Weekly Export Risk Outlook

EULER HERMES

2 June 2010

In the Headlines

FIGURE OF THE WEEK: 8.6% > INDIA'S Q1 2010 GDP GROWTH

India: Strong expansion

In calendar Q1, real GDP growth was 8.6% yr/yr, up from 6.5% in Q4 2009. Poor monsoon rains resulted in a weak contribution from agriculture (0.7% yr/yr increase) but otherwise the expansion was broad-based, with the main drivers being manufacturing (16.3% yr/yr increase) and services. With upward revisions to previous quarters, the full FY2009/10 (April-March) GDP expansion was a higher-than-projected 7.4%, compared with 6.7% in 2008/09. The outlook appears robust, even with some negative contagion from a weak Eurozone and a staged withdrawal of recent stimulatory policies. Assuming a rebound in agriculture, expect annual GDP growth of around 8-9% in both 2010 and FY2010/11. However, with inflationary pressures still feeding through, expect the Reserve Bank of India to increase key interest rates at its next meeting in July, if not before.

Czech Republic: Post-election uncertainties

Voters expressed their discontent with established parties in parliamentary elections last weekend. The Social Democrats came in first with 22.1% of the vote (down from 32.3% in 2006), followed by the ODS with 20.2% (35.4% in 2006). The KDU-CSL and the Green Party, which formed a centre-right coalition government with the ODS in 2007-2009, failed to return to government. The beneficiaries were two new centre-right parties: TOP09 (16.7%) and Public Affairs (10.9%). Coalition talks between the three centre-right parties, which together gained 118 out of 200 parliamentary seats, are underway and provide scope for a reform-minded government, although as the two new parties are relatively unknown quantities there are some uncertainties.

Colombia: First round gain

Against expectations, conservative candidate Juan Manuel Santos (Partido de la U), a former defence minister and the chosen successor of outgoing President Alvaro Uribe, has a strong lead after the first round of the elections, with 46.6% of the vote. Nonetheless, a second round run-off will be needed in which his opponent will be Antanus Mockus (Green Party, centrist). Mockus took just 21.5% of the vote in the first round, however, despite running level—or even being ahead—in most opinion polls before the election. Traditional parties finished a long way behind. It looks as though expected continuation of the strong security measures under Uribe may have swung the vote towards Santos, particularly in rural areas on a generally high turn out, and he clearly has the momentum going into the run-off.

United Arab Emirates: More debt concerns

The debt problems of Dubai World and its property subsidiary Nakheel have receded with an agreed re-profiling of obligations. However, corporate difficulties in Dubai are still evident. Dubai Holding—owned by the emirate's ruler, Sheikh Mohammed bin Rashid al-Maktoum—reported losses from its commercial arm of USD6.4bn for 2009. These relate principally to real estate sector issues. As a result, a rollover (on commercial terms) of an upcoming loan repayment of USD555mn is being negotiated. Additionally, other parts of Dubai Holding are negotiating with creditors—DIC has asked for a three-month delay in the repayment of a USD1.25bn syndicated loan. It seems unlikely that the real estate market will improve significantly in the ST, so expect pressures from this sector to continue.

Countries in Focus

Mediterranean countries & Africa – *South Africa: Growth*

Real GDP expanded by 4.6% qtr/qtr in Q1, compared with 3.2% in Q4 2009 and only 0.9% in Q3 2009, with growth evident across the board, although still modest in some sectors. Meanwhile, household incomes have yet to recover fully from 2009, with employment levels still contracting. In addition, fixed investment remains subdued, with residential building activity yet to bottom out, non-residential building activity still falling and construction experiencing weak project growth. Construction (pre-World Cup) and government spending (stimulatory policies) were driving forces that are likely to be subdued going forward but recent good rains suggest a stronger contribution from agriculture and there will be expenditure gains from the forthcoming (June-July) World Cup, so expect 3-3.5% GDP growth in 2010 overall, after contraction of 1.8% last year.

Americas – *Peru: Vigorous upturn*

Real GDP was up 6% yr/yr in Q1 (3.4% Q4 2009) the highest quarterly growth since 2008 and broadly in line with expectations. The recovery has been fuelled by stronger commodity prices, underpinned by stimulus through fiscal and monetary policies. Construction led the way in Q1, up 16.8% yr/yr, but manufacturing growth was also positive (+7.3%) for the first time since Q4 2008. On the demand side, both private investment and consumer spending turned up, although public consumption also remained strong. In response to the vigorous upturn, which could produce GDP growth of 5-6% this year—provided commodity prices do not fall sharply—the central bank began to raise policy interest rates in early May, from 1.25% to 1.5%. The external balance remains strong and public debt is relatively low.

