

Weekly Economic Commentary – Dec 18, 2016

Markets

The catalyst in global markets was the Fed's FOMC meeting, which delivered the 25bp rate hike announced for weeks. However, the US stock markets did not take well the US Fed decision to signal a more hawkish stance throughout 2017. As a result, European and Japanese bourses outperformed Wall Street, thanks also to their currencies' depreciation and positive data releases, which induced risk taking. Emerging markets, however, lost ground, while regional markets were mixed with the UAE and KSA losing ground. In currency markets the dollar trounced all other rivals as the divergence in monetary policy is set to widen. Oil price maintained the levels reached after the agreement on production cuts, while gold prices continued their slide.

Global Developments

US/Americas:

- **The US Fed** for the second time in 10 years raised the policy rate by 25bp to between 0.50% and 0.75%, as widely expected, but indicated that over 2017 there could be 3 additional hikes. The FOMC stressed that unemployment is at a pre-recession low and inflation expectations are “considerably” higher. On the other side it indicated that the “near-term risks to the economic outlook appear roughly balanced”.
- **US Inflation** was 1.7% yoy (0.2% mom) in Nov, vs 1.6% yoy (0.4% mom) in Oct, quite close to the 2.0% Fed's target. The energy CPI rose 1.2% mom, its third consecutive monthly gain.
- **The US Markit flash manufacturing PMI** in Dec rose at its

fastest pace since Mar 2015 reaching 54.2 from 54.1 in Nov and the low in May (50.7).

- **The US government** posted a USD 137bn budget deficit in Nov, a 112% increase from the USD 65bn gap in Nov 2015, as outlays rose 25% to USD 337bn while receipts fell 2% to USD 200bn.
- **US retail sales** edged up 0.1% mom in Nov vs 0.6 % rise in Oct, due to lower sales of motor vehicles. Core sales increased 0.2% vs 0.5% in Oct.
- **US business inventories** fell unexpectedly by -0.2% mom in Nov from +0.1% in Oct.
- **US industrial production** fell -0.4% mom in Nov, following a 0.1% gain in Oct.
- **US claims for unemployment benefits** decreased by 4,000 to 254,000. The 4-week moving average increased from 252,500 to 257,750. Continuing claims increased 11,000 to 2.02mn.
- **US housing starts** fell -18.7% mom to a seasonally adjusted annualized rate of 1.09mn in Nov, way below market expectations of 1.23mn and down from 1.32mn in Oct.
- **The US current account deficit** in Q3 declined to USD 113bn from USD 108bn in Q2, the smallest gap in more than a year, equivalent to 2.4% of GDP.

Europe:

- **Inflation in the Euro area** touched 0.6% yoy in Nov following a 0.5% growth in Oct. **German inflation** was 0.7% yoy (0% mom) in Nov, down from the two-year high of 0.8% in Oct. **Italy's inflation** was 0.1% yoy in Nov, after falling -0.2% in Oct. In France, inflation was 0.7% yoy in Nov, vs 0.5% in Oct. Inflation was pushed up mainly by commodity prices.
- The **preliminary composite PMI for the Euro area** in Dec was constant at 53.9, with a jump in the manufacturing component to its highest level since Apr 2011 (+1.2 to

54.9) balancing the deterioration in the services component (-0.7 to 53.1).

- The **Euro area trade surplus** decreased to EUR 20bn in Oct compared to EUR 23.2bn a year earlier.
- The **Euro area industrial production** increased 0.6 % yoy (-0.1% mom) in Oct, following 1.2% yoy in Sep. **Italy's industrial production remained unchanged mom** in Oct from September, when it dropped by -0.8% mom. **Germany's industrial production** rose 0.3% mom in Oct, after a 1.6% drop in Sep.
- The **ZEW expectations index for the Eurozone** advanced to 18.1 in Dec from 15.8 in Nov.
- The **ZEW investor confidence index** for Germany remained unchanged at 13.8 in Dec.
- The **UK CPI** increased 1.2% yoy in Nov vs 0.9% in Oct with upward pressure from all components except food & beverages. Core inflation rose to 1.4% yoy in Nov (Oct: 1.2%).
- **UK jobless rate** declined to 4.8 % in the three months to Oct from 4.9% in May-Jul and 5.2% a year earlier.

