

Weekly Economic Commentary, 26 Jun 2016

Markets

Global markets took a blow after the results of the Brexit referendum were announced on Friday. European bourses recorded heavy losses (Milan lost over 12% an absolute negative record worse than the aftermath of 9/11 or Lehman's demise). Paradoxically, amidst the debacle, the FTSE was the least affected index, while Wall Street and even emerging markets reacted more negatively. Regional bourses were also mostly down (with Egypt and Bahrain the notable exceptions), but have limited the losses so far. The GBP collapsed to levels not seen since 1985 and the repercussion extended to the euro, which also lost to the dollar and the yen. The latter benefitted from the risk averse behavior of Japanese investors dumping foreign assets. Oil prices were hit by the uncertainty hovering over global developments after the Brexit, while, conversely, gold rallied the most since the 2008 global financial crisis.

Global Developments

US/Americas:

- **US CPI inflation** was 1.0% yoy in May, almost on par with 1.1 % in Apr. Food and transportation services prices growth slowed while energy costs fell at a faster pace.
- **New orders for US manufactured durable goods** unexpectedly shrank -2.2% mom in May compared to a 3.3% rise in Apr, as a result of a dismal transport equipment. Core capital goods orders, a proxy for business spending fell 0.7 %.
- **US housing starts** slipped -0.3% mom in May to a seasonally adjusted annual rate of 1.164mn. Groundbreaking for multi-family units declined -1.2% to a 400K and single-family homes rose 0.3% to 764K.
- **The Conference Board index of leading indicators** fell -0.2% in May after a 0.6% rise in April. The index has remained almost unchanged in the past six months.
- **US unemployment benefits claims** decreased by 18,000 to 259,000, hitting its lowest level in eight weeks close to an almost forty three year low. Continuing claims fell by 20,000 to 2.142 million.
- **University of Michigan consumer sentiment index** came in at 93.5 in Jun down from 94.7 in May. The current conditions and future economic prospects sub-indices dragged the headline down.

Europe:

- In a consultative **referendum in the UK on EU membership** a majority of voters chose Brexit. PM Cameron resigned, throwing the country in the deepest political crisis since the 70's. It is uncertain the timing of the formal request to activate the procedure of art. 50 in the Treaty of Lisbon. Scotland and Northern Ireland might call a referendum to break away from the UK.

Prepared by:

- **The flash euro area composite PMI index** beat expectations scoring 54.1 in Jun from 53.6 in May, its highest reading since May 2011, driven primarily by services.
- **Inflation in the eurozone** edged down -0.1 % yoy in May, following a -0.2% fall in Apr. The CPI failed to grow for the fourth straight month, dragged down by energy cost,
- EU Commission's **consumer confidence index** for **eurozone** declined to -7.3 in Jun from -7 in May. The consumer confidence index for the EU dropped by 0.1 to -5.8. The score weakened for the first time in three months.
- The **Conference Board Leading Economic Index** for the **eurozone** inched up to 107.4 in May, 0.1 point higher than Apr.
- The **German IFO business survey** beat expectations rising from 107.8 in May to 108.7 in Jun. The improvement came from both current business environment (up +0.3pt to 114.5) and future expectations (up +1.5 to 103.1).
- The **German ZEW indicator** of economic sentiment bounced to 19.2 in Jun from 6.4 in May, but still below its historical average of 24.7.
- The ZEW expectations measure for the eurozone rose from 16.8 to 20.2.
- **Italy's new industrial orders** rose by 1% mom in Apr, reversing the -3.4% decline in Mar.

Asia and Pacific:

- The **Reuters Tankan survey on Japan manufacturing**, a leading indicator for the quarterly BOJ Tankan, was +3 in Jun after +2 in Apr, marginally above the zero threshold for recession. The non-manufacturing index lost 2 points from May, to +17.
- **Japan's trade balance** reached JPY 270bn in May. Exports faltered across most major categories and destinations, as the yen's rise in 2016 has thwarted Japan's competitiveness.
- **Average new home prices in 70 major Chinese cities** climbed 6.9% yoy in May vs April's 6.2%.
- **Taiwan** retail spending ticked up 0.9% yoy in May after a 2.3% yoy increase in Apr.
- **Taiwan industrial production** increased 1.9% yoy in May, an improvement on the -3.6% yoy decline in Apr.
- **Singapore industrial production** increased 0.9% yoy in May, down from a 3% gain in Apr.

