

Weekly Economic Commentary – Jun 12, 2016

Markets

After coming close to an 11-month record, the S&P 500 fell back towards the end of the week in line with other developed economies' stock markets. While in the US the retrenchment was due to a lack of catalyst which could justify a further upswing in Europe equities were hit by the prospect of Brexit which casts a shadow of uncertainty on the fragile recovery. Emerging stock markets indices, on the contrary, recorded a positive week and so did regional markets lifted by resilient oil prices. US crude oil inventories fell by 3.2 mn barrels in the week ended June 3 confirming that the market is not oversupplied anymore. Currency markets saw a rebound of the dollar after Yellen expressed confidence on the US economic outlook while gold and other safe haven assets like German bunds benefitted from the Brexit hysteria.

Global Developments

US/Americas:

- **Fed Chairperson Yellen in a speech** reiterated the view that the US economic expansion is expected to continue, with the labor market improving further, GDP growing moderately and inflation rebounding to 2% over the next couple of years.
- US productivity is struggling, as **nonfarm output per hour** fell -0.6% in Q1 (+0.7% yoy). Hours worked increased 1.5% qoq and hourly compensation by 3.9% qoq, implying an increase in unit labor costs of 4.5%.
- **The USA recorded a public budget gap** of USD 53bn in May, down 38% from a USD 84bn deficit a year earlier, as outlays fell 7% to USD 277bn while receipts rose 6% to

USD 225bn.

- **The University of Michigan's consumer sentiment** for the US came in at 94.3 in June 2016, down from 94.7. Future economic prospects were down, while assessments of current conditions touched a record high since July 2005.
- **Claims for unemployment benefits in the US** decreased for the fourth week to 264,000, the lowest in six weeks, from 268,000. Continuing claims fell 77,000 to 2.095 million, while the insured unemployment rate dropped to 1.5%.
- **Inflation in Brazil** was 9.32% yoy in May, following April's 9.28%. Housing prices advanced further, while the food and transportation indices grew at a slower pace.

Europe:

- **Germany's inflation** stayed negative in May at -0.1% yoy (0.1% mom), the same drop as in Apr.
- **Eurozone's inflation** rate fell -0.1% yoy slightly lower than -0.2% in Apr, confirming the ineffectiveness of extraordinary monetary policy measures by the ECB.
- **German manufacturing orders** fell -2.0% mom (-0.6% yoy) in Apr, offsetting a 2.6% (2.4% yoy) increase in Mar. Despite drops in emerging markets, orders are supported by demand from the US and the UK.
- **German industrial production** gained a solid 0.8% mom (1.2% yoy) in Apr, following a revised -1.1% decrease (+0.4% yoy) in Mar. **Italy's industrial production** rose by 0.5% mom in Apr, after a flat reading in Mar. Industrial production in France surged 1.2% mom (1.9% yoy) in Apr after a -0.4% fall in Mar. **Spain's industrial production** rose 2.7% in Apr, down from a 3.1% gain in Mar.
- **The UK industrial production** unexpectedly advanced 2.0% mom (1.6% yoy) in Apr after a 0.3% increase in Mar

(-0.3% yoy).

- **The UK Halifax house price index** rebounded 0.6% mom in May, following a -0.8% decrease in Apr. The prospect of Brexit is sapping the real estate market.
- **The Bank of Russia**, as expected, cut its policy rate by 50bp to 10.5% in view of the abating **inflation pressure** stable at 0.4% mom in both May and Apr.

Asia and Pacific:

- **China inflation** was -2.0% yoy in May down from a 2.3% increase in Apr. Food inflation slowed sharply, a sign that supply is recovering after the spell of bad weather.
- **China's PPI** fell -2.8% yoy in May, better than the -3.4% decline in Apr.
- **China's foreign trade surplus** rose to USD 50bn in May, up from USD 45.6bn in Apr as a result of both lower exports and imports yoy growth. In essence China's economy will not benefit from external demand and overcapacity remains a concern.
- **Japan's economy** is still struggling despite a surprise uptick in Q1 GDP. According to the second estimate **GDP** grew 0.5% qoq, ann, an upward revision from the 0.4% for the first estimate.
- **Japan's core machinery orders** tumbled by -11% mom in Apr, more than offsetting the 5.5% advance in Mar.
- **Japan's tertiary activity index** expanded at a brisk 1.4% mom in Apr, thanks in particular to wholesale trade and to a lesser extent to business-related services.
- **Malaysia's industrial production** consolidated its performance in Apr, rising 3% yoy after 2.8% in Mar. Manufacturing however remains vulnerable due to weak domestic and external demand.
- **Philippines' industrial production** soared 10.5% yoy in Apr, up from Mar's 7.8% thanks primarily to food and machinery production.