Asia and Pacific:

- **China's M2 money supply** grew 11.4% yoy in Nov vs 11.6% in Oct. Bank lending continues its expansion as households borrow to purchase real estate.
- **China's industrial output** grew 6.2% yoy in Nov, almost unchanged from Oct's 6.1%. Manufacturing is recovering led by some heavy industries, but, an acceleration is unlikely, as overcapacity remains a problem.
- **China's fixed asset investment growth** remained steady at 8.3% yoy in Nov, the same rate as in Oct. Investments are picking up from the low touched in the summer and data point at an economy somewhat stronger in Q4 2016.
- **China's retail sales** rose by 10.8% yoy in Nov vs Oct's 10.1%. As disposable incomes increase, thanks also to tax incentives, the gradual transition to a consumption-

oriented economy continues.

- **Foreign direct investment (FDI) into China** rose to USD 9.9bn in Nov, up from USD 8.8bn in Oct, with the majority going to the service sector.
- The **Japanese Tankan survey** shows that the sentiment index among large manufacturers rose to 10 in Dec, up from 6 in Sep.
- **Indian industrial production** declined 1.9% yoy in Oct, due to a slump in manufacturing. Export-oriented industries have been hit by sluggish global demand, while domestic industries still face serious supply bottlenecks.
- **Indian inflation** plunged to 3.6% yoy in Nov from 4.2% in Oct due to lower food prices. Demonetization will likely keep a lid on growth in coming months and hence inflation will remain subdued. **Wholesale** prices, meanwhile, rose 3.15% yoy in Nov, following a 3.4% gain in Oct.
- **Indonesia trade surplus** was USD 0.84bn in Nov, reversing USD 0.4bn deficit a year ago.
- **Singapore's non-oil exports** plunged -12% yoy in Oct, much worse than Sep's -5% decline. All sectors were hit especially electronics, pharmaceuticals, and civil engineering equipment.

Bottom line: Global reflation is underway in the wake of higher oil prices, so the ultra dovish monetary policy appears dangerously behind the curve. The Fed's estimate of the long-term equilibrium fed funds rate was raised from 2.875% to 3%. Looking forward, the fiscal policy of the incoming US Administration will dominate the analysis and will set the pace of the global economy. Stock markets have reacted enthusiastically to the prospect of a fiscal stimulus, while bonds have plunged. However, recent economic experience on aggressive budget expansion, (e.g. China, Japan, Brazil, and France) should at least induce a modicum of prudence.

Regional Developments

- **Egypt's** central bank revealed that the **high-interest deposit certificates** issued by banks since currency floatation have attracted EGP 64bn (USD 3.47bn) in new investment inflows.
- The African Development Bank (**AfDB**)'s board approved USD 500mn **loan payment to Egypt**, the second of three expected disbursements, according to the minister of International Cooperation.
- The United Bank of **Egypt** reported that its **portfolio of bad loans** had increased to EGP 3.5bn (USD 191.2mn) from EGP 3bn prior to the currency floatation, as part of the bank's debts are in foreign currency.
- **Egypt's top three export destinations** are set to remain Saudi Arabia (9% of total exports), Turkey (8%) and the UAE (8%) **by 2030**, while India (7%) will grow to fourth position, according to HSBC's Global Trade Forecast report. The fastest growing destinations for Egypt's exports in 2021-30 are expected to be China (+12% a year), India and Bangladesh (both +11%).
- **Iraq is selling more crude oil** to its biggest customer, China's Unipecc, prior to the kicking in of production cuts agreed with OPEC. Iraq is OPEC's second-biggest producer behind Saudi Arabia and now ranks third among crude suppliers to China – after Russia and Saudi Arabia. Crude imports from Iraq to India rose 24% yoy in Jan-Oct to 784,000 barrels per day, making Iraq the second-largest crude supplier into the country after Saudi Arabia.
- **Jordan** has allocated JOD 180mn (USD 253mn) from the state budget towards **wheat and fodder subsidies** for 2017.
- **Jordan** signed a USD 250mn **soft loan with the World Bank**, towards improving the financial viability of the electricity and water sectors and increasing efficiency gains in the energy and water management.