Bottom line: *The consequences of Brexit in normal circumstances would not be so dire on financial markets and even less on the global economy. However present circumstances are not normal. Markets are caught in risky interplay between valuations (which determine long-term returns) and policy patches (which drive the speculative short term investment decisions). Furthermore leverage by large financial players is still uncomfortably high and therefore even a limited shock can trigger a dramatic ripple effect, as it happened in the aftermath of the Lehman's bankruptcy. If we add that the European banking system has yet to mend all the damages suffered in the 2008-2011 crisis investors' nervous reaction is entirely justified. To prevent a fall out the monetary authorities of the major economies have pledged to inject as much liquidity as the market will require utilizing the readily available central bank liquidity swap agreement among the G6 central banks. Nevertheless the rest of the year will require an extra dose of prudence in devising investment strategies.*

Regional Developments

- **Bahrain's** sovereign wealth fund **Mumtalakat** has “no intention of borrowing this year” and plans to finance its projects this year using income from investments and will not seek government assistance, according to its chief executive.
- A new **SPV** has been proposed by industry experts to collect USD 1.1bn to revive and fund four stalled developments in **Bahrain**.
- **US investments** in **Egypt** fell by 85.9% yoy in 2015 while **trade** dropped by 10.7% to EGP 41.9bn, according to official statistics. The number of American **tourists** visiting Egypt increased by 22% and the number of nights spent grew by 6.9% last year.
- Banque Misr, **Egypt's** second-largest state **bank**, disclosed that it had obtained a USD 105mn murabaha financing facility from three UAE banks (without revealing their names) and that it will be paid back in two years.
- **Jordan** reached an agreement with the **IMF** over the Extended Fund Facility: under this program, the country is expected to achieve a budget surplus of JOD 170mn in 2019. Reform measures of raising prices and taxes were also announced: raising price of cigarettes, tax on liquor, fixed charge on fuel prices, among others. Measures to lower spending would save the country JOD 318mn by the end of this year, according to the finance minister.
- **Lebanese banks** received USD 7.2bn in **wire transfers** last year, representing close to 15% of GDP, according to the head of Union of Arab Banks. Though lower oil prices and associated slowdown dipped remittances into the country by about 3.3% last year, it was less severe than 2014's 8.4% drop on security concerns.
- **Oman's** Ministry of **Tourism** unveiled its **2040 strategy**, which will see investments of around OMR20bn and creation of more than half a million jobs.
- Foreign direct investment (**FDI**) **inflows to Oman** increased by 11% yoy to USD 822mn in 2015, according to UNCTAD's World Investment Report 2016, but remained well below their pre-crisis annual average of above USD 2bn, according to the UN agency. The FDI inflow in 2015 was equivalent to 4.8 % of Oman's GDP compared to 3.3% of GDP in 2014.
- Oman's Ministry of Finance commissioned five international banks to arrange **the issue of two dollar-denominated sukuk** totalling USD 2.5bn - a USD 1bn five-year issue and a USD 1.5bn ten-year issue - to finance the budget deficit.
- **Qatar** approved laws to set up a **new state-owned company** to sell oil products; the company is to be established and represented by Qatar Petroleum, and be wholly owned by the state of Qatar.
- **Qatar's real GDP growth** is forecast to average 3.6% over 2016-2018, on “on the back of continued expansion in the non-hydrocarbon economy, which although moderating, remains strong”, according to the “Qatar Economic Outlook 2016-2018” report issued by the Ministry of Development Planning and Statistics.
- **Saudi Arabia's** Capital Market Authority has amended rules - by changing references to “shares” in the rules into “securities” - to allow **foreign institutional investors** to buy

exchange-listed **debt** instruments, as part of the reform process. These reforms are likely to be implemented by mid-2017.