Asia-Pacific – *Thailand: Uncertain outlook*

After the army's breakup two weeks ago of the siege of parts of Bangkok's commercial district by anti-government protesters—which resulted in heavy violence—order appears to have been restored in the capital and most businesses have resumed operations, although the state of emergency has not been lifted. PM Abhisit today survived a no-confidence vote over the handling of the crisis. Q1 real GDP grew 3.8% qtr/qtr (seasonally-adjusted) while base effects lifted the yr/yr change to 12%. GDP is likely to contract qtr/qtr in Q2 as a result of the impact of the unrest and both the political and economic outlooks are highly uncertain for H2. Assuming that political instability fades back to the level of 2006-2009, when the economy still grew at a reasonable pace, GDP may expand by around 4% in calendar 2010.

Europe – *Slovenia: Still contracting*

The economy remains in recession as seasonally-adjusted real GDP contracted by 0.5% qtr/qtr in Q1 after falling by 0.3% in Q4 2009. On a yr/yr basis, the pace of decline eased from 5.5% in Q4 to 1.2% in Q1. Household spending was flat and government spending grew 1.8% yr/yr, but a fall of 8.2% in investment pulled down domestic demand by 1.6%. External demand made a positive contribution of 0.5pp as export growth (4.5%) outpaced import growth (3.8%). Unemployment increased from 6.4% in Q4 to 7.1% in Q1, so expect consumer spending to remain weak and marginal GDP growth of only around 0.5% in calendar 2010. Consumer price inflation eased slightly to 2.1% yr/yr in May from 2.3% in April but was higher than the average 1.4% in Q1.

Worth knowing

US

Recent economic data continue to suggest a robust recovery—GDP, consumer confidence, factory orders, ISM indexes, construction spending, home sales, income etc. Friday's employment report is also likely to be strong, showing job growth for the fifth straight month, but expect unemployment to remain at 9.7%-9.9%.

Commodities

Oil: Benchmark Brent USD72.7/barrel (year to date average USD78.9/b); **Gold**: USD1227/oz (ytd average USD1141/oz).

9 June 2010

In the Headlines

FIGURE OF THE WEEK: EUR80BN > GERMANY'S FISCAL CONSOLIDATION

Germany: Austerity package

After two days of intense talks within the ruling centre-right coalition, German Chancellor Angela Merkel announced a large fiscal consolidation plan of more than EUR80 billion. Described as a 'unique effort', the austerity package largely relies on cuts in social welfare and unemployment benefits and reductions in various subsidies and public sector jobs (up to 15,000 losses), but also contains new taxes (e.g. on air travel, the nuclear power industry and the financial sector). The measures will be implemented from 2011 to 2014 with the aim of reducing the fiscal deficit from the 5.5% of GDP expected in 2010 (3.1% 2009) to 3% by 2013. However, further consolidation will probably be needed to meet the terms of the new constitutional law, which limits the budget deficit to 0.35% of GDP beyond 2015.

US: Disappointing employment data

The employment report (May non-farm payrolls) last Friday disappointed as the private sector created only 41,000 jobs, well below what had been expected. (Overall job-creation was 431,000, but this figure included 411,000 temporary jobs at the Census Bureau). However, the good news is that May was still the fifth consecutive month in which the report was positive. Moreover, Fed Chairman Bernanke commented that, while the unemployment rate will remain elevated, he thought the recovery in the US was gaining traction. The jobless rate fell slightly to 9.7% from 9.9% in May.

Hungary: Market turbulence

Comments by two senior party officials of the newly-elected Fidesz government claiming that Hungary faced a Greek-style crisis after the previous governments had allegedly falsified fiscal data sent markets tumbling last week. The forint fell by 4.7% against the euro within two days. The statements were probably aimed at lowering public expectations on election promises (tax cuts), but were ill-timed. Since the weekend, the government has begun damage-limitation with the economy minister affirming the commitment to the 3.8% of GDP fiscal deficit target agreed under the IMF Stand-By Arrangement currently in place. The forint has since recovered by 2.3%. While Hungary's fiscal/debt position, which is under strong scrutiny by the IMF and EU, is concerning, it is not as bad as that of Greece, but, nonetheless, expect markets to remain jittery for some time.