- **Jordan** has invited expressions of interest in building **six wind and solar energy power plants** with a total capacity of 300 megawatts. This would bring the total capacity of renewable energy projects to 1,600MW by 2020.
- Total **aid commitments from Germany to Jordan** have reached EUR 471.7mn this year, of which around EUR 153mn are humanitarian aid related to Syrian refugees and the rest are bilateral development support or projects related to the Jordan Response Plan to the Syrian refugees' crisis (JRP) 2016-2018.
- **Kuwait's Emir** addressed the new Parliament, stating that the austerity measures have "become inevitable", as the country seeks to plug a KWD 9.5bn (USD31bn) budget deficit in the current fiscal year. The re-appointed PM said that he intended to push ahead with reforms, which would be presented to the assembly "soon".
- **Kuwait Capital Market Authority** is considering requests from local companies to issue USD 2bn worth of **conventional bonds and Sukuk**, according to the chairman. He also disclosed that the CMA was working on creating regulations for a **secondary market** to trade bonds and Sukuk.
- **Oman's 2017 state budget** targets a deficit of approximately OMR 3bn based on an average oil price assumption of US\$45 per barrel.
- **Oman's consumer price inflation** stood at 1.85% in Nov, following a 10.2% price hike in the transport basket.
- **Bilateral trade between Oman and India** is expected to remain stable at USD 3.8bn over the 2016-17 financial year (which runs from Apr 2016), unless commodity prices rebound.
- **Oman ranked second in the Arab world in the 2016 Sustainable Development Index** issued by the Seoul Ability Foundation. Globally, Oman was placed 70th among 135 nations.
- **Value Added Tax (VAT)** could generate in excess of USD

1bn per annum in **Oman**, according to a high-level Adviser at the Ministry of Finance.

- **Qatar's 2017 budget** expects to post a deficit of QAR 283bn (revenues: QAR 170.1bn; expenditure: QAR 198.4bn). The budget is based on an oil price assumption of USD 45 per barrel and earmarks QAR 93.2bn for major projects.
- **Qatar's Ministry of Economy and Commerce** will grant **licenses to households for small business activities at home**. The annual licensing fee has been fixed at QAR 1,020 and covers activities like sewing, services such as filming weddings and events, designing cards, preparation of perfumes, and food preparation among others.
- In a bid to improve the business environment in **Qatar**, the government has opened the **single window project** for investor services, which aims to remove possible bureaucratic obstacles facing investment and unify ministerial procedures for the citizens and investors.
- **Qatar-US bilateral relations** remain strong: Qatar's imports from the US grew by 87% yoy to USD 3.3bn in H1 2016. The head of Qatar Investment Authority (QIA) told US officials that it will invest USD 10bn in infrastructure projects within the US – it remains unclear whether this is part of its commitment to invest over USD 35bn in US over the next 5 years.
- **Saudi Arabia** plans to **boost the capital of the Saudi Industrial Development Fund** by SAR 6bn (USD 1.6bn), in addition to the recent injection of SAR 3bn, to help finance entry into new industries, according to the Energy Minister. New industries include renewable energy, conversion industries, automotive, pharmaceutical and military among others.
- **Saudi Arabia's Monetary Authority (SAMA)** foreign exchange reserves are estimated to reach nearly SAR 1.961 trillion (USD 523bn) by the end of this year, according to estimates by Jadwa Investment.
- **Saudi Arabia's Ministry of Education** has announced a

public-private partnership plan to promote investment in and development of buildings and infrastructure in the **education sector**, as part of a wider initiative to support the Vision 2030 strategy.

