

Weekly Economic Commentary, 20 Mar 2016

Markets

The markets were in a sort of suspended animation until the Fed's announcement, then shot up in celebration, especially the emerging markets where the consequences of the tightening cycle are widely perceived to be most severe. The global optimism spread to the MENA region helped by oil price resilience after US crude oil inventories increased by 1.3 mil barrels well below expectations of a 3.2 mil barrel. The outlier was Egypt where the central bank announced a devaluation of the pound. In the currency market the dollar weakened substantially after the Fed's decision, while on the other side strengthened once again.

Global Developments

US/Americas:

- **The Fed's FOMC** took a decisively dovish turn holding its rate target in the range 0.25% to 0.5% and, more crucially, shifting down the path of future hikes. For the first time since the Asian and Russian crises of the late 1990s, the Fed is explicitly taking into account global conditions in its decision. Nine FOMC members declared that two additional rate hikes would be enough to hit their forecasts this year.
- **US core CPI**, which excludes food and energy, rose 0.3% mom and 2.3% yoy in Feb, the largest yoy gain since May 2012, after the 2.2% yoy recorded in Jan.
- **US industrial production** slipped -0.5% in February, a weaker showing Jan's growth was also revised down to 0.8% from 0.9%.
- **US initial claims for unemployment benefits** rose 7k to 265k after the prior week's 19k decline, which put new filings among the lowest in 40 years. New filings have been below 300k for over a year, the longest streak since 1973. The 4-week moving average rose 750 to 268k. Continuing claims rose 8,000 to 2.235mn.
- **The US current account deficit** in Q4 narrowed to USD 125.3bn (Q3: USD 129.9bn). The figure is among the highest since 2009 due to the strong dollar and weak global conditions. The goods and services deficit decreased in Q4 to USD 133.7bn (Q3: USD 138.6bn).
- **US retail sales** dipped -0.1% in Feb after a -0.4% fall in Jan.
- The preliminary **University of Michigan consumer confidence index** dropped 1.7 points in Mar, falling to 90, the lowest since October and the third consecutive monthly decline. Meanwhile the **Conference Board leading indicators index** crawled up by 0.1% in Feb for the first time in three months.

Europe:

- **Eurozone industrial production** surprised on the upside rising 2.1% mom (2.8% yoy) in Jan, erasing the -0.5% (-0.1% yoy) decrease in Feb.

Prepared by:

- **The Eurozone's trade surplus** narrowed in Jan to EUR 6.2bn, from EUR 7.1bn in Jan 2015.
- **Eurozone inflation** fell to -0.2% yoy in Feb, following a 0.3% increase in Jan, due mainly to lower energy prices.
- **German producer prices** fell -3% yoy in Feb, following a -2.4% drop in Jan.
- **Total earnings of workers in the UK**, including bonuses, rose 2.1% yoy in the three months to January from 1.9% in Q4. **The Bank of England** kept its main repurchase rate at 0.5% and its target for asset purchases at GBP 375bn in Mar.

Asia and Pacific:

- **China's semi-official sources** are ventilating that the fiscal deficit will be in the order of 4% of GDP. Nevertheless the widening gap between China's outlays and revenues suggests it may be much larger than that.
- **China's M2 money supply** grew 13.3% yoy in Feb, decelerating from Jan's 14% increase.
- **Foreign direct investment into China** declined to USD 8.5bn in Feb from USD 14.1bn in Jan, a -1.3% yoy decline.
- **New home prices in 70 major Chinese cities** rose 3.6% yoy in Feb, the fastest pace in 2 years, after Jan's 2.5% rise.
- **The Bank of Japan** left its monetary policy unchanged but downgraded its view of the economy, opening the door to further easing.
- **Japan's machinery orders** grew 15% mom in Jan, up from 1% in Dec.
- **Japan's industry activity index** rose 1.5% mom in Jan, up from Dec's -0.6% decline.
- **Japan's exports** continue to struggle at the start of 2016, as **the trade balance** recorded JPY 166.07bn in Feb, largely from a greater fall in imports rather than any rise in exports.
- **India's CPI inflation** eased in Feb to 5.2% yoy from Jan's 5.7% yoy, with the decline mainly due to food prices. **India's wholesale price index** fell -0.9% yoy in Feb, a slightly lower rate than Jan's -1.1% fall.
- **India's Feb's trade deficit** was USD 6.5bn, an improvement from Jan's USD 7.7bn deficit.
- **Korea's Feb's unemployment rate** soared to 4.1% (Jan: 3.5%), the highest rate since 2010.
- **Singapore non-oil domestic exports** grew 2.1% yoy in Feb, up from Jan's -9.9% drop.
- **Australian unemployment rate** improved in Feb, falling to 5.8% from 6% previously in Jan, although employment stalled.
- **Bank Indonesia** cut its main rate to 6.75%, the third consecutive 25-basis point rate cut.
- **New Zealand's GDP** grew by 0.9% qoq in Q4 2015, the same result as Q3 2015.

