Weekly Economic Commentary – May 1, 2016

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Markets

As we have argued for several months, equity prices at present are primarily driven by exceptionally lax monetary policy and to a lesser extent by fundamentals (the S&P 500 bull market is 2,610 days old, the second longest in history). So global equity markets reacted un-enthusiastically to the Fed's hawkish message and when later the Bank of Japan disappointed expectations of more monetary drug, the Japanese bourse took a hit. Regional markets were mixed pulled in opposite directions by the oil price and the global retrenchment. In currency markets the dollar was weak while the yen snapped up after traders had nurtured expectations of a dovish BoJ. Oil price is once again climbing steadily the upward slope reaching new 2016 highs on Friday, thanks to a weak dollar and falling production in the US. However the rise in the Middle-East production thwarted the momentum. Gold had another positive week, most likely because it attracts momentum buyers.

Global Developments

US/Americas:

- **The US GDP growth** hit a bump in Q1 growing at 0.5% qoq annualized, the slowest pace in 2 year, down from 1.4% in Q4. The slowdown is due to a fall in domestic demand and exports. Consumer spending increased by 1.9%, down from 2.4% in Q1, while private investment collapsed by -5.9% – the biggest decline since 2009 crisis.
- **The US Fed** left rates unchanged and adopted a more

hawkish language, increasing the probability of a hike in June. The final statement stressed that labor market conditions have improved, although “growth in economic activity appears to have slowed”. The Fed stressed that it is attentively watching inflation and that global economic fragility remains a concern.

- **New orders for US durable manufactured goods** rebounded by 0.8% mom in Mar after declining 3.1% in Feb, well below expectations as demand for vehicles, computers and electrical goods fell signalling that the weakness in manufacturing is persisting.
- **Consumer spending in the US** edged up 0.1% mom in Mar, lower than an upwardly revised 0.2% gain in the previous month and below market expectations of a 0.2% rise. It is the lowest gain so far this year.
- **US Case Shiller existing-home price national index** growth was stable in Feb at 5.3% yoy. The 20-city composite index was up 5.4% yoy, down from 5.7% in Jan.
- The final University of Michigan’s **consumer sentiment index** came in at 89 in Apr, down from 91.0 in Mar.

Europe:

- **The eurozone’s economic growth** accelerated at the beginning of the year, expanding by 0.6% qoq in Q1 and 1.6% yoy.
- The **eurozone’s deflation pressures** intensified again in Apr, with CPI falling by -0.2% yoy from 0% in Mar.
- **The eurozone M3 growth** was up 5% yoy in Mar, from 4.9% in Feb. The M2 credit aggregate was again the main driver.
- **UK GDP** growth ticked down in Q1 to 0.4% qoq, compared with the 0.6% in Q4, but held firm at 2.1% yoy. Services added 0.6% while all other main sectors declined. Agriculture fell -0.1%, industry -0.4%, and construction -0.9%.
- **Spain GDP growth** accelerated in Q1 to 0.8% qoq (3.4%

yoy) despite 6 months of political drama.

- **The eurozone's unemployment** rate fell to 10.2% in Mar, the lowest since Aug 2011. The number hides wide variation among countries, with Greece recording 24.4% and Spain 20.4%.
- **The Conference Board Leading Economic Index** for the euro zone was 106.9 in Mar, up 0.3 of a point from Feb.
- **The eurozone's economic sentiment indicator** increased to 103.9 in Apr from 103 in Mar.

Asia and Pacific:

- **The Japanese central bank** surprised the market by doing nothing. Most economists had expected more easing in response to the strengthening yen, but Governor Kuroda decided to wait to gauge the effect of negative rates before further action.
- **Japanese CPI** fell -0.3% yoy in March. Weak price pressure in Japan suggests that the Bank of Japan's 2% inflation target remains elusive.
- **Japan's industrial output** rose strongly by 3.6% mom in Mar, partially offsetting the -5.2% drop in Feb.
- **Japan's unemployment rate** was 3.2% in Mar, down slightly from Feb's 3.3%.
- **Japan retail sales** fell -1.1% yoy in Mar after posting a revised 0.4% gain in Feb. Weak income growth and economic conditions are weighing on Japanese consumption activity.
- **Japan's housing** prices rose 8.4% yoy. The relative trend remains weak, however various prefectures, including Tokyo experienced strong gains.
- **Japanese workers' households expenditure** fell -4.9% yoy in Mar following Feb's 2.2% gain.
- **Hong Kong's trade deficit** rose to HKD 47 bn in Mar from Feb's deficit of HKD 33.1 bn.
- **Taiwan's GDP** fell -0.5% yoy in Q4 2015 but expanded 0.5% qoq.

