

Weekly Economic Commentary – Jul 24, 2016

Markets

With 25% of the S&P500 companies having reported their Q2 results, the blended earnings decline (a combination of expected and actual earnings) was -3.7% yoy compared with an expected -5.5% as of June 30. Hence the S&P500 crawled up to another record close, but the weekly performance on global stock markets was lackluster. European shares were almost flat, but the companies heavily exposed to the UK economy sunk after the disastrous PMI release. The MSCI Emerging Markets index remained almost stable over last week and the same happened to overall GCC stock indices. Meanwhile the total value of government bonds in the world with negative yields, according to calculations by Bank of America Merrill Lynch has reached USD 13 trillion. In currency markets the dollar benefitted from a flight to safety effect and the pound took another beating due to the impending Brexit-induced recession. The euro was on the defensive after the ECB remained on hold. Oil prices ended the week with a large loss to a two-month low, hit by a large oversupply of gasoline in the US. Gold prices zig-zagged most of the time, registering a mild weekly loss.

Global Developments

US/Americas:

- **The US flash manufacturing PMI advanced** to a 9-month high of 52.9 in Jul (vs 51.3 in Jun), thanks to an expansion in new business volume and an upturn in hiring: the manufacturing payroll numbers are the strongest in a year.
- **The US Conference Board index of leading indicators rose**

3% in Jun with wide-based improvements in initial unemployment claims, financial items and building permits.

- **US housing starts jumped** 8% mom to a seasonally adjusted annualized rate of 1.189 mn in Jun, after falling -1.7% in May. Figures were a top for the past 4 months and smashed expectations of a 0.5% gain.
- The **NAHB housing market index dipped** marginally to 59 in Jul (vs 60 in Jun), with all three components – current and future sales expectations, and buyer traffic – registering mild declines.
- **Chicago Fed National activity index recovered** to 0.16 in Jun from -0.56 in May. The index's three-month moving average rose to -0.12 in Jun from -0.39 in May; though slightly below the historical trend, the average was the highest reading since Feb this year.
- **Existing US home sales climbed** in Jun, rising 1.1% mom to 5.57 million (s.a.) – the highest level since Feb 2007. Strong job growth, improving wages and near-record low mortgage rates are helping: the share of first-time buyers hit 33% in Jun, its highest level since Jul 2012.
- **Jobless claims fell** by 1,000 to a 3-month low of 253k. continuing claims fell by 25k to 2.13mn.
- **Net capital inflows to the US** were USD 41.1bn in May as private investors turned their April net outflow into a net inflow. However, foreign official investors remained net sellers of US Treasury notes and bonds as in 19 of the past 20 months.

Europe:

- **The flash composite PMI** for the Eurozone in Jul **deteriorated** to an 18 month low of 52.9 vs 53.1 in Jun. Both the manufacturing and services sector components slowed moderately. Business expectations in the service sector fell to a 19 month low.
- **The German ZEW indicator of economic sentiment collapsed**

by 26 points in Jul to -6.8 from 19.2 in Jun. The ZEW expectations measure for **the euro zone** fared even worse from 20.2 to -14.7, as a result of the uncertainty spurred by the vote on Brexit.

- **Credit conditions in the Eurozone** remained **favourable** in Q2, with the net percentage of banks reporting tighter credit for corporations at -7%, following -6% in Q1.
- **The Eurozone's current account surplus** almost doubled to EUR 15.4 bn in May, not seasonally adjusted, from EUR 8.4 billion in May 2015. Energy prices represent the main factor behind export and import trends.
- **The composite flash UK PMI** in July **collapsed** deep into recession territory to 47.7 (from 52.4 in Jun), the lowest reading since Apr 2009. The **manufacturing** PMI declined to 49.1 from 52.1 previously the weakest reading for 41 months. The **services** index dived to 47.4 from 52.3 the lowest reading for 88 months. These data are the harbinger of the impending post-Brexit recession.
- **UK headline inflation** remained at 0.5% yoy in Jun, as in May. The depreciation of the pound will add to upward pressure in the coming months.
- **UK unemployment rate** for the three months to May fell to 4.9%, its lowest since mid-2005.
- **UK retail sales** rose 3% yoy in June, vs 5.7% in May, a rate that confirm the solid performance of the overall economy.
- **Italy's new industrial orders** dropped -2.8% mom in May after a 0.9% increase in Apr. **Industrial production** dropped -0.6% mom in May, as production of nondurable goods, capital goods and energy deteriorated sharply.

