Weekly Economic Commentary – Jan 24, 2016

Markets

Stocks on Wall Street closed higher on Friday, in the wake of Thursday's advances, to close the week in positive territory for the first time this year. European indices also recovered especially after ECB President Draghi raised expectations of further liquidity injections and gave assurance that the banking sector in the Eurozone is solid. The Nikkei, which seemed poised to break the 16000 support, was pulled up by the optimistic mood. In emerging markets though the rebound was not as strong with the MSCI EM closing virtually unchanged. Regional markets benefitted from the lift in oil prices above USD 30/b but mostly closed lower compared to a week ago. The situation continues to remain volatile. Over the past 28 years (i.e. 336 months), only in 12 months has the MSCI World stock index dropped more than in Jan 2016. Over half of those were associated with major market crises, including the Lehman Brothers bust of 2008/09, the dot.com burst of 2001/02 and the emerging markets crises of the late 1990s. The upswing on stock markets pushed the dollar higher on all crosses. Oil came off the multi-year lows and gold which had gone above USD 1100 per ounce for the first time in 2 weeks held onto most of the gains.

Global Developments

US/Americas:

- **The US inflation** was negative mom at -0.1% in Dec (0.7% yoy) after a flat mom reading in Nov. Declines were broad-based, as food dropped -0.2% and energy fell 2.4%. Excluding food and energy, the CPI rose 0.1%, from Nov's 0.2% increase. Such unexpected decline could make

Federal Reserve officials less willing to take the risk and hike interest next Mar.

- **The flash Markit US Manufacturing PMI** came in at 52.7 in Jan improving from the 38-month low reading of 51.2 in Dec. Output and new business increased briskly while job creation eased to a 4-month low.
- **US housing starts** were 1.149mn in Dec, down by 2.5% from the Nov total but still up 6.4% yoy. Housing starts averaged 1.11mn units in 2015, the highest since 2007 and up from 1.00mn units in 2014.
- **Net long-term capital flows** remained positive in Nov for the 16th consecutive month at USD 31.4bn (Nov: USD 17.7bn), supported by the strong purchase of US treasury bonds and notes by foreign private investors.
- **The NAHB Housing Market Index** remain unchanged in Jan from Dec’s 60 score. Overall, building sentiment is indicative of steady growth for housing despite some setback for certain components and regions.
- **US unemployment claims** rose 10,000 to a seasonally adjusted 293,000, the highest recorded since early-Jul.

Europe:

- **The ECB minutes** of the last policy meeting confirmed that some members did not see a sufficient case for further policy action, although other members advocated a more activist policy. Such frictions are unlikely to pave the way to decisive action.
- **Eurozone annual inflation** accelerated to 0.2% yoy in Dec from 0.1% in Nov.
- The **flash Markit Composite PMI for the Eurozone** came in at an 11-month low of 53.5 in Jan compared to 54.3 in Dec. The drop was led by services, which fell to a 1-year low of 53.6.
- **Eurozone credit conditions** improved in Q4, with the net percentage of banks reporting tighter credit for corporations at -4% in the three months to Dec,

unchanged from the Q3.

- **Eurozone current account surplus** expanded to a seasonally adjusted EUR 26.4bn in Nov, from a revised EUR 22.4bn a year earlier.
- **The UK unemployment rate** for the three months to Nov fell to 5.1% from 5.2% in the previous period, its lowest since the three months through Jan 2006.
- **The German ZEW economic confidence indicator** fell to a 3-month low of 10.2 in Jan from 16.1 in Dec. The indicator remains below its historical average of 24.7. The **ZEW economic confidence indicator for the Eurozone** fell 11.2 points to 22.7 in Jan.
- **UK retail sales** value fell 1.0% yoy in Dec, the first fall since May 2009. The quantity bought in the retail industry showed growth for the 32nd consecutive month in Dec, increasing by 2.6%.
- **UK CPI** rose 0.2% yoy in Dec after climbing 0.1% yoy in Nov, whereas **PPI** fell -1.2% yoy Dec after dropping -1.5% yoy in Nov.
- **PPI** in **Germany** fell -2.3% yoy in Dec, following a -2.5% yoy drop in Nov.

