in 2018, +8.1% in 2017) is expected to continue in 2019 (+7%). Oil and metals are the main growth drivers, adding to key strengths in agricultural commodities (cocoa and coffee). But commodities are not the only game in town. Ghana is less vulnerable to USD shortages than before. The current account deficit narrowed (-3.2% of GDP in 2018, compared to -12% in 2013) and is now fully covered by FDI inflows (+3bn USD in 2018, more than in Nigeria). Ghana also broadened its growth cycle to other sectors. Increased savings (mainly driven by higher export revenues) have helped to finance growing healthcare spending (+1pp contribution to growth in 2018). But, even in a virtuous circle, do not forget credit risk. The government had to close nine banks in 2018, with fiscal costs of 3.4% of GDP according to the World Bank. Good news was the swift resolution, something that is not common in Africa.

### Australia: Monetary easing needs fiscal stimulus on its side

The Reserve Bank of Australia (RBA, the central bank) cut its key policy interest rate by 25bp to an all-time low of 1.25% in early June and indicated in the minutes (released this week) that a further cut is on the horizon. The RBA cited low inflation (1.3% y/y in Q1) and rising unemployment (5.2% in April and May, up from a recent low of 4.9% in February) as drivers for its move. Moreover, real GDP growth decelerated to +1.8% y/y in Q1, the slowest increase since Q3 2009. Fixed investment (-1.5%) and private consumption (+1.8% y/y) were particularly weak in Q1; and nominal retail sales in April (-0.1% m/m) do not point to an improvement in Q2. Monetary easing is likely to support growth somewhat in H2 but given already low interest rates, fiscal stimulus would be more effective. With public debt at just 41% of GDP, the government has sufficient fiscal leeway but, as in Germany, a political obsession with achieving a budget surplus may inhibit more substantial measures than those efforts on tax changes and a few infrastructure projects that have been outlined in the budget.

## What to watch

- June 21 – Japan May CPI
- June 23 – Turkey: Istanbul election rerun
- June 24 – Germany June ifo business climate
- June 24 – Mexico April Economic Activity Index
- June 24 – Poland May retail sales
- June 24 – Poland, Turkey June business confidence
- June 25 – France June business confidence
- June 25 – Hungary monetary policy meeting
- June 25 – Vietnam Q2 GDP growth (flash estimate)
- June 26 – U.S. June consumer confidence
- June 26 – Argentina Q1 current account balance
- June 26 – Argentina May trade balance
- June 26 – Czechia monetary policy meeting
- June 26 – France June consumer confidence
- June 26 – Thailand monetary policy meeting

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