Brazil: Strong Q1 GDP growth

Q1 real GDP growth was a strong 2.7% qtr/qtr (seasonally adjusted), the fourth successive quarter of expansion and the most rapid to date. Driven by domestic demand, on the expenditure side, household spending continued to gain but the biggest increase was in gross fixed investment, while import growth surged outstripping that of exports. On the production side, industry led the way. Q1 growth of real GDP was also a very rapid 9% yr/yr, though from a low Q1 2009 base. The growth rate is likely to slow, but with consensus expectations of growth in calendar 2010 in excess of 6%, expect further interest rate increases (the central bank's monetary policy committee is meeting this week) to head off inflationary pressures.

Countries in Focus

Mediterranean countries & Africa – *Madagascar: EU aid remains frozen*

Resolution of political differences—a coup in March 2009 was followed by attempts to forge a power-sharing system—remains elusive. This was illustrated in May when there was reportedly a failed armed mutiny by some factions of the police, perhaps reflecting uncertainty in relation to the rival power bases of former-president Marc Ravolomanana and the current leader of the interim government, Andry Rajoelina. The latter continues to govern unilaterally, with apparent disregard for power-sharing considerations. Accordingly, investor and donor communities remain hesitant, with the EU last week deciding to maintain suspension of development aid (approximately USD700mn) for another twelve months.

Americas – *Chile: Rebound after earthquake*

Latest data point to the economy bouncing back from the dislocation of the major earthquake in February. The monthly economic activity indicator (IMAECE) in April was up 8.2% mo/mo (seasonally adjusted) driven by increases in retail and wholesale trade output, along with utilities and communications. Manufacturing declined again, though at a more moderate pace. On a yr/yr basis, the indicator was up 4.6% after a 2.9% contraction in March. April's data suggest that the economy is still on course to grow by 4.5% in 2010, though much depends on copper prices, with the global recovery still fragile. Copper accounts for 14% of GDP and 53% of exports. However, the sound policy framework has been maintained by the new government and should continue to underpin overall stability.

Asia-Pacific – *Pakistan: Fiscal pledges, but uncertainty*

The federal budget for FY2010/11 (July-June) aims to cut the annual deficit by 1-2pp, to around 4.1% of GDP. This appears challenging, given that much of the reduction is projected to be achieved through increased revenues—rather expenditure savings—and military and other security spending will increase. In addition, increased revenues from the introduction of VAT as a replacement for the current sales tax will not be evident until after October, when the new tax is now scheduled to be introduced, following differences between the federal and provincial governments. Moreover, full implementation of VAT—exemptions have formed political negotiating counters—is not assured. Nevertheless, the current fiscal stance should satisfy the IMF for the time being, although significant political and economic risks could still derail the budget plans.

Europe – *Estonia: Euro entry*

This week, the finance ministers of the EU backed Estonia's Euro zone accession on 1 January 2011. As the country had already got the green light from the European Commission and the ECB in May, expect EU heads of state to follow these recommendations at the EU summit later this month. Despite the deep recession in 2009 (GDP shrank 14.1%), the authorities have managed to meet the Maastricht criteria, though the ECB retains concerns about the sustainability of inflation convergence. Inflation was for years the only obstacle to euro entry, but thanks to the recession-related deflation in 2009 the inflation criterion was finally met. Last month, the OECD also acknowledged Estonia's achievements by inviting it to become a full member of the Organisation.

Worth knowing

G-20

The G-20 meeting of finance ministers and central bank heads in South Korea last week-end confirmed that fiscal deficit reduction to lower government debt-GDP ratios has moved to the forefront of the agenda in the wake of the Euro-zone crisis.

Philippines

Q1 real GDP grew 7.3% yr/yr (2.1% Q4 2009) and 3.0% qtr/qtr (seasonally adjusted; 0.9% in Q4). May inflation was 4.3% yr/yr, which is also the average year-to-date. The central bank left its key policy interest rates unchanged last week.