Asia and Pacific:

- **Japan all industry activity index** fell 1% mom in May (Apr: +0.8%), for the first time in 3 months. **Industrial production** slid 2.6% while growth in construction

activity slowed to 1.5%.

- **Japan's flash Nikkei manufacturing PMI**, at 0 in Jul (Jun: 48.1), **declined** for the fifth consecutive month. Both production and new orders declined, albeit at weaker rates than in Jun.
- **Bank Indonesia** left **interest rates unchanged** at 6.5% following four rate cuts this year, given slowing inflation; the governor stated further that "the room (for easing) is still there".
- **Singapore non-oil domestic exports tumbled** by -12.9% mom and 2.3% yoy in Jun (May: +11.6% yoy), with shipments to China and Europe extending their slide. The surprise jump in overseas shipments in May was fueled by gold and pharmaceuticals sales.
- **Inflation in Malaysia increased** at the slowest pace in 15 months, rising 1.6% yoy in Jun (May: 2.0%), thanks to the sharp dip in the transport sub-index which fell -8.5% yoy.

Bottom line: In the US, data continue to underline that the expansion is strengthening, while in Asia and Europe the situation remains precarious. Retail sales were surprisingly strong, the PMI shows that the worse is over for manufacturing, average wages are on the rise and even the housing market is rebounding. Conversely, Europe is facing a twofold source of profound uncertainty: Brexit and recurrent security crises ranging from the failed coup in Turkey to random attacks on civilians. Furthermore, the refugee and migrant wave is poisoning politics in favor of xenophobic and populist parties. Asia is in the doldrums awaiting developments in China. The IMF revised its forecasts, on the basis of the better-than-expected economic activity so far in 2016 and the impact of Brexit: global growth for 2016 and 2017 was revised down by 0.1% compared to the Apr 2016 forecasts, to 3.1% and 3.4%, respectively.

Regional Developments

- The **IMF** in its July update, **raised the 2016 growth forecast** for the Middle East and North Africa (**MENA**) region to 3.4%, from the previous 3.1% estimate, citing fiscal consolidation and modest recovery in oil prices. However the 2017 forecast was trimmed to 3.3% on “geopolitical tensions, domestic armed strife, and terrorism”.
- The government of **Bahrain approved full foreign ownership** in **multiple sectors**, including residency, real estate, entertainment and leisure, food and administrative services, health and social work, information and communications, and manufacturing among others.
- **GDP in Bahrain grew** by 4.5% yoy in Q1 this year – its highest level since 2014 – led by the 12.1% yoy growth in the oil sector. The non-oil sector growth was supported by a pickup in the construction sector (5.4% yoy) while the financial sector grew by 3.1%.
- **Trade deficit in Egypt narrowed** by 26% yoy to EGP 23.9bn in Apr. Official statistics reveal that the volume of foreign trade decreased to EGP 57.1bn in Apr versus EGP 61.3bn a year ago.
- **Oil exports from southern Iraq** in the first 21 days of this month averaged 3.28 million barrels per day (bpd), compared to the 3.18mn bpd in Jun.
- **Iraq overtook Saudi Arabia as India's top oil supplier in Q2**, helped by sales of discounted heavy crude. Iraq accounted for about a fifth of Indian imports in the second quarter, up from 16% a year ago.
- US expects to raise more than USD 2bn at the **donor conference for Iraq**: the funds are expected to provide support to the country's humanitarian crisis, where more than 3.3 million people have been displaced by conflict.
- The **World Bank** offered up to USD 1.4bn of **financing** to **Jordan** for the coming six years, after the 2017-2022 **country partnership framework** was endorsed. The first batch of loans includes a USD 300mn package at an

interest rate under 1% and will likely be finalised in Oct.