- **Korea's industrial production** improved in Feb, by 2.4% yoy following a -2.2% decline in Jan.
- **Singapore's industrial production** fell -0.5% yoy in Mar after Feb's -3.8% drop.
- **Australia's inflation** surprised on the downside declining -0.2% qoq after a 0.4% rise in Q4.
- **Thailand's industrial production** fell -1.6% yoy in Feb after a revised -3.5% fall in Jan. The main sources of weakness were drops in the production of automobiles and metal products.

Bottom line: Although monetary policy has been effective in helping to stabilise financial markets, neither businesses nor consumers have responded to very low interest rates in the expected way. The flood of money has propped up the price for existing housing and financial assets, but has not stimulated private investments into labour intensive activities. The dismal US GDP data are just the latest confirmation of such evidence. Overall global economy is in a worse underlying state, because the performance remains dependent on exceptional stimuli, which are obviously unsustainable.

Regional Developments

- Lower oil prices and conflicts are the main culprits of lower economic activity in the Middle East, North Africa, Afghanistan and Pakistan region, according to the latest issue of **IMF**'s **Regional Economic Outlook**. The report, which estimates growth in the GCC at 1.8% this year, called for more action to reduce budget deficits, rebuild financial reserves and save money for future generations. A cumulative fiscal deficit of USD 900bn is estimated for GCC and Algeria in the period 2016-2021.
- **Saudi Arabia** released its **Vision 2030** document (http://vision2030.gov.sa/en/): one of the highlights was the plan to end dependence on oil by 2020. Plans include the potential sale of a stake in Aramco (less than 5%), creation of the world's largest sovereign

wealth fund (USD 2 trillion), rolling out a "green card" for expats living in the country in 5 years, and creation of a military industries holding company, among others. Quite the ambitious plan, more details about implementation is expected over the next few weeks.

- The **Bahrain** and **Egypt**ian bourses signed off on a **dual listing agreement** last week, in addition to enhancing the technological infrastructure and informatics. Bahraini investments in Egypt are worth some USD 2.7bn, according to the Egyptian trade and industry ministry, while the trade volume increased to USD 320mn in 2014, from USD 181mn in 2013.
- **Inflation** in **Bahrain** edged up to 3.3% yoy in Mar (Feb: 2.9%), as housing and utility costs increased 4.0% amidst a 3.9% rise in prices of food and non-alcoholic beverages.
- **Egypt**'s **money supply**, M2, increased 18% yoy to EGP 1.987 trillion in Mar.
- As **Egypt** continues to negotiate a USD 500mn **loan** from the **World Bank** for developmental projects, it was disclosed that the **EU** had approved a new aids programme for the country (estimated at EUR 500mn) and this was to be presented to the parliament in the coming days.
- **Egypt**'s **tourism revenue** was down 66% yoy to USD 500mn in Q1 this year; only 1.2mn tourists travelled into the country in Q1, down from 2.2mn a year earlier. The new tourism minister revealed that the country is aiming for around 10mn tourists in 2017.
- **Iraq** has signed a long-term "strategic framework agreement" with **GE** in an attempt to boost its **power grid**. Separately, **IFC** announced financing of USD 375mn to an Iraqi power company to add capacity in a Kurdistan plant and complete a new power plant near Baghdad.
- **Kuwait** passed the law last week to **increase electricity and water prices** and will be effective 15 months after publication in the official gazette. Only Kuwaiti citizens residing in villas or apartments are excluded

from the law.

- **Kuwait**'s finance minister disclosed that the country's economic reform plan does not include **privatisation** of oil and gas production, education, health services (as per Article 4 of Law 37 for 2010) or selling government assets to individuals or firms that may monopolise them.
- **Bank lending** to the private sector in **Kuwait** slowed to 6.8% in Feb (Jan: 7%) while money supply growth increased by 2.5% (Jan: 2%).
- **Oman** plans to build a **major oil storage terminal** on its southeastern coast, spending between USD 300 mn and USD 400 mn on the first phase.
- The **US has emerged as the second largest buyer of Oman's crude** after resuming oil imports from the Sultanate following a nearly three-year interruption. Asian countries have been the traditional buyers of Oman's crude with China accounting for a 71.2% share.
- **Qatar** became the latest country in the GCC to implement **subsidy reform**: petrol and diesel prices will be allowed to fluctuate in line with global prices though the formula (that includes global fuel prices, production and distribution costs within Qatar and prices elsewhere in the region) was not disclosed. Local diesel prices were reduced by 7% and petrol prices left unchanged for this month.
- **Qatar**'s **foreign trade surplus** declined by 15.3% mom and 58.7% yoy to QAR 6.3bn in Mar; imports increased by 12.6% mom and 4.7% yoy to QAR 10.8bn.
- **Saudi Arabia**'s central bank reported a decline in **net foreign assets** by USD 6bn in Mar; assets were down 16.2% yoy and 1% mom to SAR 2.17trn. **Money supply** (M3) was down 0.4% yoy in Mar (Feb: -0.9%). Inflation picked up by 0.2% mom and 4.3% yoy, driven by transport costs (+12.4% yoy) and prices of housing and utilities (+8.5%).
- **Saudi Aramco**'s board approved a number of funding initiatives including the creation of a sukuk programme

and also decided to set up joint ventures for onshore and offshore rig services, according to the company's weekly magazine.