- **Taiwanese monthly trade surplus** narrowed to USD 3.5bn in May from USD 4.8bn.
- **The Reserve Bank of India** left the repo rate unchanged at 6.5%, but adopted a more hawkish tone in its Jun monetary policy meeting due to an uptick in inflation. Uncertainty over the reappointment of Mr. Rajan at the helm of the central bank is sapping investors' confidence.
- **The South Korean central bank** unexpectedly cuts its 7-day repo rate by 25bp 1.25% to ease the corporate debt restructuring process.
- **New Zealand dollar** surged after the Reserve Bank of New Zealand kept rates unchanged.

Bottom line: The data flow last week did not include any major surprise and the anemic global conditions were confirmed by the OECD composite leading indicator stuck at 99.6 in Apr, unchanged from Mar, the lowest reading since the beginning of 2013. The markets' reaction to polls showing a huge support for Brexit is a sign that investors have little confidence in current asset valuations and any perturbation of such unstable equilibrium ignites a bout of risk aversion and flight to safety (as if buying overpriced government bonds could offer a safe haven). On the positive side, in the US nonfinancial corporate business balance sheets are improving in Q1 with net worth improving again. Companies are holding a record amount of liquid securities, including cash, and do not rely on short-term financing, which dry up as a result of financial shocks. In other words, US businesses are resilient to an unforeseen downturn, although their overall debt levels remain quite high from a historical point of view.

Regional Developments

- **Egypt's urban consumer inflation** rose to 12.3% yoy in May (Apr: 10.3%), the highest level since Feb 2009, while core inflation also picked up to 12.23% (Apr: 9.51%).

- **PMI in Egypt** stayed below the 50-point mark for the 8th consecutive month, registering 47.6 in May (Apr: 46.9); new orders improved to 46.9 points, up from Apr's 45.5.
- **Egypt's EFG Hermes** disclosed that it had received Lebanon central bank's approval to sell a 40% stake in Credit Libanais; EFG Hermes had bought the stake in 2010 for USD 542mn.
- **Iraq's** central bank revealed that an estimated IQD 30 trillion in cash are held outside the Iraqi banking system vis-a-vis only IQD 10 trillion in the banking system. The central bank therefore plans to set up a deposit guarantee fund – with a capital of IQD 100bn – to encourage the use of banking services. The fund will collect an undisclosed percentage of the deposits held by the private and state-owned banks.
- **Iraq** plans to sell USD 2bn in **eurobonds** in Q4 this year, after receiving international aid which would subsequently lower cost of borrowing, according to the finance minister.
- **Kuwait's budget** for the 2016/2017 fiscal year includes only about KWD 238mn for petroleum and gas products subsidies, versus the billions allocated in past years, according to the head of the National Assembly's budgets committee. He also revealed that budget cuts to the tune of KWD 53mn were made across twelve government departments.
- The **Omani government** issued a USD 1bn 5-year note and a USD 1.5bn 10-year note. The price guidance is set at mid-swaps plus 262.5bp on the 5-year tranche and at 337.5bp on the 10-year tranche. It is the first sovereign issuance in almost two decades.
- **Qatar Investment Authority** is on track to acquire a major **stake in Irish telecoms firm** Eir, reported the *Irish Times*, without citing any sources.
- **Qatar's Ooredoo** signed a USD 1.0bn **six-year revolving credit facility**; this will be used for general business purposes and refinancing debt due to mature in March

2017, according to the company.

- **Qatar's Aljaber Group** – a construction firm – is planning an **IPO** that could be worth USD 800mn, reported *Reuters*, citing sources aware of the matter.
- **Saudi Arabia** released its **National Transformation Plan**, a 110-page list of policies and targets for 2016-2020 that aims to reduce the country's dependence on oil. Efficiency savings and spending cuts on existing projects will help pay for the economic reform plan, estimated to cost around SAR 270bn, according to the finance minister. Ranging from cuts in electricity and water subsidies to reducing public sector wages, and taxation, the reform plan touches upon multiple aspects. The document is available at: http://vision2030.gov.sa/sites/default/files/NTP_En.pdf
- At the crux of the **Saudi reforms** is **job creation**: the plan aims to increase the number of private-sector jobs by 450k by 2020 in addition to lowering public-sector salaries as a proportion of budget to 40% from 45%. Unemployment among Saudis is targeted to fall to 9% from 11.6% in the next five years.
- The **Saudi energy ministry**, according to the NTP, expects to maintain its oil production capacity at 12.5mn barrels per day (bpd), raise gas output capacity to 17.8bn standard cubic feet a day from 12bn, and raise refining capacity to 3.3mn bpd from 2.9mn. It also aims to install 3.45 gigawatts of renewable power capacity by 2020 and spend SAR 300mn on identifying locations for atomic electricity plants and preparing them for construction.
- **Saudi Arabia's** housing minister stated that a **housing** construction programme with an aim to build 1.5mn homes in the next 7-8 years is on the cards. The reform plans aim to double real estate sector's contribution to GDP to 10% by 2020. This will be supported by reducing the average time required to approve and license new residential real estate projects as well as by

