

Weekly Economic Commentary, 10 Jan 2016

Markets

Global stock markets started the year with severe losses led by a plunge in the Chinese bourses. Despite circuit breakers and interventions by the Chinese central bank early January seems a replay of last August's turmoil. The speed and extension of the contagion has worry some traits with the average S&P500 stock down 15% from its 52-week high. Regional markets too were swept away, with KSA recording a double digit loss. Tensions between KSA and Iran, a nuclear test in North Korea and a steep fall in oil prices contributed to depress the mood across the globe. The risk of default by energy companies is impacting the whole high yield asset class and raising the liquidity premium required to hold these assets. The euro-dollar FX remained relatively quiet in the midst of such disruption while the yen took off in part after the Chinese authorities let the yuan devalue markedly. Oil prices slid to a 12-year low, as the market continues to be depressed by a persistent supply glut, but then recovered some ground on Friday. Gold prices benefitted from the fear that the New Year blues is the harbinger of tumultuous times.

Global Developments

US/Americas:

- **US non-farm payrolls** added 292k jobs in Dec, well above the 200k expected. The unemployment rate was unchanged at 5%, underscoring that the US growth is buoyant despite global headwinds.
- **Initial unemployment claims** dropped 10k, reaching 277k, pushing down the 4-week moving average by 1,250 to 275,750.
- The **minutes of the Fed FOMC meeting** revealed that most policymakers predict that declining spare capacity in 2016 will push up inflation. However some FOMC members despite the unanimous vote considered the rate hike a "close call", supporting a "cautious approach" in the tightening cycle. The text indicates that the Fed is inclined to follow a very gradual approach.
- **US Fed's Stanley Fischer** stated publicly that predictions of 4 rate hikes in 2016 are "in the ballpark".
- The **ISM manufacturing PMI** went down to 48.2 in Dec from 48.6 in Nov, the lowest level since July 2009. The sub-indices on new orders, production, employment and raw materials inventories fell.
- The **ISM non-manufacturing PMI** fell to 55.3 in Dec from 55.9 the previous month. The index recorded the 4th consecutive decline in the past 5 months.
- **US wholesale inventories** decreased 0.3% mm in Nov, the second straight monthly decline.

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- The **Black Knight house price index** expanded 5.5% yoy in Oct in line with the appreciation in Sep.
- **The Atlanta Fed's US real GDP growth forecast** for Q4 based on a series of coincident indicators was revised down to +1.0% qoq ann.

Europe:

- **Eurozone inflation** was up 0.2% yoy in Dec unchanged from Nov. Core inflation stood at 0.9% yoy. In **Germany inflation** was 0.3% yoy in Dec, vs 0.4% in Nov and much below market expectations of 0.6%, due to a drop in food prices. In **Italy, inflation** was stable at 0.1% yoy in Dec vs in Nov.
- The **Markit Eurozone Composite PMI** rose marginally to 54.3 in Dec from 54.2 in Nov with buoyant growth in both manufacturing and services.
- **The euro zone's economic sentiment indicator** ticked up to 106.8 in Nov from 106.1 previously.
- **Euro zone retail sales** volume dipped -0.3% mom in Nov, after - 0.2% mom drop in Oct .
- **The euro zone's unemployment rate** was 10.5% in Nov, -0.1% point down from 10.6% in the Oct and from 11.5% yoy.
- **German industrial production** fell -0.3% mom (0% yoy) in Nov, following a 0.5% mom increase in Oct (0.5% yoy). **Germany's unemployment rate** held steady at 6.3% in Dec. **German manufacturing orders** rose 1.5% mom (2.2% yoy) in Nov vs a 1.7% increase (1.6% yoy) in Oct.
- **German exports** advanced 0.4% mom in Nov after a -1.3% drop in Oct, while imports rose 1.6% mom, reducing the trade surplus to EUR 19.7bn. Export-led growth is giving way to consumption-driven growth.
- **German retail sales** rose 0.2% mom in Nov after falling -0.1% mom in Oct.
- **Industrial production in France** slid -0.9% mom in Nov, offsetting the 0.7% rise in Oct.
- **France's consumer confidence index** held at 96 in Dec, with most sub-indices remaining virtually unchanged.
- **Euro zone producer prices** fell -3.2% yoy in Nov, following the same drop in Oct. The decline was driven by a drop in energy price.
- **Real GDP in Russia** declined -4.1% yoy in Q3 after a -4.6% yoy drop in Q2. Inflation was 0.8% mom in Dec the same as in Nov.

