

Weekly Economic Commentary – Aug 23, 2015

Markets

The Shanghai stock exchange plunged again at the start of the week and then another spate of negative macro data from China spread the contagion to the main world stock markets. Weekly losses are in the range 5-7%. Regional markets were hammered by the skid in the oil price and even this morning have continued their rout: the KSA bourse has lost over USD50 bn of market capitalisation so far in August. The currency markets have penalized the US dollar, while emerging markets continue to bear the repercussions of the yuan devaluation. Vietnam devalued its currency again while Kazakhstan scrapped its trading band for the Tenge leading to a 25% plunge in its value. But turmoil has spread to many places from Turkey to Russia, from Malaysia to Brazil. Oil prices fell to their lowest since 2009 with the WTI below USD 40\$/b, in the eighth consecutive week of losses. In particular on Wednesday a huge unexpected crude inventory increase in the USA renewed fears over the global oil glut. Crude oil for delivery in 2020 costs only about \$20 more than current prices, futures markets show. Gold on the contrary has benefitted from the global uncertainty and fears of currency wars.

Global Developments

US/Americas:

- **The minutes of the US Fed** did not signal an imminent rate hike: “Almost all” FOMC members prefer to wait for additional evidence before they feel “reasonably confident” in the inflation and growth outlook. On wage growth: “the ongoing rise in labor demand still appeared not to have led to a broad-based firming of wage

increases". Concern about China's woes appeared mild.

- **US inflation** rose 0.1% mom (0.2% yoy) in Jul, vs 0.3% (0.1% yoy) in Jun. The higher gasoline price more than compensated the drop in other energy items. Core inflation increased 0.1% mom, down from 0.2% in Jun. Not even the slightest whiff of inflation pressure is perceptible at present.
- **NAHB market index** rose to 61 in Aug, gaining a paltry 1 point from Jul. **Existing home sales** in Jul increased by 2% mom and by 10.3% yoy, confirming the gradual recovery of the real estate sector.
- **Initial unemployment claims** rose by 4,000 to 277,000. The four-week moving average rose by 5,500 to 271,500.
- **The Conference Board index of leading indicators** fell by 0.2% in Jul. In the six months ended in Jul, the leading economic index increased by an annualized 3.5%.
- The central bank monthly indicator of **GDP for Brazil** contracted -0.6% mom sa in Jun, down from a 0.6% mom increase in May. The figure indicates that in Q2 GDP dropped -1.9% qoq sa (nearly 8% annualized).

Europe:

- **The Euro area flash composite PMI** rose 0.2pt to 54.1 in Aug, against expectations of a small decline. The manufacturing sector PMI was flat at 52.4, while the services sector PMI gained 0.3pt to 54.3. At the country level, the **German composite PMI** rose by 0.3pt to 54.0 in August, driven by a strong +1.4pt gain in the manufacturing PMI. The **French composite PMI** fell -0.2pt to 51.3.
- The **euro zone's current account surplus** expanded to EUR 31.1 bn in Jun, from a revised EUR 4.3 bn in May. The euro zone's external trade surplus widened in Jun to EUR 26.4 bn, from EUR 19 bn in May and from EUR 16 bn in Jun 2014.
- The **UK CPI** rose 0.1% in Jul, after remaining unchanged

in Jun. The **UK's producer price index** fell -1.6% yoy in Jul after dropping -1.6% in the previous three months.

- The **UK retail sales index** rose 4.1% yoy in Jul, slightly down from a revised 4.2% increase in Jun.
- **German producer prices** fell -1.3% yoy in Jul, following a -1.4% drop in Jun. Interestingly, Germany new-home prices rose 6.4% yoy in Jun, following a 5.9% gain in May.

Asia and Pacific:

- **Japan's Q2 GDP** disappointed by shrinking 0.4% qoq after a solid 1.1% gain in Q1. This unexpected contraction was mainly due to a slump in private consumption and external demand and confirms that Abenomics is largely ineffective.
- The **Japanese Reuters Tankan survey** in Aug showed an improvement in the manufacturing index by 3 points from Jul to +17, marking the first improvement in 3 months. The non-manufacturing index advanced by 3 points from Jul to +27. The retail DI improved by 18 points, after recording a sharp decline in July on weather related factors. Overall the index confirms a lackluster outlook.
- **Japan's monthly trade deficit** rose to JPY -370 bn in Jul from June's JPY -283 bn shortfall.
- **China's foreign direct investment** plunged to USD 8.2 bn in Jul, from USD 14.6 bn in Jun. Capital outflows continue to rise, as investors seek better returns elsewhere.
- The **Chinese central bank** announced RMB 110 bn in 6-month 3.35% loans to 14 unnamed financial institutions, to boost liquidity, a move that raised fears of a bank crisis.
- **The preliminary Caixin/Markit China Manufacturing PMI** stood at 47.1 in Aug, well below expectations and down from 47.8 in Jul. It was the worst reading since

March 2009, and the 6th straight reading below the 50-point level, which separates growth from contraction.