- **Jordan** has approved **foreign funding** for **nine projects** at a total cost of USD 15.9mn as part of the Jordan Response Plan to the Syrian crisis. In total, some 142 projects worth USD 257mn have been proposed this year.
- **Inflation in Jordan** was **down** by 1.4% in H1 this year, thanks to drop in prices of transportation (-7.0%), meat and poultry (-8%) and fuel and lighting (-7.8%).
- **Oman's peak average annual power demand** for the next seven years in the main interconnected areas is projected to grow 8% from 5,565 MW in 2015 to 9,529 MW in 2022.
- Financing provided by **Islamic banking entities in Oman** surged 61% yoy to OMR 2.1bn at end May. Total deposits held with Islamic banks and windows rose 80% yoy to OMR 1.8bn in May. Assets totaled OMR 2.6bn (up 64% yoy) reaching 8.2% of the total banking system.
- **Qatar's mobile subscriber base** is forecast to **rise** to 5.42mn by 2020, from an estimated 4.86mn by end of this year, according to BMI Research.
- The share of **Qatar's non-hydrocarbon sector** grew to a sizeable 63.8% in 2015, up from 48.9% in 2014, reported a QNB research note. Non-oil GDP grew by 7.8% last year, with the building and construction sector contributing an estimated 2.2 percentage points to non-oil GDP growth.
- **Moody's** maintained a **stable outlook for Qatar's banking system** in spite of funding pressures. Underlying capital buffers and profitability are expected to be solid this year. Though NPLs are forecast to rise to 2% of total loans by Dec this year, it is still likely to remain the lowest in the GCC.
- **Saudi Arabia** regained its position (from Russia) as **China's top crude supplier** in June. China imported 1.112mn barrels per day (bpd) of crude from Saudi Arabia in June – down 14.2% on the year but beating 961k bpd in

May. Meanwhile, China imported around 999,420 bpd of crude in Jun from Russia, down from a record 1.24mn bpd in May.

- **Saudi Aramco's SAR 50bn Fadhili gas project** is expected to raise natural gas production to 17 billion standard cubic feet per day by 2020, in line with the country's National Transformation Plan.
- **Saudi Arabia** is home to 680,200 **unemployed** men and women, according to the General Authority for Statistics. The number of the jobless represents about 5.6% of the total 12.2 million people in the working age group.
- **Saudi Arabia's broad money supply shrank** 5% in Apr; deposits with SAMA dipped by 8.4% yoy – the largest since Nov 2009 – as both bank deposits and public financial institutions deposits fell by 6.2% and 48.9% respectively. Government bonds issuances surged by an annualized 163.1% to SAR 140bn by the end of Apr, highlighted a report by National Commercial Bank.
- **Total cross-border M&A transactions in the GCC surged in 2015:** net sale transactions grew more than three-fold to USD 2.2bn, from USD 676mn in 2014, according to KAMCO Research. Qatar recorded the highest value in cross border purchase transactions at USD 8.8bn, followed by UAE at USD 5.2bn last year.
- **Investment banks** received USD 416.8mn in **fees for Middle Eastern transactions** during H1 this year, up 8% yoy, disclosed the Thomson Reuters/Freeman Consulting report. Fees from completed M&A transactions totaled USD 104mn – the slowest half since 2012 – while syndicated lending fees accounted for its highest share of the fee pool since 2003, at just over 55%, and debt capital fees were up 48% to USD 63.7mn.
- Saudi Arabia has the **most hotel rooms under construction** in the Middle East and Africa, with 35,770 hotel rooms being built in 81 hotels, according to STR's June Pipeline Report. The UAE has 26,989 rooms under

construction in 93 hotels.