allocating about SAR 59bn over the next five years to a loan guarantee programme and other schemes that provide financing to home buyers and real estate developers. The Real Estate Development Fund is also likely to issue a sukuk by end of 2017-18.

- **Saudi Arabia's PMI** climbed to a 6-month high of 54.8 in May (Apr: 54.2), thanks to higher output and new orders at a 5-month high.
- The **Saudi Capital Market Authority** Board approved the final draft of the amended **Investment Funds Regulations**: this includes 104 articles covering fund management, custody, offering and selling units, merging funds and offering units of foreign funds in the country.
- The **Saudi health care market**, the largest in the GCC, is set to grow by 69% from USD 16bn in 2015 to USD 27bn by 2020, according to a recent report by Alpen Capital.
- In 2015, **Saudi Arabia** sent USD 7.57bn in **remittances to Egypt**, according to World Bank estimates, through the country's 1 million expatriate Egyptians.
- **SAMA** has banned the use of **options** and other derivatives to speculate against the riyal, reported *Reuters*, citing banking sources; non-speculative trade in riyal forwards market is not prohibited.
- Businesses in the region are not yet prepared for **VAT**, according to two new **surveys**: Deloitte's survey had more than half of its respondents indicating that their business had "minimal understanding" of the impact of VAT while around 81% stated that they were yet to incorporate VAT into their financial plans. An online survey by the CFA society found that 82% of the 68 respondents believed higher inflation to be one of the outcomes of VAT.

UAE Focus

- **UAE PMI** increased to 54.0 in May (Apr: 52.8), picking up at the fastest pace in 8 months, supported by higher

output levels (59.9 in May vs. Apr's 56.9). New orders rose to 55.8 from 54.6 while the index for employment rebounded to 50.4 after dropping to its lowest level since Dec 2011 in Apr (50.0).

- The **Dubai Economy Tracker Index** expanded to 54.5 in May, up from 52.7 the previous month, recording the strongest gain since last Aug.
- The **UAE** central bank reported a 16.6% yoy increase in **net foreign assets** to AED 323.8bn in Apr (Mar: AED 306.2bn).
- The **dirham** will continue to be pegged to the dollar, according to the **UAE** central bank governor, who also stated that any volatility in the forwards market was limited. The dirham has weakened to a premium of around 60 points against the dollar in the one-year forwards market since last Aug from around zero previously. Separately, the governor also reiterated that there was no issue of **liquidity**, citing the substantial amount of certificate of deposits banks hold with the central bank.
- A boost for **SMEs**: around 3500 businesses registered with Dubai SME will now be automatically enrolled as **potential suppliers to Expo 2020 Dubai**, according to a statement from Expo 2020.
- **DP World** earned a 50-year concession to develop a **port project in Ecuador** that will require initial investment of USD 500mn. This amount will be used for “the purchase of land, dredging of a new access channel, a 20 km access road and a 400 metre berth equipped to handle containers and other cargo”.

Media Review

Saudi Arabia unveils its transformation plan

<https://next.ft.com/content/cdb73ea4-2c74-11e6-a18d-a96ab29e3c95>

<http://www.bloomberg.com/news/articles/2016-06-09/what-we-learned-from-four-days-of-briefings-in-saudi-arabia>

GCC needs to cut deficits to keep currency peg: IMF blog-post
<https://blog-imfdirect.imf.org/2016/06/08/oil-exporters-learn-to-live-with-cheaper-oil/>

Saudi Aramco listing lures banks with prospects of game-changing deals

<http://www.reuters.com/article/investment-banking-saudi-idUSL5N18F3V7>

What will be the Uber of the banking sector?

<http://www.zawya.com/mena/en/story/ZAWYA20160609130751/>

Egypt's power plant fast track

<http://www.thenational.ae/business/energy/egypt-on-power-plant-fast-track>

10th annual MENA Private Equity Association report

menapea.com/research-association.php?fileid=10th_MENAPEA_AnnualReport_2015_Rev15.pdf

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