

Weekly Economic Commentary – Feb 19, 2017

Markets

US stock markets again beat a series of records after inflation data showed that reflation is in full swing. Global markets were pulled by the momentum on Wall Street, with the FTSE All-World index, where US stocks account for just over 50%, beating its previous all-time high from May 2015. Furthermore, it was noteworthy that investors were not discouraged by the prospect of tighter monetary policy, and focused on the positive assessment of the economy that Yellen illustrated in her semi-annual Congressional testimony. Regional markets, like most emerging and frontier markets, displayed an overall positive tone. Bond markets seem unfazed by higher inflation: after surpassing a 2-year high in Dec, the yields on 10-year US Treasury have oscillated in a 25bp range so far in 2017. In Europe however French bonds sold off as the left and far-left ventilate an electoral cartel. In currency markets the pound took another hit after dismal retail sales data, while on major crosses the yen made some moderate gains in the wake of mildly positive GDP data. Oil prices stalled, as the inventory data cast doubts on the effects of the OPEC production cuts. Gold continued to attract those investors worried that Trump fiscal expansion could reignite inflationary pressures.

Global Developments

US/Americas:

- **The US Fed** kept its target range at 0.5 – 0.75%. The central bank noted the improvement in business and consumer sentiment and the pickup in inflation, but stressed that near-term risks to the economic outlook

are roughly balanced.

- **US inflation** surged 0.6% mom (2.5% yoy) in Jan, double Dec's 0.3%, the largest monthly gain since 2013 again in the wake of energy prices (+4% mom). Core CPI increased 0.3% mom (2.3% yoy).
- **S retail sales** grew 0.4%, mom in Jan vs 1% in Dec pulled up by fuel sales but hit by dismal vehicle sales. Core sales, excluding those two components rose 0.7% mom vs 0.1% in Dec.
- **US industrial production** declined -0.3% mom in Jan due to a weak utilities performance (-5.7% mom). Capacity utilization in manufacturing crawled up 0.1%.
- **US business inventories** grew 0.4% in Dec after a 0.8% gain in Nov with wholesale stockpiles up 1% mom. The inventory-to-sales ratio is down to 1.35 from 1.38.
- **Initial unemployment claims in the US** rose 5,000 to 239,000. The 4-week moving average was almost steady at 245,250. Continuing claims fell by 3,000 to 2.076 mn confirming the healthy state of the labor market.
- **US housing starts** dropped -2.6% mom (+10.5% yoy) in Jan probably due to bad weather in the West. Completions also fell in Jan.
- **The Conference Board index of US leading indicators** rose 0.6% mom in Jan, the fastest pace since Jun 2015.

Europe:

- **The Eurozone's GDP** rose 0.4% qoq in Q4, the same pace as in Q3.
- **German GDP** advanced 0.4% qoq (1.8% yoy) in Q4, doubling the score of Q3 (1.7% yoy). Growth was lifted mainly by private and government consumption, while fixed investment improved moderately and net exports fell in qoq terms. For the whole of 2016, GDP was 1.8% vs 1.5% in 2015.
- **Italy's GDP** in Q4 gained 0.2% qoq down from 0.3% in Q3 with net exports driving the performance.