Bottom line: Last week brought two surprises: industrial production in Europe had a fillip and the Fed delivered a message that was interpreted as overly dovish. Data from Asia confirm that the global economy remains in the doldrums and hence financial markets, once the effects of the monetary steroids wanes, remain vulnerable to reversal of expectations. Clearly the actions and the message from central banks are completely dissonant, An investor who acquires a 10-year corporate bond yielding 0.5% is knowingly accepting a negative real return if he actually believes that inflation will rebound to 2% in

a couple of years. And indeed the swap rates around the world indicate that markets are forecasting interest rates below 1% for years and sometimes for decades to come. A robust economic expansion will ultimately have to depend less on demand side quick fixes and more on a painful clean up of the financial waste that litters the global landscape. For example zombie companies are absorbing capital that might be better used elsewhere; labor protections laws are preventing the transfer of human capital to new and more profitable ventures; non performing loan are hampering credit expansion to the healthy parts of the economy.

Regional Developments

- **Bahrain's** exchange has established a market for Real Estate Investment Trusts or **REITs**, which will enable REITs licensed by the central bank to be listed and traded by investors in the secondary market. More details and trading mechanisms are to be announced later, as per the official statement.
- **Egypt's** central bank **raised interest rates** by 150bps last week to put a lid on inflationary pressures, just three days after the EGP was devalued. The overnight deposit rate was raised to 10.75% and the overnight lending rate rose to 11.75%.
- **Egypt devalued its currency** to EGP 8.85 per USD from EGP 7.73 last Monday, before strengthening it to EGP 8.78 two days later after adopting a more flexible exchange rate policy. Alongside Monday's move, the central bank pumped nearly USD 200mn into the banking system in a surprise sale.
- **Tourism in Egypt** touched 440k visitors in Dec, its lowest levels since Dec 2015, and down from Nov's reported 559k tourists. However, tourists from the Middle East grew to 116k versus 95k a month earlier.
- **Jordan's** prime minister revealed that the **Syrian crisis** had cost the country over USD 7bn since 2011. Separately, the IMF lowered Jordan's growth rate this year to 3.2%, which is substantially lower than the government's forecast of 3.7%.
- **Kuwait's** cabinet approved a spate of **reforms aimed at lowering the fiscal deficit** including introduction of a 10% tax on corporate profits and "repricing" of some commodities and public services - though no further details about implementation were provided. In a report to the cabinet various other reform measures mentioned were: allowing private citizens to own up to 50% of public-private joint ventures, reforming the labour market and the civil service system, and making the public sector more efficient by linking pay to productivity. Prior to this, the central bank governor was reported stating that the monetary policy might need to be changed if no steps were taken to reduce the budget deficit.
- **Lebanon's fiscal deficit** widened by 28% yoy to USD 3.95bn in 2015, in spite of a nearly USD 1bn decline in energy costs, with tax revenues slightly lower. Last year's deficit should be read carefully, especially since revenues in the previous year were boosted by a one-off transfer of accumulated telecoms receipts.