Weekly Export Risk Outlook

EULER HERMES

16 June 2010

In the Headlines

FIGURE OF THE WEEK: 10% > Q1 UNEMPLOYMENT RATE IN THE EURO-ZONE

Euro-zone: Labour market report

Following six consecutive quarters of contraction, seasonally-adjusted Euro-zone employment was stable in Q1, compared with Q4 2009. This resulted mainly from stabilisation in Germany, France, Spain, Belgium and Portugal but also reflected an increase in the number of people employed in some other countries—Italy (+0.4% qtr/qtr), Austria (+0.1%) and Finland (+0.5%)—with Greece as a notable exception. Overall within the zone, financial services, business activities and other services recorded increases, but the trend was still negative in manufacturing (-1%) and construction (-1.5%). All in all, total employment in Q1 was at the Q3 2006 level, with around 144mn officially registered as employed. This is still significantly under (-1.2%) the level recorded in Q1 2009 and is consistent with an unemployment rate of 10%, the highest level since H2 1998, which will have direct negative influences on private consumption.

China: Trade surplus increases

Exports surged in May—up 48.5% yr/yr, well above expectations—taking the trade surplus to USD19.5bn (USD1.7bn in April and small deficit in March). Imports also increased strongly (48.3% yr/yr) and this is indicative of continued positive demand expectations. The bi-lateral trade surplus with the US continues to be high, so expect continuing scope for friction between the two countries, particularly over appreciation of the exchange rate. Also in May, retail sales growth was slightly above and industrial output growth slightly below expectations, bank lending continued at a more moderate pace but still above target and consumer price inflation was 3.1% yr/yr. Data are mixed, but on balance do not point to growth slowing abruptly or inflation accelerating alarmingly at present.

US: “Modest” recovery

Fed Chairman Ben Bernanke spoke three times last week and indicated that he thought a “modest” recovery was underway, including strength in consumer spending and business investment. He also reiterated the common opinion that the unemployment rate will fall only at a very slow pace. Bernanke forecast GDP growth for 2010 of a healthy 3-4%. The Fed’s “Beige Book” report noted similar positive developments in all 12 Fed bank districts. The Fed meets next week and is widely expected to leave rates untouched, but may alter the language in the statement, perhaps signalling a subtle shift away from the current stance. Retail sales slipped 1.2% in May, but on a real and yr/yr basis sales are still growing at a solid 4.6%.

Slovak Republic: Election aftermath

President Gasparovic gave PM Fico the first option of forming a government, following last weekend's parliamentary elections in which Fico’s Smer party gained 34.8% of the vote (62 seats; up from 29% and 50 seats in 2006). However, Smer's success was at the expense of its current coalition partners, with the SNS gaining just 5.1% (9 seats) and the HZDS without parliamentary representation. As a consequence, four broadly centre-right opposition parties won a narrow majority of 79 out of 150 seats in parliament and have pledged to form a government. Their common aversion to PM Fico may help in this respect but personal rivalries and disagreements could arise as obstacles to a long-term stable government. Nonetheless, overall systemic political risk will remain low, underpinned by EU membership.

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Countries in Focus

Mediterranean countries & Africa – *Morocco: Growth outlook*

Official figures indicate that GDP growth had slowed to 4.9% yr/yr in 2009 from 5.3% in 2008. The slowdown would have been more pronounced if there had not been an exceptional harvest and therefore above-average contribution from the agricultural sector. Nevertheless, the economy showed resilience from recession in some major trading partner countries and recent business surveys suggest that a majority of companies are expecting increased output in Q2 2010 relative to Q1 (particularly in construction, but also food processing, chemicals and minerals production). However, with a relatively weaker performance by agriculture—which accounts for over 40% of the workforce—and uncertainties in key export markets—around 50% by value go to the EU—expect overall GDP growth of 4-5% in 2010 and in 2011.

Americas – *Venezuela: Exchange rate regime*

Changes to the exchange rate regime have created a third regulated tier determined by the US-dollar bond market. Anyone who cannot obtain foreign exchange through the Cadivi system will have to obtain it by buying US dollar-denominated bonds from the central bank. The main aims of the authorities are to prevent speculation and capital flight and to help curb inflation. However, it remains to be seen how effective this will be as the central bank will need to make the process work effectively enough to ensure adequate supply of goods, including food and raw materials, most of which are imported, and police any “parallel market”. Inflation was 31.2% yr/yr in May and the economy is likely to contract again in 2010, while important legislative elections are scheduled for September.

