Weekly Export Risk Outlook

EULER HERMES

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In the Headlines

FIGURE OF THE WEEK: -5% > US HOUSING STARTS IN JUNE

US: Financial reform bill, housing market

The U.S. Congress has passed sweeping reforms of the financial services industry, including regulations on institutions posing systemic risk, consumer protection, derivatives trading, hedge funds, mortgage instruments, bank capital, rating agencies and more, but there was nothing about the mortgage giants Freddie Mac and Fannie Mae who were instrumental in the crisis. The expiration of the USD8,000 home-buying tax incentive distorted May housing data, but the market is still sputtering. Housing starts dropped 5% mo/mo in June and are down 5.8% yr/yr, though they are still 15% off the recessionary bottom in April 2009. Permits actually re-bounded 2.1% mo/mo in June, but were down 2.3% yr/yr, though they are also still 12% off the bottom. Nonetheless, the Housing Market Index survey fell to 14 from 22 in May. Less sputtering is needed for recovery.

Hungary: IMF/EU discussions

The IMF and the EU suspended talks during a review of the EUR20bn loan programme last weekend over differences on fiscal deficit reduction plans, underlining that the new Fidesz government can be a difficult negotiating partner. Markets have tumbled and the HUF/EUR exchange rate has weakened 3.5%. Hungary is not facing immediate financing pressure—it had stopped drawing on the facility last year when it regained access to LT bond markets—but the dispute has affected investor sentiment and raised borrowing costs (in a ST bond sale this week Hungary raised less than planned, while yields climbed). It may also put pressure on sovereign ratings and increase the risk of private sector defaults on FX-denominated loans. Without a follow-up to the existing loan programme (ends in October) Hungary will have to operate without a safety net, in a still fragile environment.

Greece: IMF/EU review

The IMF, EU Commission and ECB have completed the first interim review under the stabilisation package agreed in May. The review was generally positive—the state budget deficit was lower than projected and the structural reforms are making progress. Indeed, the H1 deficit was down 45%, better than target, and a pension reform bill has been passed by parliament, which if fully implemented will be a radical adjustment. The positive assessment contributed to an improving mood in bond markets—Greece issued 13-week T-bills this week and 26-week bills last week (both oversubscribed). However, long-dated yields remain high, GDP is expected to contract in 2010-11 and the current account deficit is not closing as rapidly might have been expected, though there was a surplus in May, which suggests that Greece still faces a long haul. Much will depend on EU growth.

Brazil: Interest rates

The central bank's monetary policy committee, meeting this week, is likely to raise interest rates again, which would be the third consecutive increase. With consensus growth forecasts of 7.2% for 2010, May retail sales up 10.2% yr/yr and 1.4% mo/mo, sa and inflation expectations of 5.4% at year-end, overheating concerns are still likely to outweigh signs that the economy may be slowing such as data on industrial production (down slightly mo/mo, sa in May) a more modest increase in May employment and a fall in consumer prices in the first half of July, but nonetheless the pressures on interest rates may be abating. Meanwhile, President Lula da Silva opened the first commercial deep-sea oil production well this week, but events in the Gulf of Mexico illustrate the daunting technological requirements of exploiting the future potential of Brazil's offshore reserves**.**

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Countries in Focus

Mediterranean countries & Africa – *Algeria: new regulations*

New procedures regarding the award of non-oil public contracts are aimed at the promotion of local businesses but may be seen as further restrictions on foreign participation. The government is implementing a USD286bn five-year plan (2010-14) of public projects and the new regulations are officially intended to ensure that the regulatory environment will minimise wastage, corruption and inefficiency. However, with oil and gas exports supporting current account surpluses and FX reserves of USD148bn (25 months import cover) the economy is relatively robust and does not appear to need measures that may be seen as restrictive. Expect the private sector trading environment to remain difficult—last year, legislation was enacted that required imports to be purchased only by use of documentary credits issued by local banks.

Americas – *Jamaica: debt dynamics*

An IMF programme was formally approved in February 2010 and an orderly, quasi-voluntary domestic debt exchange was completed in January 2010. The former provides a credible framework for economic adjustment and, importantly, all the quantitative targets were met in the first review in June. The latter lengthened the maturity of and reduced interest payments on domestic public debt. Nonetheless growth is expected to contract in 2010 for the third consecutive year (aluminium production is well down) and the debt dynamics remain daunting (overall fiscal deficit 2010 of around 6.5% of GDP). The external balance also remains fragile, though FX reserves have increased. The government has a legislative majority but poor economic prospects and security concerns could erode popular support.

Asia-Pacific – *Thailand: monetary tightening*

Although inflation remained moderate at 3.3% yr/yr and 0.2% mo/mo in June, the Monetary Policy Committee raised its key policy interest rate by 25 bps to 1.5% last week, arguing that the impact of the political turmoil on the economy in Q2 has been limited and expecting increased inflationary pressure in the period ahead. Manufacturing output fell 2.9% mo/mo in April and 3.9% in May but still grew an average 19.5% yr/yr in the two months after a 31% rise in Q1. In April-May, growth of merchandise exports picked up to 38.5% yr/yr from 32% in Q1 while private consumption grew 7.2% (7.7% in Q1) and private investment 20% (18.1% in Q1). Meanwhile, a state of emergency—imposed in the wake of the political unrest—was lifted in eight northern provinces but was extended in 16 other provinces, including Bangkok.

Europe – *Croatia: still contracting*

Economic recovery is taking a long time to arrive. Real GDP contracted by 2.5% yr/yr in Q1, after declining by 4.5% in Q4 2009 and 5.8% in calendar 2009. Domestic demand was particularly weak in Q1, with investment shrinking by 14%, private consumption 4% and public spending 1%. Early indicators for Q2 are not promising. Retail sales shrank about 4% yr/yr in May, similar to the outcome of previous months, and unemployment remained high at 16.6% in June. Inflation, however, is low at 0.7% yr/yr in June. In 2010, the fiscal and current account deficits are forecast to be around 4% and 5% of GDP respectively, while external debt will rise to a hefty 105% of GDP. The HRK/EUR exchange rate has been stable year-to-date, supported by solid FX reserves which currently provide over six months import cover.

Worth knowing

Ireland

Moody's downgraded LT sovereign debt rating to Aa2 from Aa1, but 6- and 10-yr bonds were issued successfully this week

Australia

Snap general elections have been called for 21 August, less than one month after Julia Gillard replaced Kevin Rudd as head of the ruling Labour Party.