- The **GCC** is expected to raise **revenues** in excess of USD 25bn per annum from the proposed **VAT rate of 5%**, according to EY estimates.
- **GCC** is investing around **USD 100bn in airport expansion projects** as the number of passengers is expected to double by 2035. UAE will lead the Middle East growth in number of air travelers with over 6.3% annual growth, as per International Air Transport Association forecasts.
- **GCC construction downturn to continue into 2017:** according to MEED Insight, contracts worth USD 112bn (worst-case scenario) to 152bn (based on the current pipeline) could be awarded in the GCC next year. This year, new contracts issued in the GCC could close at USD 120bn, down nearly a third on 2015 and “well below what was initially forecast”.

UAE Focus

- **UAE** was one of the 10 non-EU countries **authorised to offer clearing and trading of securities to EU firms**; once a country is deemed equivalent, its financial firms who want to operate in the EU must also seek approval.
- The **Dubai Economy Tracker** index increased to 55.2 in Nov from a 7-month low of 53.2 in Oct, thanks to faster growth in the travel and tourism sector, which recorded a series high reading of 57.5.
- Dubai is working with HSBC on the **financing of Expo 2020**; the financing is expected to come from bank loans and from various export credit agencies while HSBC has been appointed to coordinate the export credit agencies and financing supported by them.
- CBD Now, the **UAE's first digital-only bank**, plans to start operations in early 2017; the bank is expected to

offer customers a smart, seamless and personalised mobile bank, allowing them to perform all financial services via their smartphone.

- **UAE's** growth has benefitted from investment in services such as tourism and financial services, resulting in an increase in the **contribution of services to total exports** from 16% in 2000 to 23% in 2015, according to HSBC's Trade Forecast report. HSBC forecasts the share of travel and tourism in services exports to increase to 62% by 2030. It also revealed that India would become UAE's largest import and export trade partner, both in terms of goods and services, by 2030.
- The Abu Dhabi National Oil Company (**ADNOC**) disclosed that it would **cut crude supplies** by 3-5% across its three export grades to meet commitments, to comply with the **OPEC production cut deal**. This move is most likely to affect Asian customers.
- The **UAE** will start **sharing financial data** under Common Reporting Standards (**CRS**) in 2018, implying that banks and financial institutions will start collecting required financial data from early 2017.
- **Dubai Future Accelerators Program** has launched with 19 pilot projects worth a combined value of AED 120mn, and is spread across seven strategic sectors including energy, transportation, and infrastructure.
- **Abu Dhabi** has reinstated a **5% rental cap**: the rental cap outlined in Law No 20 of 2006, which was abolished in 2013, is now applicable again.
- Dubai Electricity and Water Authority (**DEWA**) got finance for the construction of a 2,400 megawatt **coal-fired power plant** in the emirate, estimated to cost USD 3.4bn.
- **Abu Dhabi's cruise tourism sector** is expected to grow at a rate of 10.5% annually, attracting 450k cruise passengers by 2020, and over 808k passengers in 2025, as per Oxford Economics estimates. Around 250k cruise passengers are expected this season (till Jun 2017).

Media Review

How Global Oil Flows Might Look After OPEC's Supply Shock

<https://www.bloomberg.com/news/articles/2016-12-16/what-global-oil-flows-might-look-like-after-opec-s-supply-shock>

The Age of Hyper-Uncertainty

<https://www.project-syndicate.org/commentary/age-of-hyper-uncertainty-by-barry-eichengreen-2016-12>

Saudis to claim partial victory in taming huge deficit with 2017 budget

<http://in.reuters.com/article/saudi-budget-idINKBN1421DJ>

Saudi Arabia's roadmap for the future

<http://saudigazette.com.sa/saudi-arabia/roadmap-for-future/>

<https://www.bloomberg.com/news/articles/2016-12-11/saudi-arabia-economic-reform-is-a-harder-sell-in-heartland>

Profits under pressure: GCC banks to face challenging business environment in 2017

<http://gulfnews.com/business/sectors/banking/gulf-banks-will-continue-to-face-challenging-business-environment-in-2017-1.1943374>

Trump's Chinese Scapegoat

<https://www.project-syndicate.org/commentary/trump-trade-war-with-china-by-eswar-prasad-2016-12>

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