Asia-Pacific – *Singapore: Strong Q1 and Q2 growth*

Very high export dependency makes the economy vulnerable to external and cyclical shocks—highlighted again by the recession in 2008-09 in the wake of the global economic crisis. However, as a result of very sound macro-economic fundamentals, the economy has recovered quickly since mid-2009 and posted 15.5% yr/yr growth in Q1 2010. April data for manufacturing output (+51% yr/yr) and total exports (+30%) indicate strong growth in Q2 as well, even though retail sales fell 2.6%. Base effects imply that growth will ease in H2. Expect real GDP to increase by 7%+ in calendar 2010. The political system in Singapore is stable and policymaking is very effective and the business environment is among the strongest in the world. Overall country risk is very low.

Europe – *Bulgaria: Statistical anomalies*

The pace of real GDP contraction eased to 3.6% yr/yr in Q1 from 5.9% in Q4 2009. Early indicators for Q2 signal that industrial output and exports have started to recover. Even so, expect the economy to contract moderately in 2010 as a whole. Last week, the EU commission expressed concerns over Bulgaria's national statistics, indicating that the country may have its data examined under new EU audit powers. This comes shortly after the government had to revise its 2009 budget deficit from 1.9% of GDP to 3.7%, allegedly resulting from secret procurement deals of its predecessor. While the authorities may need to put ambitious euro adoption plans on hold, they remain firmly committed to the currency board arrangement in place, which does not appear to be at risk for the time being.

Worth knowing

India

Wholesale price inflation was 10.2% yr/yr in May, well above expectations and the government’s 5-6% target range. Expect further monetary tightening, with interest rates likely to rise before the scheduled July monetary policy review.

Iran

On 9 June, the UN Security Council passed a further (fourth) round of sanctions against Iran.

Kyrgyzstan

Two months after the ousting of President Bakiyev through mass street protests, violent ethnic riots between Uzbeks and Kyrgyz flared up in the south last week, prompting more than 50,000 ethnic Uzbeks to flee across the border to Uzbekistan.

These assessments are, as always, subject to the disclaimer provided below.
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Weekly Export Risk Outlook

EULER HERMES

24 June 2010

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.

Countries in Focus

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.

Weekly Export Risk Outlook

EULER HERMES

30 June 2010

In the Headlines

FIGURE OF THE WEEK: +29% > INCREASE IN GLOBAL INSOLVENCY INDEX 2009

Global Growth Outlook: Slower in 2011

Euler Hermes' latest forecast is for global economic growth of 3.3% in 2010, slowing to 2.9% in 2011. The slowdown will be proportionally more pronounced in OECD countries (+2.1% in 2010 and +1.8% in 2011) than in the rest of the world (+5.6% in 2010 and +5.1% in 2011). World trade will move more or less in line with GDP trends, with volume growth declining from 11% in 2010 to 8% in 2011. Europe is the only region to be affected lastingly by the crisis, with growth failing to reach 1% in the Euro-zone in both 2010 and 2011 and domestic demand growth virtually nil in 2010 and still very weak in 2011 (-0.2% and +0.5% yearly average, respectively) hampered in particular by announced or expected austerity measures. Investment, which contracted significantly in 2009, will not pick up again until 2011, when it is expected to grow by 1.2% after a fall of 3% in 2010.

Insolvency Outlook: Regional differences

Euler Hermes' Global Insolvency Index broke two records in 2009—the volume of insolvencies (at its highest) and the annual increase of insolvencies (+29%). The global economic recovery, although set to slow in 2011, should be accompanied by a decline in corporate insolvencies worldwide, but the decline is likely to be moderate (-3% 2010 and -5% 2011) and as uneven from country to country as the economic recovery. Expect insolvencies to decline significantly in the Asia-Pacific region (-9% in 2010) and, after rising substantially for two years, in the US (-10%). In contrast, insolvencies should continue to rise in several European countries, particularly in southern Europe—Spain (+10%), Greece (+25%) and Portugal (+5%). Corporate insolvencies are unlikely to decline as an annual average before 2011 in Germany (+1%), France (+2%), Austria (+5%) and Ireland (+9%).