Asia and Pacific:

- **The Caixin-Markit Manufacturing PMI in China** unexpectedly dropped to 48.2 in Dec from 48.6 in Nov, the lowest in 3 months. The PMI has been in recession territory since Mar and production fell for the 7th time in 8 months. Both domestic and foreign demand were weak, with new export falling for the first time in 3 months. Employment was also down and deflationary pressures persisted.
- **The People's Bank of China** pledged to keep the yuan's exchange rates "basically stable" at equilibrium level and work to further promote its internationalization.

- **China CPI** accelerated to 1.6% yoy (0.5% mom) in Dec, compared 1.5% yoy (0.0% mom) in Nov. Meanwhile, **China PPI** was unchanged (-5.9% yoy) in Dec from Nov.
- **Japan's real cash earnings** (wages adjusted for inflation) fell -0.4% yoy in Nov, after rising 0.4% in Oct. Solid wage increases, key to Abenomics' narrative, are still evanescent.
- **Taiwan's CPI** in Dec accelerated to 0.1% yoy (0.7% mom) after Nov's 0.5% increase.
- **Singapore's GDP** grew 2% yoy in Q4 2015, a tad above the 1.9% growth in Q3.
- **A spate of trade figures from Asia** show the uneven impact of China slowdown: **Taiwan's monthly trade surplus** widened to USD 4.2bn in Dec from USD 2.8bn in Nov. Imports are depressed by oil prices and falling demand for tech inputs. **Korea's monthly trade surplus** narrowed to USD 7.2bn in Dec from USD 10.3bn in Nov driven by falling exports, partly offset by a drop in imports. **Malaysia's monthly trade balance** decreased to MYR 10.2bn in Nov from MYR 12.1bn in Oct, driven by a 6.1% growth in exports and a 9.1% gain in imports.

Bottom line: *US macroeconomic data point to a weaker-than-expected recovery, but still entrenched enough to support higher long term interest rates. In Europe latest data indicate a mild acceleration of the snail growth pace. Asia on the contrary remains gloomy and exposed to the vagaries of China's transition to a more sustainable growth model. Japan seems hopelessly frozen, despite the massive stimulus. The impact of the macro picture on asset prices is poised to amplify over the next few months: when the outlook is cloudy, small surprises generate high volatility and large surprise trigger chaos.*

Regional Developments

- **M2 money supply** in **Egypt** was up 19.4% yoy to EGP 1.878 trn in Nov. **Foreign currency reserves**, meanwhile, grew to USD 16.445bn at end-Dec (Nov: USD 16.422bn).
- **Egypt's** central bank revealed plans to issue a one-year treasury bill worth USD 850mn with a Jan 12 settlement date.
- According to the petroleum minister, **Egypt's arrears to foreign oil companies** increased to USD 3bn at end-Dec from USD 2.7bn at end-Oct.
- The **Takaful industry** in **Egypt** is expected to grow about 20% in 2016, according to the Chairman of the Insurance Federation of Egypt. Takaful insurance companies accounted for 12% of Egypt's insurance market during Jan-Aug 2015, compared with a share of 8.75% for 2014.
- **Iraq's** oil ministry disclosed that the **volume of oil exports** exceeded 99mn barrels of oil, earning revenues of around USD 2.973bn. For the full year 2015, revenues stood at USD 49.8bn, with an average price of around \$44.
- **Jordan's GDP** grew 2.6% yoy in Q3 to JOD 3.4bn, with extractive industries reporting the highest growth rate of 17.5%, followed by electricity and water sectors.
- **Jordan's exports** declined by 6.1% yoy to JOD 4.65bn during Jan-Oct, while imports fell 10.3% to JOD 12bn, resulting in a 12% dip in trade deficit.
- **Electricity consumption** in **Jordan** grew 5.1% yoy to 18,689 gigawatt hours in 2015.