- A trial exchange of power capacity along the **interconnected system linking Oman** with the wider **GCC electricity grid** is planned this year; this could eventually lead to commercial power trading within the bloc. The existing interconnection linking Oman's network with that of Abu Dhabi at Mahadha can potentially handle up to 800MW in electricity transfers (capacity equivalent to a mid-sized power plant) during emergencies.

UAE Focus

- **Non-oil growth** in the **UAE** is projected to **slow** to 2.4% in 2016 (2015: 3.7%), according to the IMF, due to fiscal consolidation, the stronger dollar, and tighter monetary and financial conditions. Over the medium-term, a pick-up to above 4% is expected. The IMF urged more reforms: "priority should be given to upgrading the quality of education, promoting innovation and entrepreneurship, and facilitating SMEs' and start-ups' access to finance, notably through an approval of the bankruptcy law and further broadening the credit bureau's coverage".
(<http://www.imf.org/en/News/Articles/2016/07/20/23/23/PR16349-United-Arab-Emirates-IMF-Executive-Board-Concludes-2016-Article-IV-Consultation>)
- **Abu Dhabi inflation** increased to 2.7% yoy in H1 this year, mainly due to a 7.1% rise in the housing, water, electricity, gas and other fuels component.
- **Inflation in Dubai** was 0.76% mom and 2.23% yoy in Jun; inflation grew 1.75% yoy in H1, thanks to rise in prices of education (5.79%), housing, water, electricity, gas, and other fuels group (3.91%) and food and beverages group (2.04%).
- The **investment strategy** of Abu Dhabi Investment Authority (**ADIA**) "will remain focused on identifying

long-term trends and patiently growing capital”, according to its MD. The 20-year (and 30-year) annualised rate of return on ADIA’s portfolio fell to 6.5% (7.5%) in 2015 from 7.4% (8.4%) the year before, as disclosed in its annual review. ADIA also cut the role of external fund managers and reduced the proportion of its assets invested in passively managed or index-replicating strategies. (More details: http://www.adia.ae/En/pr/ADIA_Review_2015_Web.pdf)

- **Real estate related transactions in Dubai fell 4% yoy** to AED 113bn in H1 this year; of the 28,251 deals (+22.8%) struck, sales accounted for 43% share and AED 48.71bn in value.
- **Dubai’s Department of Economic Development issued 6391 new licenses** in Q2 (+5.6% yoy), renewed 45,295 licenses (+53% yoy). Commercial licenses accounted for the largest share of the renewed licenses (67.8%).
- **UAE’s Khalifa Fund for Enterprise Development plans to pump USD 200mn into Egypt** (via Egyptian Social Fund for Development) in the coming five years, revealed its chairman.
- **MAF Global Securities listed a third conventional bond on Nasdaq Dubai**, valued at USD 300mn. It had previously listed bonds of USD 500mn each in Jul 2013 and May 2014.
- **Dubai launched the Dubai Future Accelerators initiative** to enable rapid deployment of “transformative technologies”. Companies will be brought in to address seven key “21st century opportunities” including the application of cutting edge technologies like AI and robotics, genomics, 3D printing, biomimicry and biotechnology.

Media Review

IMF issues World Economic Outlook July update

<http://www.imf.org/external/pubs/ft/weo/2016/update/02/index.htm>

The top physics lab in the world reviews IRR and other Private

Equity metrics

<https://www.investorintelligencenetwork.com/research/trends-and-analysis/if-not-irr-then-what-cern-pension-fund-grapples-private-equity-metric-0>

The populist roulette after Brexit

<https://www.northerntrust.com/insights-research/detail?c=c64afc67fdf296b3819d1f44831f4a34>

Lebanon central bank pledges stability amid political paralysis

<http://www.reuters.com/article/us-lebanon-economy-cenbank-idUSKCN1000DL?il=0>

Saudi Aramco not worried about others gaining market share in Asia: CEO

<http://www.reuters.com/article/us-saudi-aramco-refineries-idUSKCN1000Q1>

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