Romania: IMF funding

Last week, the Constitutional Court overturned a planned 15% pension cut this year, which was an essential part of government austerity measures pushed through parliament in a confidence vote a week earlier, despite large public protests. The austerity package was deemed necessary to meet an IMF-agreed fiscal deficit target of 6.8% of GDP and, faced with a possible breach of the target the Fund postponed a decision on the disbursement of EUR850mn scheduled for this week. The government quickly responded to the court decision by raising the VAT rate from 19% to 24% from 1 July, an option it had rejected earlier, and hopes that this will be sufficient to restore IMF support. Through June, uncertainty over the implementation of the programme has pushed the RON down by about 5% against the EUR and also resulted in the failure of bond tenders.

India: Fuel subsidies cut

Significant cuts to energy and fuel subsidies were announced last week. In a country with pervasive poverty and where annual subsidies can amount to 1.6% of GDP, this is a strong policy statement, reflecting a relatively stable political and economic environment. The prices of four fuel products—petrol, kerosene, gas used for cooking (LPG) and diesel—have been controlled for eight years but, under the new regime, petrol prices were increased effectively by 7-8% and will now be determined by market forces. Other changes to the subsidy programme will be phased in. The government appears determined to achieve its target of reducing the budget deficit by 1-2pp of GDP in FY2010-11 and with these subsidy reductions expect an overall fiscal deficit of around 6-7% of GDP in 2010 and 2011.

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Countries in Focus

Mediterranean countries & Africa – *Central Africa: Banking*

The IMF suspended disbursements to CEMAC countries—Cameroon, Central African Republic, Chad, Congo Republic, Equatorial Guinea and Gabon—through the group's central bank, BEAC, because of concerns with the administration of the latter. This raises uncertainties relating to regional integration, use of the common currency (CFA franc) and general trading conditions. However, despite some heightened nationalism, it is unlikely that the Central African group will collapse as it provides financial and economic strengths otherwise unavailable to individual states. In addition, the CFA franc is also the currency of another African bloc (UEMOA in West Africa) and is freely convertible into the euro and so is unlikely to be replaced. Expect CEMAC to improve the workings of BEAC but lingering concerns will adversely impact on the trading and investment environments.

Americas – *Argentina: Debt swap completed*

The debt swap offer to hold-out bondholders from the 2005 sovereign debt restructuring has achieved a 66% acceptance rate, above the government's 60% objective. It remains to be seen, however, if this can be followed by a return to international capital markets at a satisfactory interest rate, though the government does not have an urgent borrowing need. Paris Club debt is still an outstanding issue, but is unlikely to be resolved quickly as a solution will probably involve some form of economic review by the IMF, which could prove fraught. Meanwhile, recently released data confirmed strong Q1 growth of real GDP at 6.8% yr/yr and the indicator of economic activity for April was up 9.7% yr/yr, helped by strong agricultural output.

Asia-Pacific – *Taiwan: Cross-straits agreement*

An Economic Co-operation and Framework Agreement (CFA) has been signed with Mainland China. The CFA will cut tariffs on goods and lift some restrictions on services, enhancing economic links. The agreement also reflects the improved relationship between the two under in the past two years under the leadership of the KMT, which replaced the pro-independence DPP. In a surprise move this week, the central bank raised the policy interest rate to 1.375%, beginning to reverse expansionary monetary policy as the economy has grown strongly in the first part of 2010. However, there are signs that the economy is already slowing (industrial production was flat in the past three months and export and import orders are growing less strongly).

Europe – *Slovenia: Solid fundamentals*

The economy was dragged into recession in 2009 by the impact of the global economic crisis, but macroeconomic fundamentals have remained solid overall and a mild economic recovery is forecast in 2010. Expect real GDP to grow by 0.5% this year after contracting by 7.8% in 2009. The fiscal deficit rose sharply to 5.5% of GDP in 2009 and is forecast to reach about 6% in 2010 but public debt was still a moderate 35.9% of GDP at end-2009 and, overall, the fiscal position is better than the average of the Euro-zone. Adoption of the euro in 2007 provides for low transfer and convertibility risk and has substantially decreased external vulnerabilities related to exchange rate volatility. Systemic political risk is very low, underpinned by EU and NATO membership, and the business environment is strong.

Worth knowing

Mexico

The monthly economic activity indicator increased by 7.2% yr/yr in May, the strongest in two years.

Kenya

PM Raila Odinga has reportedly had an operation to remove fluid from the brain. Expect further political uncertainties, with Odinga's ODM and President Mwai Kibaki's PNU in a fragile power-sharing government.

Burundi

Official results from Monday's presidential elections are not yet available but incumbent Pierre Nkurunziza will win—he was the only candidate.