- **Saudi Arabia**, as per its Vision 2030 document, plans to generate 9.5 gigawatts of electricity from **renewable energy** by 2030.
- The **MENA** region raised only USD 615mn from 2 **IPOs** in Q1 this year, reported EY. IPOs were executed in Saudi Arabia and Egypt – the most active markets the region, which accounted for 8 of the total 14 IPOs done last year.
- The **GCC railway** is expected to create 80k direct and indirect jobs, according to the secretary-general of GCC Chamber of Commerce and Industry.

UAE Focus

- **Abu Dhabi** initiated a USD 5bn **two-part bond offering** last week, in the first bond sale since Apr 2009; the bonds mature on May 3, 2026, according to market participants.
- **Inflation** in **Abu Dhabi** fell to 2.8% yoy in Mar, following a 3.1% decline in transport prices, and in spite of the 6.9% rise in housing and utilities costs.
- **Petrol prices** in the **UAE** will go up by around 10% in May, as a result of rising oil prices globally – Brent closed at $48 last Friday, recording its best monthly gain in seven years.
- The Islamic Corporation for the Development of the Private Sector (**ICD**), the private arm of the Islamic Development Bank group, listed a USD 300mn **Sukuk** on **Nasdaq Dubai** last week, bringing the total nominal value of sukuk currently listed in Dubai to USD 42.61bn. IDB has seven other sukuk currently outstanding on Nasdaq Dubai that have listed since 2014, with a total nominal value of USD 8.05bn.
- **Passenger traffic** at **Dubai airport** increased 7.4% yoy to

7.24mn persons in Mar, bringing the year-to-date total to 20.95mn (+6.8%).

- **Dubai** attracted 4.1mn **overnight tourists** during Q1 this year, with those from Saudi Arabia and Oman accounting for 476k (+14%) and 322k (+5.1%) respectively. India was the second-largest market, with visitors growing 17% to 467k, followed by UK with 334k persons (+10%).
- According to Network International, **overall card expenditure** in the **UAE** increased 9% in 2015 while for UAE-issued cards, spending was up 13%. The top-five spenders were US, Saudi Arabia, Qatar and Kuwait (in addition to UAE); Qataris replaced Russians in the biggest spenders list.
- **DP World** reported a 2.4% rise in gross container volumes to 15.5mn TEUs in Q1 2016, with growth driven by Europe and the Indian sub-continent. UAE reported a 5.9% drop to 3.6mn TEU.
- The **average daily rate** in **Dubai**’s **hotels** during Q1 fell 10.1% to USD 234.88; this still remained the highest across the globe with only three other markets – Paris, New York and Singapore – reporting ADRs above the USD 200-mark.
- **Travel spending** by **UAE residents** grew 8.2% yoy to USD 20.8bn in 2015 – ie. an average spend of AED 8174 per UAE resident, according to a Euromonitor report. This is expected to increase by about 40% to USD 29bn by 2020.

Media Review

Managing debt in an overleveraged economy

https://www.project-syndicate.org/commentary/debt-management-overleveraged-global-economy-by-michael-spence-2016-04

IMF publishes its Regional Economic Outlook for the MENAP region

http://www.imf.org/external/pubs/ft/reo/2016/mcd/eng/pdf/menap0416.pdf

IIF issues MENA report (subscription)

https://www.iif.com/publication/regional-overview/mena-weather *ing-low-oil-prices*

Saudi Arabia's post-oil future

http://www.economist.com/news/middle-east-and-africa/21697673-bold-promises-bold-young-prince-they-will-be-hard-keep-saudi-arabias

Saudi financial district overhaul

http://www.zawya.com/story/Saudi_to_overhaul_floundering_financial_district_economic_cities-TR20160426nL5N17T5Z0X2/

KPMG: GCC Banking sector financial results and outlook

http://www.kpmg.com/BH/en/Documents/GCC%20Listed%20Bank%20Results%20Report%20(2015)%20-%20A%20new%20paradigm.pdf

Food for thought: how do you measure prosperity?

http://www.economist.com/news/leaders/21697834-gdp-bad-gauge-material-well-being-time-fresh-approach-how-measure-prosperity

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