- **Singapore's non-oil domestic exports** fell 0.8% yoy in July following a downwardly revised 4.5% gain. Exports suffered another steep deterioration in tech. demand driven by the weak PC market.
- The **State Bank of Vietnam** weakened its reference rate by 1% to 21,890 dong to the USD and increased the scope for fluctuations to 3% on either side, after doubling the range.
- **Thailand's Q2 GDP** expanded 2.8% yoy slightly below Q1's increase of 3%. Weak domestic demand and hefty household debts will drag the performance in the second half of the year.

Bottom line: Asia remained in focus during the week as Japanese GDP fell again despite the massive monetary and fiscal stimuli launched by Prime Minister Abe. Data from China confirm that the economy is coming to a screeching halt with repercussions across many emerging markets. One of the main policy consequences of this turmoil together with the yuan revaluation is the inception of the US Fed tightening cycle. Overall the impact on US so far has been modest, particularly given the rally in longer-dated bonds, but it is incontrovertible that every time the Fed is about to cautiously raise rates, global markets falter and then plunge. This is a symptom that financial markets are still saddled by an enormous stock of debt (and leverage), largely unsustainable if the dollar interest rates were to increase even by a few basis points.

Regional Developments

- **Egypt** will lower the top **tax rate** on companies and individuals to 22.5% (from 25%) and freeze a 10% **capital gains tax** within two weeks, according to the finance minister; though both amendments were announced earlier this year in Mar and May respectively, these are yet to be signed into law.

- **Unemployment rate** in **Egypt** edged down to 12.7% in Q2 this year, down slightly from 12.8% in Q1 and 13.3% in Q2 a year ago. Though 66k new jobs were created during Q2 to reach a total 27.8 million, the unemployment rate in the 15-29 age bracket remained high at 26% and at 44.6% for university degree holders or higher.
- **Egypt** and **Saudi Arabia**'s Aramco have agreed upon a 3-month **oil products deal** worth USD 1.4bn, to begin in Sep this year, and also that Aramco would be paid within a year.
- **Inflation** in **Iraq** was up 1% mom and 2.6% yoy in July; food and non-alcoholic beverages prices (+4.8% yoy) and higher housing prices (+3% yoy) contributed to the increase.
- **Kuwait** approved **projects** worth KWD 3bn, according to the finance ministry, for a series of power plants, desalination facilities and other infrastructure. It was revealed that 50% of the financing would be raised through stock market offerings, though no timescale was mentioned for most of the projects.
- **Kuwait inflation** was up 3.5% yoy in Jun, thanks to higher housing prices (+6.5% yoy) while food prices increased 3.6%, its most rapid pace in over a year.
- **S&P** affirmed its 'AA/A-1+' long- and short-term foreign and local currency sovereign credit ratings on **Kuwait**, with a stable outlook, citing the country's "strong" fiscal and external positions.
- **Oman's budget deficit** surged ahead to almost OMR 2bn in H1, against a surplus of OMR 250mn for the same period in 2014, primarily due to a plunge in oil prices. The government deficit target for 2015 was set at OMR 2.5bn.
- **Oman's Ministry of Commerce and Industry** approved the proposed merger of Oman International Development and Investment Co (Ominvest) and Oman National Investment Corp Holding (ONIC).
- **Oman's conventional banks** have achieved an 8.89% growth in total credit at OMR 17.8bn in H1, from OMR 16.37bn in