Asia and Pacific:

- **China's GDP** expanded 1.6% in Q4 (6.8% yoy), slowing from 1.8% (6.9% yoy) in Q3. These data are not particularly reliable, but nevertheless confirm that the slowdown is not accelerating, as gains in services and consumption offset weaker manufacturing and exports.
- **Industrial production** in **China** rose 5.9% yoy in Dec down from a 6.2% in Nov. Manufacturing expanded by 7.0%, while electricity, heat, gas and water production and supply declined by -0.8%. **Retail sales** grew 11.1% yoy in Dec, bringing the full year growth to 10.7% compares to 12% in 2014.
- The **Chinese central bank PBOC** announced that it would use reverse repos to meet liquidity demands around the

New Year holiday, an injection of more than RMB 600bn through a number of refinance tools and a reduction in the 3-month MLF rate to 2.75%.

- **Industrial production in Japan** plunged -0.9% mom (+1.7% yoy) in Nov, vs a 1.4% rise in Dec (-1.4% yoy). It is the first drop since Aug, mainly driven by shipments (-2.4 percent).
- **Consumer prices in Malaysia** rose 2.7% yoy in Dec, driven by food prices, and slightly above Nov's 2.6% increase. This is the highest reading since Aug.
- **Industrial production in Taiwan** decreased -6.2% yoy in Dec accelerating from a -4.8% drop in Nov.
- **India's monthly trade deficit** widened to –USD 11.7bn in Dec, down from –USD 9.8bn in Nov. The wider deficit signals sluggish global demand, which has hurt India's exporters over the past year.
- **Domestic trade in Taiwan** continued its downward trend in Dec, contracting -3.4% yoy following a -2.3% drop in Nov.
- **Singapore's nonoil domestic exports** fell -7.2% yoy in Dec after dropping a revised 3.4% yoy in Nov, driven by a sharp contraction in its volatile pharmaceuticals exports.
- **New Zealand's CPI** surprised heavily on the downside and fell -0.5% qoq in Q4, from a gain of 0.3% in Q3.

Bottom line: ***Another week of generally downbeat macro data (except the US housing data). Morgan Stanley now sees a 20% chance of world recession, as defined by sub-2.5% growth rate needed to keep pace with population gains. Talks of a recession in the US are intensifying, while neither Europe nor Japan show signs of a decisive improvement. Against this background there appears to be few arguments in favor of a turnaround in oil prices, but signs of slowly declining non-OPEC oil supply especially in the US are emerging: analysts suggest that about 1.5mb/d of crude, corresponding to 1.5% of global supply is cash-negative at USD 40/b. A number of***

producers are biting the bullet hoping for a rebound before they run out of cash. This being said the glut is still sizeable (with more on the way from Iran in about 6-18 months) and large inventories will need to be depleted before a recovery in energy prices gains traction.

Regional Developments

- **Bahrain GDP growth** touched 2.4% yoy in Q3 last year, bringing the year-to-date growth to 3.0%. The non-oil sector reported 3.3% growth in the quarter, supported by a 7% increase in private sector jobs, while reporting 4.2% pickup in the period up to Q3. Infrastructure was highlighted as a key growth driver going forward, with the report stating that nearly USD 6bn worth of projects were allocated, USD 3.7bn tendered and USD 1.3bn commenced to date.
- The **Bahrain** bourse disclosed that it would **list and trade Treasury bills** issued by the government, though no details were provided about the start date. Central bank data show that outstanding T-bills rose to BHD 1.60bn at end-Jun from BHD 1.23bn at the end of 2014.
- **China** offered **financial support to Egypt**: this includes a USD 1bn financing agreement for Egypt's central bank, a UD 700mn loan to state-owned National Bank of Egypt, alongside planning 15 projects in electricity, infrastructure and transport with investments that could total USD 15bn. During the visit, the Chinese PM also offered political support by backing Egypt's efforts to maintain stability.
- **Egypt** aims to increase bank **lending to the SME sector** by EGP200bn, equivalent to 26% of end-3Q15 total banking sector loans, over the coming years to end-2020. According to Fitch, this rule could weaken asset quality as banks are forced to lend to fulfill lending quotas.
- **Egypt**'s central bank governor revealed the possibility of **floating 2 state banks** (diluting around 20%),

clarifying that neither National Bank of Egypt nor Banque Misr were included, and also that it was considering “offering a stake in one of its ventures to a strategic investor”.

