

Weekly Economic Commentary, 17 Jan 2016

Markets

Another week of heightened volatility and widespread plunge on global stock markets which mark the worst start of the year on record. Sell side analysts who in recent months had modified their rhetoric from “soft patch” to “limited correction” now appear busy on cable TV to reassure that “it will not be as bad as 2008”. If one were to find a silver lining, the sell-off, so far, has been gradual rather than panic-driven, but few see an end in sight as investors reassess their outlook for global growth and recalibrate their risk appetite. In essence the rally post Great Recession has run its course. At roughly 19x reported earnings, global stock valuations are overstretched. Among geographies the P/E in the US S&P 500 is around 20, while Europe trades at roughly 18, and Japan at 16. The average P/E ratio in the Shenzhen index is 41.4, so finding a floor will not be a matter of days. In currency markets major crosses have been remarkably stable with the exception of the GBP which touched a one-year low versus the euro and a five-and-half year low against the dollar. The main oil crude grades tumbled below USD 30 per barrel on Friday, as China growth is stalling and the impending Iranian exports reinforce concerns over the supply glut. Even the gold which should be a safe haven was not immune to the global sell off.

Global Developments

US/Americas:

- **US industrial production** saw a drop of 0.4% mom in Dec with manufacturing output down 0.1%, both for the 2nd straight month. Utilities, mining and auto were the main underperforming sectors.
- **The US Fed Beige Book** reported brisk growth in most districts led by private consumption, but highlighted that wages and prices remained subdued. A strong U.S. dollar and subdued growth overseas continued to hold back manufacturing activity in many areas.
- **US PPI** recorded its 4th consecutive yoy decline, dropping -0.2% mom in Dec, reversing the 0.3% gains of Nov. The drop came in the wake of lower oil prices and dollar appreciation.
- **US retail sales** recorded a marginal -0.1% mom fall in Dec, reversing a gain of 0.4% in Nov. Sales have been stagnant for the last 3 months as a result mainly of low oil prices.
- **US imports prices** dropped 1.2% mom in Dec, recording the sixth consecutive decline and the largest since Aug, fueled by a 9.5% drop in imported fuel prices.
- **US budget deficit** ended 2015 at its lowest level since 2007 (the sixth straight annual drop) USD 478bn, i.e. around 2.6% of GDP, down from USD 488 bn, or 2.8% of GDP in 2014.
- **Jobless claims in the US** increased from 277,000 to 284,000 with the 4-week moving average rising 3,000 to 278,750. Continuing claims rose 29,000 to 2.263 mn. New and

Prepared by:

Dr. Nasser Saidi
Founder & President
nsaidi@nassersaidi.com

Aathira Prasad
Director, Macroeconomics
aathira@nassersaidi.com

continuing claims suggest that job growth moderated early this year, after December's unsustainable gains.

Europe:

- **Germany's annual real GDP** grew 1.7% in 2015, marginally up from 1.6% in 2014.
- **Eurozone industrial production** fell -0.7% mom (+1.1% yoy) in Nov vs a 0.8% (2.0% yoy) increase in Oct. The drop was due to weak energy output down -4.3% mom (mild weather), capital goods -1.9%, and durable goods -1%. Nondurables crawled up by 0.1% and intermediate goods by 0.7%.
- **Eurozone's external trade surplus** rose in Nov to EUR 23.6bn from EUR 20.1bn in Nov 2014.
- **Data from Greece** point to a rebound from a dreadful situation. The manufacturing PMI for Greece came in at 50.2 (expansion territory) the highest level since May 2014; CPI rose in Dec by 0.4% yoy its highest level since May 2012; industrial production gained 1.8% yoy in Nov.
- **Italy's industrial production** deteriorated in Nov, with output falling -0.5% mom after a 0.5% increase in Oct. **Spain's industrial production** rose 4% yoy in Nov, down slightly from a 4.1% yoy gain in Oct. **The UK industrial production** fell -0.7% mom (1% yoy) in Nov after a revised 0.1% (1.7% yoy) increase in Oct.

Asia and Pacific:

- **China's M2 money supply** grew 13.3% yoy in Dec, decelerating from a 13.7% increase in Nov. Credit growth accelerated thanks to a rise in atypical lending, while regular bank lending was flat.
- **China's trade surplus** rose to USD 60.1bn in Dec, up from USD 54bn in Nov. Exports improved, helped by gains towards the U.S. and Europe, but were still -1.5% lower yoy.
- **Foreign direct investment into China** disappointed expectations at USD 12.2bn in Dec, a -8.2% yoy decline.
- **Japan's consumer confidence** crawled up in Dec to 42.7 from 42.6 in Nov. Sentiment over livelihood and income growth improved, while willingness to buy durable goods softened.
- **Japan core private sector machinery orders** fell -14.4% mom (+1.2% yoy) in Nov, offsetting two months of steady gains.
- **India's industrial production** surprised on the downside falling -3.2% yoy in Nov after a 9.9% rise in Oct.
- **India's wholesale prices** fell -0.7% yoy in Dec, recovering from Nov's -2% yoy fall. The broad-based drop was partly offset by rising food prices after the unfavourable monsoon season.
- **Malaysia's industrial output** grew just 1.9% yoy in Nov, decelerating from a 4.2% increase in Oct.
- **Philippines industrial production** rebounded to 7.5% yoy in Nov from Oct's 1.7%.