- The **Lebanese banking system** supports the **government debt market** by buying debt directly and by buying certificates of deposit issued by the Banque du Liban. Hence bank liquidity is key to government debt servicing, according to a recent Moody's report.
- **Oman's** total production of **crude oil** and condensates amounted to 29.4mn barrels in Feb, a daily rate of 1.01mn barrels, an increase of 0.72% compared with Jan 2016.
- **Qatar** plans to submit a draft public-private partnership (**PPP**) law to the cabinet by Aug, in the hopes of being able to implement it by end of this year, according to a senior ministry official.
- **Qatar** central bank governor disclosed that the central bank had stepped up monitoring of **liquidity** in the system and had issued circulars to improve liquidity, without elaborating further.
- **Inflation** in **Qatar** increased by 0.6% mom and 3.3% yoy in Feb; housing and utility costs were up 0.4% mom and 5.7% yoy while food and beverage costs grew 0.3% mom but fell 1.3% yoy.
- **Saudi Arabia's** central bank **raised loan to value limit** from 70% to 85% for those buying homes.
- **Crude oil production** in **Saudi Arabia** remained steady at 10.22mn barrels per day in Feb while Kuwait produced 3mn bpd of oil (unchanged from Jan) and UAE pumped 2.78mn bpd (Jan: 3.13mn bpd).
- The **value of awarded contracts** in **Saudi Arabia** was down 25% qoq to SAR 45.6bn in Q4, according to the NCB Construction Index. This brought the total value of awarded contracts in 2015 to SAR 223.4bn, up 1.2% yoy.
- Moody's revised the outlook for **Saudi Arabia's banking system** to negative from stable, citing rising credit risks from the prolonged drop in oil prices. NPLs were expected to rise to 2.5% from a low average of 1.4% as of Sep 2015.

UAE Focus

- A Law on **Dubai Government Financial Regulation** was passed last week with an aim to promote transparency in addition to improving the management of public capital and government budgets. According to an official statement, the Law "regulates the tabulation and approval of financial statements and closing accounts, financial and audit policies and procedures, financial governance KPIs, principles of financial records and improvement of financial risk management". The Law is applicable to all government entities listed in the general budget, government entities with independent budgets and entities that receive financial support from the government.
- **Non-oil foreign trade** in **Abu Dhabi** grew 11% yoy to AED 169.1bn in 2015, with imports up 10.5% to AED 119.3bn. Largest trade partners by imports were the US (33% of total imports), Saudi Arabia (22%) and Japan while on the non-oil export side, Saudi Arabia (44% of total non-oil exports), Switzerland (31%) and China (13%) were the top three.

- **Inflation in Dubai** was down 0.22% mom in Feb 2016 (Jan: -0.34% mom), thanks to a 2.79% fall in prices of transportation and a 0.68% decline in food and beverage prices. In yoy terms, inflation was up 1.43%; education and the housing, electricity and water sub-groups saw an increase in prices by 4.83% and 3.98% yoy respectively.
- **UAE** was the **main destination for Oman's non-oil exports** during the first nine months of 2015: though accounting for 19.8% of Oman's total non-oil exports, at OMR 468.7mn this however represented a 18.1% yoy decline.
- **Domestic non-cash spending** in the **UAE** increased 13% yoy in 2015, according to Network International. Based on credit and debit card transactions in the UAE, it was found that spending by UAE-issued cards remained steady between AED 9-10bn per month, with supermarket spending a major component of consumption (+9% yoy) while the F&B sector reported the largest increase in spending (up 23% yoy).
- The **World Happiness Report 2016** places **UAE** at 28th globally, with the top spots earned by Denmark, Switzerland and Iceland respectively.
- **Passenger traffic** through **Dubai airport** increased 6.3% yoy to 7.33mn persons in Jan this year.

Media Review

A list of honest mistakes an investor can make in financial markets

<http://awealthofcommonsense.com/2016/03/how-to-be-wrong-as-an-investor/>

Orpic successful international debt financing

<http://www.globalfinancialconferences.com/news/article/481/orpic-in-large-debt-financing>

GCC financing needs at USD 151bn: Markaz

http://www.zawya.com/story/GCC_needs_USD151bn_worth_of_financing_needs_Markaz-ZAWYA20160316050111/

Booz Allen Hamilton: approach to improving labor nationalization in the private sector

http://www.zawya.com/story/GCC_private_sector_urged_to_hire_more_locals-ZAWYA20160317032316/

EU-Turkey deal on Syria

https://www.washingtonpost.com/world/europe/europe-offers-deal-to-turkey-to-take-back-migrants/2016/03/18/809d80ba-ebab-11e5-bc08-3e03a5b41910_story.html