- Liberalisation measures begin: **Saudi Arabia** granted SaudiGulf Airlines a license to operate domestic flights within the country. The airline will begin domestic flights from Sep 1 and expects to start international flights to Dubai from Dammam by the end of the year.
- **Saudi Arabia's GDP growth** is expected at just +0.8% this year, its weakest growth since 2002, as a result of lower government spending amidst lower oil prices according to Oxford Economics estimates. The report also discussed the dismal state of the **GCC's overall productivity** performance: it made zero or negative contributions to the GCC economies at the economy level between 2002-2015, while accounting for marginal improvements when focusing on the non-oil sector.
- Strong **entrepreneurial class in the Middle East**: research by HSBC Private Bank shows that the region has more than 2,800 active business owners, worth between USD 250,000 - USD 20mn, with the youngest average age of entrepreneurs at just 26 years old.

UAE Focus

- “Several banks” were in talks for a “**market maker**” role with the Abu Dhabi Securities Exchange (**ADX**), disclosed the CEO of the exchange, without providing any further details. NBAD had launched and closed within a year its market making operations on ADX; though sources stated it as “unprofitable” for the bank, the exchange’s CEO stated that it was due to technical difficulties.
- **Bank lending** in the UAE picked up by 6.9% yoy in May (Apr: 6.6%) while M2 money supply growth was 1.4% (Apr: 4.5%)
- Saudi Arabia accounted for 45% of **Dubai's trade** in the region in 2015, according to the Dubai Chamber of Commerce, followed by Oman and Kuwait at 19% and 16% respectively.
- The Commercial Bank of Dubai (**CBD**) is due to sign a USD 500mn **loan deal** to refinance existing debt (a USD 450mn loan that matures in Dec, according to a source), reported Reuters. Separately, **Emirates NBD** signed a three-year loan of USD 1.7bn last week- about USD 450mn more than it had originally sought.
- **Moody's** upgraded **Emaar Properties** to Baa3 long-term issuer rating with a stable outlook, on “financial strength and ability to create sustained shareholder value through its ongoing projects and assured recurring revenues from its malls and hospitality businesses”.
- **Masdar** is aiming for a production capacity growth of 20% per annum in the next five years both in solar and wind energy, and plans to tap North Africa, Levant and the Indian subcontinent as potential growth markets in addition to the GCC.
- The **Dubai Municipality** plans to establish the largest plant in the Middle East to **convert solid waste into energy**, as part of the emirate’s plan to reduce the landfill by 75% by 2021. The plant, to be built at a cost of AED 2bn, is expected to be operational in Q2 2020; receive 2,000 metric tonnes of municipal solid waste per day in phase 1 to produce 60 megawatts.

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- Mercer’s “Cost of Living” survey places **Dubai** and **Abu Dhabi** among the top 25 most **expensive cities** for expatriates, ranking 21 and 25 respectively. Hong Kong topped the list, while Luanda (Angola), Zurich, Singapore and Tokyo accounted for the top 5.
- **UAE’s start-ups** are making their presence felt globally, with a four-fold increase in their role compared to the year before, according to the GE’s 2016 Global Business Innovation Barometer. About 85% of UAE respondents recognised “digital Darwinism”: i.e. becoming obsolete as technology is evolving faster than they can adapt while 72% felt that lack of talent or inadequate skills hindered their ability to innovate. (*More details:* <http://www.gereports.com/innovation-barometer-2016/>)

Media Review

Understanding the Brexit & next steps

<http://www.economist.com/news/leaders/21701265-how-minimise-damage-britains-senseless-self-inflicted-blow-tragic-split>

<http://www.economist.com/news/finance-and-economics/21701292-uncertainty-abounds-expect-global-chilling-effect-investment-why-brexit>

<http://www.economist.com/blogs/economist-explains/2016/06/economist-explains-23>

<http://qz.com/716947/four-ways-the-uk-can-reverse-brexit-if-it-really-really-wants-to/>

Brexit & impact on the GCC

<http://www.thenational.ae/business/economy/regional-economies-brace-for-effects-of-british-vote-to-leave-the-eu>

<http://www.zawya.com/mena/en/story/ZAWYA20160624104807/>