- **Bank Indonesia** unexpectedly cut its **official rate** by 25bp to prop up the economy. Although **inflation** has settled within BI's 3% to 5% target range, the risk of capital outflows looms.
- **Indonesia** recorded its second consecutive **monthly trade deficit** in Dec. The USD 240mn deficit was slightly lower than Nov's revised USD 400mn deficit (previously reported at USD 350 m).

Bottom line: *Macro data lately remain mixed at best, with the notable exception of the US labor market, and therefore it is not surprising that a chill has spread to financial markets which had bet on a marked improvement. The OECD composite leading indicator was 99.8 in Nov, the same level as in October. Although the composite indicator was flat for the G7 economies, the US and UK sub-indices dropped, while France ticked up. Another key indicator corroborates the evidence of anaemic growth: the Baltic Dry Index at 383 reached a historical minimum. Its peak was 12000 in 2008 and 600 was the previous minimum. All in all the world economy is engaged in a difficult process of secular transformation which most market analyst have mistaken for a cyclical phenomenon. The disruptive phase is far from over and a decisive upswing will not start until a new paradigm of growth prevails. Hence risks have risen and asset return expectations must be adjusted downward.*

Regional Developments

- The EU and **Iran** announced that most **US, EU and United Nations** sanctions will be immediately removed, since Iran completed the steps required by July's deal on its nuclear program, as confirmed by U.N. atomic agency.
- **Bahrain** raised **fuel prices** last week by up to 60%, with the prices climbing to \$1.25 per gallon for regular gasoline and \$1.60 per gallon for premium fuel.
- Fitch expects **Bahrain's pipeline of projects** within the manufacturing, construction and tourism sectors to continue and support growth amidst low oil prices. Official estimates place the overall pipeline of projects at USD 72.3bn as of mid-Dec 2015.
- **Egypt business activity** rose to 48.2 points in Dec from 45 points in Nov, but remaining below the 50-point mark for the third consecutive month.
- **Urban inflation rate** in **Egypt** remained unchanged at 11.1% in Dec while core inflation eased to 7.23% (Nov: 7.44%).
- **Egypt** amended **credit market rules**: central bank cut the maximum amount that banks are allowed to lend to a single client to 15% of their Tier One capital, down from 20% previously; it reduced the total sum that banks can invest in money market funds to 2.5% of their total deposits in local currency from 5% previously.
- **Egypt** announced an **SME initiative** that would see the country's banks inject EGP 200bn into supporting businesses over the next four years.
- Saudi Arabia has promised to meet **Egypt's petroleum** needs with payment facilities and interest rates up to 1% for three months starting from Feb, reported Reuters.