- **Lebanon's PMI** was at a 3-month high of 47.9 in Dec, but still below the 50-mark. Private sector output declined for the 31st consecutive month, and the Dec number was the slowest since Aug.
- **Total trading volume** at the **Beirut** Stock Exchange dipped 22.9% to 74,636,997 shares in 2015 while the total value of traded stocks was down 4.9% to USD 629mn; market capitalization was nearly unchanged from end of 2015 at USD 11.2bn.
- The **Oman government** issued a 5-year plan to halve the economy's dependence on the oil industry as low crude prices put pressure on government finances.
- The Central Bank of **Oman** published **rules for countercyclical buffers**, a move aimed at protecting against the consequences of booms in lending, but which could force Omani lenders to raise more capital in future.
- **GDP growth** in **Qatar** was up 3.8% yoy and 2.8% qoq in Q3 (Q2: 4.8% yoy) to QAR 201.33bn; the non-oil sector reported growth rate of 7.8% yoy vis-a-vis 4.4% the quarter before.
- **Qatar** was set to sign a USD 5.5bn **loan** by end of last week, according to Reuters reports; the five-year facility is expected to pay an all in price of 90bps.
- Bank **assets** growth in **Qatar** is estimated at 10.5% in 2015, according to Qatar National Bank, which also expects **lending** to be driven by project financing and population growth.
- **PMI** in **Saudi Arabia** fell to series-low of 54.4 in Dec (Nov: 56.3), on slower expansion in output and new orders, as well as weak employment, while the average for Q4 2015 also the weakest on record (55.4).
- In an interview with the Economist magazine [see Media Review section], **Saudi Arabia's** Deputy Crown Prince revealed that the government was considering **selling shares in Aramco** as part of a privatisation drive. He also stated that the government planned to implement the value added tax "by the end of 2016 or 2017, and we'll try to expedite it".
- **Saudi Arabia's** civil aviation authority will **privatise** Jeddah and Dammam **airports** in 2017, in Q2 and Q3 respectively, revealed the regulatory body. The airport privatisation will be open to foreigners; local investments in some airports will be capped at 25% to ensure foreign operators have a majority holding in operating contracts, according to the vice-chairman of the General Authority of Civil Aviation.
- **Sovereign wealth funds** (SWFs) made USD 23.5bn worth of **overseas acquisitions** in Q4 2015, according to Reuters data, down 13% from the previous quarter. In 2015, SWFs invested in 127 transactions (2014: 148), with the total value of deals down 6.9% to USD 68.7bn.
- **Sukuk issuance** is likely to be lower this year, as lower oil prices hit GCC investment spending: according to S&P, total issuance is expected to be USD 50-55bn this year, compared with USD 63.5bn in 2015 and USD 116.4bn the year before.

UAE Focus

- **UAE PMI** was at a 40-month low of 53.3 in Dec (Nov: 54.6), with lower readings for new orders, employment, output and the backlogs of work. The new orders sub-component slipped to 55.7 in Dec (Nov: 57.5), the lowest level since Aug 2011.
- UAE emirate **Sharjah** is planning to issue a **Sukuk** in Q1 this year, reported Reuters and from sources familiar with the matter. The amount is expected to exceed USD 500mn and investor meetings could be announced as early as this month.
- **Dubai Duty Free** group announced an annual turnover of AED 7.057bn last year, of which duty free sales alone accounted for AED 6.892bn. However, sales was down 1.5% compared to a year ago, with weaker euro, lower Russian spending and change in the buying patterns of Chinese passengers cited as the main reasons for the decline.

Media Review

Saudi Arabia's margin for maneuver

<http://www.oxfordbusinessgroup.com/analysis/breathing-room-low-debt-and-ample-fiscal-reserves-provide-insulation-market-forces?>

America ends its oil export ban after 40 years

<http://www.energyandcapital.com/articles/us-shale-oil-goes-global/5273>

The US Fed rate hike of 1994 and what we can learn today

<http://thomsonreuters.com/en/articles/2015/lest-we-forget.html>

A visual map of global M&A activity in 2015

<http://pitchbook.com/news/articles/a-visual-recap-of-global-ma-activity-in-2015-datagraphic>

Soros worries for a replay of 2008

<http://www.bloomberg.com/news/articles/2016-01-07/global-markets-at-the-beginning-of-a-crisis-george-soros-says>

The Economist's interview with the Saudi Deputy Crown Prince

http://www.economist.com/saudi_interview