the same period last year,

- The **Muscat Securities Market lost** more than OMR 500mn in capitalization over 3 weeks as oil prices touched a six-year low.
- **Qatar banks'** assets and liabilities rose by 4.1% mom to QAR 1.06 trillion in Jun, according to central bank data. Total domestic loans and credit facilities to Qatar's private sector showed an increase of QAR 14.2bn to QAR 385.6bn while credit to the real estate sector was up QAR 2bn to QAR 99.5bn.
- **Inflation in Qatar** grew 0.6% mom and 1.6% yoy in July, aided by rising costs of education (11.1%), hotels (3.7%), transportation (3.2%) and rents (2.3%).
- Growth in **Saudi Arabia** will slow to 2.8% this year and 2.4% in 2016, following the oil prices slump, the **IMF** forecast on Monday last, also recommending "sizable multi-year fiscal adjustment".
- **Fitch** Ratings lowered the outlook for **Saudi Arabia** to 'negative' from 'stable' in the light of low oil prices, slower growth outlook & growing budget deficits
- **Saudi Arabia's non-oil exports** were down 21.1% yoy to SAR 15.38bn in Jun, and imports fell by 9.9% to SAR 51.83bn. UAE, China, Singapore, India, and Egypt were the largest recipients of Saudi non-oil exports, accounting for 41.36% of the total non-oil exports.
- **Tourism's** share in **Saudi Arabia's** GDP stands at 2.7% and at 5.2% with respect to non-oil GDP, revealed *Iqtisad* Magazine. Furthermore, it was stated that the country captured 15.3% of tourism revenues in the Middle East region in 2014, which attracted 5% of global tourists.

UAE Focus

- **Inflation in the UAE** was up 0.3% mom and 4.4% yoy in July, at its highest level since Feb 2009, and with housing and utility costs up 0.1% mom and 10.1% yoy.
- **UAE and India** agreed to set up a USD 75bn **infrastructure**

investment fund – with an aim to build railways, ports, roads and other projects in India – and to boost two-way trade by 60% over the next five years. The countries also agreed to take advantage of India's experience in small and medium enterprises "to create a vibrant industrial base in the UAE".

- **Money supply in the UAE**, both M1 and M2 declined: the former by 0.7% mom to AED 460.8bn in Jul this year and the latter by 0.4% mom to AED 1184.7bn.
- **UAE** has issued a **law** (Law No. 22 of 2015) regulating the **partnership between the public and private sector**: this is much needed to boost private sector participation in development projects. While projects need to be economically, financially, technologically and socially feasible, there are conditions for the approval of projects (e.g. any government body's director general or their deputy can approve a project worth lower than AED 200mn; projects valued at more than AED 500mn will be approved by the Supreme Financial Policy Committee).
- The Emirates Nuclear Energy Corporation announced contracts with more than 1100 **UAE** companies, totaling more than USD 2.5bn, for the construction of UAE's first **nuclear energy plants**.
- The number of **Chinese overnight visitors** to the **UAE** was up almost 25% yoy to 241,000 persons during H1 this year. China was not only one of Dubai's top 10 tourism source markets in 2014, but visitors from the country are also estimated to have grown by 25% during that year.
- **Dubai** was third-highest ranked in a list of 10 most-improved cities in the last five years and placed 75th of a total 140 cities, according to a recent **EIU** study on **liveability rankings** across the globe.
- **Total humanitarian aid** provided by the **UAE** reached almost USD 4.9bn in the past five years 2009-14, revealed the Head of UAE Committee for the Coordination of Humanitarian Foreign Aid.

Media Review

El Erian on the stock markets

<http://www.bloombergvew.com/articles/2015-08-21/brutal-week-in-markets-but-what-comes-next->

Stock market performance capped by the plateau in earnings

<http://www.businessinsider.com/chart-rapidly-maturing-earnings-cycle-2015-8>

Sell in May and Go Away would have been a good option – in hindsight!

<http://qz.com/485324/sell-in-may-and-go-away-would-have-been-a-great-idea-this-year/>

The Great Emerging Market Bubble

<http://www.project-syndicate.org/commentary/emerging-markets-stagnation-by-bill-emmott-2015-08>

Bahrain & Oil uncertainty

http://www.zawya.com/story/Bahrains_economy_adapts_to_oil_uncertainty-ZAWYA20150819064920/

The Norwegian SWF revises its strategy in the face of low oil prices

<http://www.bloomberg.com/news/articles/2015-08-19/oil-cash-slump-triggers-new-risks-at-world-s-biggest-wealth-fund>

Oman: Opportunities and Challenges in the construction sector

http://www.zawya.com/story/Opportunities_and_challenges_in_Omans_construction-ZAWYA20150817055042/

Gulf-based Islamic Banks Weakened Outlook: S&P

http://www.zawya.com/story/Gulfbased_Islamic_banks_face_weakening_outlook-ZAWYA20150816034550/