NASSER SAIDI

— & ASSOCIATES —

- **Egypt** aims to reduce its **import bill** by 25% this year from USD 80mn in 2015, disclosed the central bank governor.
- **Iraq** signed an **IMF monitoring programme**, as a pre-condition for a loan: the country plans to finance its balance of payments deficit by drawing its foreign exchange reserves down to USD 43bn in 2016 from USD 59bn at end-Oct.
- **Inflation** in **Jordan** edged down by 0.9% yoy in 2015, thanks to drops in transportation costs, fuel and lighting and beverages amidst other sub-sectors.
- **Kuwait trade surplus** fell to KWD 1.8bn in Q3 2015, with oil revenues down to KWD 3.7bn in the quarter (Q2: KWD 4.3bn) and non-oil export growth dipping by 8% yoy.
- The interim **budget deficit** in **Kuwait** points to a decline in the first eight months of fiscal year 2015-16, thanks to lower government spending (which at KWD 6.6bn as of Nov, was down 22% compared to the same period a year ago); wages & salaries and capital spending still showed an uptick. National Bank of Kuwait estimates full year deficit at KWD 3.9bn.
- **Lebanon** witnessed a cumulative **illicit financial outflow** of USD 19.9bn during the period 2004-2013 (equivalent to almost USD 2bn a year), according to a report by Global Financial Integrity, which also ranks the country 54th highest in the world.
- **Gasoline** and diesel fuels prices have been increased in **Oman** to reflect international prices as part of the subsidy reforms.
- **The Omani government has borrowed** USD 1bn to cover public deficit.
- **Qatar** raised **gasoline prices** by about 30% from last Thursday; the official forecast is for a budget deficit of QAR 46.5bn in 2016, its first deficit in 15 years.
- **Inflation** in **Qatar** was 2.7% in 2015, thanks to the rising costs of education (+18%), rents, communications (3.2%) and transport (3.1%).
- **Saudi Arabia's** government is likely to retain a controlling interest in **Aramco**, if it decides to list, revealed the company's CEO. Separately, the Chairman of Aramco was quoted in the *Wall Street Journal* as stating there was no specific timeline or concrete plan for the listing
- **SAMA's** governor reiterated that the country would continue to retain its **dollar peg**. Volatility in the forwards market was due to "unrealistic expectations", said the governor. Traders were pricing in an exchange rate of SAR 3.85 to the dollar in 12-months, a near 3% devaluation from the SAR 3.75 level that has held since 1986.
- **Saudi Arabia's** dairy firm Almarai announced that it would see a cost increase of around SAR 200mn as a direct result of higher fuel, electricity and water tariffs and an additional SAR 100mn as indirect costs from its local suppliers that are also affected by the price hikes.
- **Saudi Arabia's** Jeddah **airport** received 30mn **passengers** in 2015, a 6.6% yoy increase.
- Following a meeting of the **GCC Finance Ministry** officials, it was reported that **draft VAT legislation** was awaiting final approval from the cabinet or parliament in Saudi Arabia, Oman, Bahrain and UAE, with Kuwait and Qatar still preparing their law.
- Local media reported that the **GCC** nations have decided to impose a **uniform tax** of 100% on tobacco products, 100% on energy drinks and 50% on soft drinks. The Committee on

Financial and Economic Cooperation was mandated to complete all necessary requirements for the decision in preparation of its signing by mid-2016 and approval in early 2017.

- The UN disclosed that donors pledged USD 250mn to educate more than a million **Syrian refugee children** this year, but it needs an additional USD 500mn to fund the programme in Turkey, Lebanon, and Jordan.

UAE Focus

- The **Dubai Economy Tracker** declined to 51.8 in Dec (Nov: 53.4), on slower growth of output and new orders. Output index slowed to 52.6 (Nov: 54.9) and new order growth also slowed, with the index at 53.9 last month.
- The UAE is still in preparatory phase of the **VAT law**, according to the Under-secretary at the Ministry of Finance. Expected to range between 3-5%, the value added tax will likely take two years to be implemented after the law is passed. “Any two countries that are ready can begin implementation of VAT from 2018”, he stated based on the discussions among the GCC countries.
- Lower deposit growth, tightening liquidity and decline in earnings are forecast for the **UAE banking sector** this year, amidst fall in oil prices, as per a recent S&P report.
- The **Dubai airports** reported a 6.01% yoy rise in passenger traffic to 5.57mn in Nov last year, taking the year-to-date figure to 70.96mn (+10.9% yoy)
- The **Dubai Land Department** revealed that **real estate transactions** surpassed AED 267bn last year, from 63,719 total transactions. Sales and mortgages relating to land transactions recorded more than AED 194bn from the total real estate figure for 2015, with the total of 16,751 transactions.

Media Review

The end of sanctions against Iran

<http://www.wsj.com/articles/iran-completes-steps-to-implement-nuclear-accord-1452978143>

Is shale production on the verge of collapsing?

<http://www.forbes.com/sites/arthurberman/2016/01/11/big-drop-in-rig-count-points-to-capitulation-by-u-s-shale-drillers/#2715e4857a0b33d84f0062da>

Oman’s economic performance in 2015

<http://www.oxfordbusinessgroup.com/news/oman-year-review-2015?>

The woman shaping the Iranian oil future

<http://www.bloomberg.com/news/articles/2016-01-13/the-woman-shaping-iran-s-oil-future?>

El Erian: Hedge funds losing momentum

<http://www.bloomberg.com/news/articles/2016-01-13/momentum-darlings-hit-wall-in-s-p-500-as-hedge-fund-stocks-slide>

A spate of forecasts for 2016

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<http://blogs.wsj.com/economics/2016/01/14/what-forecasters-expect-from-the-economy-in-2016/>

The mystery of Aramco

<http://www.theguardian.com/business/2016/jan/16/saudi-aramco-10-trillion-dollar-mystery-heart-of-gulf-state>

Shale production is remarkably resilient

<http://etfdailynews.com/2016/01/15/eia-report-shows-no-sign-yet-of-u-s-production-cuts/>

\$20 is the new \$40

<http://www.economist.com/news/finance-and-economics/21688446-why-oil-price-has-plunged-20-new-40>