- **Egypt** received USD 1.5bn in **foreign direct investment** in Q1 of the 2015-16 fiscal year, according to the investment minister, who also revealed that the target for full year is between USD 8-10bn.
- **Iraq** finance minister revealed that the country plans to sell local bonds to the public for the first time since 2003, with an IQD 5trn (~ USD 4.24bn) issue expected this year.
- **Iraq**‘s **oil exports** from the southern region have been running at an average daily rate of 3.297mn barrels per day so far this month, unaffected by tribal clashes reported in the region.
- **Kuwait**’s Emir set the stage up last week for upcoming **subsidy cuts**: he was quoted as saying “we will lift subsidies and will raise the prices of petrol, electricity and water” though no details of the timeframe were given.
- **Kuwait**’s M2 **money supply** dropped for the first time since at least 2008, reporting a decline of 0.8% yoy in Nov (Oct: 3.1%). Private deposits continued to decline, with Nov reading down by KWD 427mn.
- **Lebanon**’s **balance of payment deficit** widened by more than 130% to USD 3bn in Jan-Nov 2015, as a result of a dip in capital inflows, despite a contraction in the trade deficit.
- Up to **five Omani companies**, including three state-owned, are expected to go public through an IPO on the MSM this year.
- According to **Oman**’s Minister of Oil and Gas, the Sultanate is willing to **cut oil output by 5 to 10%** to support prices on condition that all producers do the same.
- **The Central Bank of Oman** issued one-year Treasury bills

worth OMR 17mn.

- **Saudi Arabia** is forecast to **grow** at just 1.2% in 2016, and 1.9% the year after, according to **IMF** estimates released at the latest World Economic Outlook update. This is a full percentage-point lower compared to its previously released estimate in Oct 2015.
- **Saudi Arabia** plans to create a **new sovereign fund** to manage part of its oil wealth and diversify its investments. One of the sources revealed that the new fund would ideally be operational within 12 to 24 months, while another stated that the planned fund may be able to invest directly in companies rather than channeling investments through foreign asset managers.
- **Saudi Arabia**'s government has contacted local banks to sell them **local currency bonds** worth SAR 20bn this week, reported the Maaal financial website. The previous issue was mid-Dec.
- Saudi Gulf Airlines is set to obtain regulatory approvals to launch **flights** within **Saudi Arabia** by end-Mar or early-Apr, revealed an official from the General Authority of Civil Aviation. If granted this would kick-off the liberalisation plans announced late last year.
- The **GCC** could reap multiple benefits from scaling up **renewable energy** as per Irena's recent report. Increasing renewables to meet national plans and targets (by 2030) will cut fuel use in the power and water sectors by 50% in the UAE, 23% in Saudi Arabia and 21% in Kuwait. It would also reduce the region's per capita carbon footprint by 8%.
- **Germany** must double its spending on public housing to address the **influx of refugees**, according to the housing minister. She stated that government funding, which was already doubled last year to EUR 1bn annually between 2016 and 2019, must be doubled again to EUR 2bn a year until 2020.

UAE Focus

- **UAE** is considering the **removal of subsidies** on both electricity and on gas sold to companies generating power, revealed the country's energy minister at the World Economic Forum.
- The **IMF** has projected **UAE growth** at 2.6% this year, 0.5% lower than its Oct forecast, making it the slowest growth rate the country has experienced since 2010.
- The **Emirate of Sharjah** priced a USD 500mn five-year **Sukuk** issue last week, attracting orders nearly double its issue size; the deal was priced at a spread of 250 basis points over mid-swaps.
- The **UAE central bank** has **removed waivers** previously given to foreign banks in 2012 related to lending to government and state-owned enterprises. The exposure to the government and government-linked companies of branches of foreign banks in the UAE must not exceed 30% of the local capital base vis-a-vis permission to use their group's capital reserves to calculate lending previously.
- **Inflation** in **Abu Dhabi** was up 0.4% mom in Dec, mainly due to price hikes within the hotels and restaurants sub-sector (+3.8% mom) and housing, water, electricity, gas and other fuels (+1.6% mom).

Media Review

The asset price slump is driven by SWFs

http://www.bloomberg.com/news/articles/2016-01-19/sovereign-wealth-funds-are-driving-asset-slump-jefferies-says

The emerging markets' stock plunge in 5 charts

http://www.bloomberg.com/news/articles/2016-01-17/emerging-market-rout-visualized-in-graphs-shows-abundant-gloom

Goldman Sachs' page on the oil market

http://www.goldmansachs.com/our-thinking/pages/the-new-oil-order/index.html

The IMF's World Economic Outlook update

http://www.imf.org/external/pubs/ft/weo/2016/update/01/index.htm

What is worrying global CEO’s? The PwC Global CEO survey 2016
http://www.pwc.com/gx/en/ceo-agenda/ceo-survey-2016.html

Xi Jinping’s tour of the Middle East
http://www.economist.com/news/21688786-chinese-president-makes-his-first-visit-region-xi-jinpings-tour-middle-east

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