- **Germany's inflation** crawled up to 1.7% yoy in Jan from 1.6% in Dec, a top since July 2013.
- **The Eurozone's inflation** rose sharply to 1.8% yoy in Jan from 1.1% in Dec due to commodity prices, more solid activity and the devaluation of the euro.
- **The Eurozone's industrial production** slid by -1.6% mom (+2% yoy) in Dec reversing the 1.5% jump in Nov (+3.2% yoy). Production of capital goods, which dropped -3.3% mom drove the fall, the sharpest rate of contraction since Aug 2014. Most other sectors also recorded negative performances.
- **The Eurozone's current account surplus** narrowed to EUR 31bn in Dec down from EUR 36.4bn in Nov, but up from EUR 24.9bn in Dec 2015. In 2016 the current account surplus added EUR 45.5bn to reach EUR 364.7bn.
- **The Eurozone's external trade surplus** expanded in Dec to EUR 28.1bn from EUR 24.4bn in Dec 2015 reflecting the depreciation of the euro in early November. In 2016 the surplus advanced to EUR 273.9bn from EUR 238.7bn in 2015.
- **The UK inflation set a record** since Jun 2014 at 1.8% yoy in Jan from 1.6% in Dec, due to a jump in fuels prices (16.8% y/y), and food prices (0.5% yoy). Core inflation was unchanged at 1.6% yoy.
- **UK Retail sales** dropped for the third month in a row in Jan, declining -0.3% mom well below market expectations for a 1% gain. In yoy terms, the headline slowed to 1.5% from 4.1% in Dec.
- **The ZEW Investor confidence index for Germany** declined to 10.4 in Feb from 16.6 in Jan.
- **The ZEW expectations index for the euro zone** in Dec retreated to 17.1 from 23.2 in Jan.

Asia and Pacific:

- **Japan's GDP expanded** 1% qoq ann in Q4 down from 1.4% in Q3. It was the fourth consecutive quarterly gain thanks

to external demand and investments, while private consumption stalled.

- **Industrial production growth in Japan** slowed to 3.2% yoy in Dec from 4.6% in Nov.
- **China's M2 money supply** growth was 11.3% yoy in Jan, the same as in Dec driven by bank lending to the housing market,
- **China's CPI inflation** reached 2.5% yoy in Jan from 2.1% in Dec as a result of higher transport costs but pressures are building across the board. In fact producer price inflation jumped 6.9% yoy in Jan vs 5.5% in Dec.
- **China's foreign direct investment** rose 5.7% yoy to USD 12.9 bn in Dec, offsetting a -4.6% yoy fall in Nov, thanks to investment in services, primarily high-tech. Average growth in 2016 was a mere 4.1%, compared to 6.4% gain in 2015.
- **Taiwan's GDP** expanded 2.9% yoy in Q4 vs 2% in Q3 lifted by exports of electronics, while domestic demand remained weak.
- **Malaysia's GDP** rose 4.5% yoy in Q4 from 4.3% in Q3 lifted by private consumption. Exports, on the other hand, was subdued.
- **India's inflation** decelerated was 3.2% yoy in Jan from 3.4% in Dec. Food prices declined again thanks to a good monsoon season and disruptions caused by the demonetization.
- **India's WPI prices** surged to 5.3% yoy in Jan from 3.4% in Dec due to higher fuel prices.
- **India's exports** in Jan recorded a fifth consecutive monthly increase rising 4.3% yoy with the overall monthly trade deficit at USD 9.8 bn.
- **Singapore's non-oil domestic exports** rose 8.6% yoy in Jan vs 9.1% in Dec. In addition to electronics exports good performances were recorded in machinery and petrochemicals.

Bottom line: As more data become available, the evidence of a global pickup in manufacturing, with electronics at the forefront, gathers strength (despite the unexpected drop in European industrial production in Dec). Growth in emerging markets has also picked up sharply at the end of last year, as highlighted by industrial production and trade data especially in economies like Singapore and Taiwan that are extremely sensitive to global conditions. Even hard hit Russia and Brazil seem to have stabilized. The laggard is Japan where the central bank has failed to pull the economy sustainably out of deflation, despite flooding the banking system with cash for two decades and the government has refrained from any substantial structural reform.

Regional Developments

- **Money supply (M2) in Bahrain** grew by 3.2% in Nov (Oct: 3.7%) while credit to the private sector was up 2.5% (Oct: 2.8%). The central bank's foreign assets dipped by 28.1% yoy to BHD 0.879bn in Nov.
- Around 17% of employees in **Bahrain's public sector** are **expatriates**, according to the parliament affairs minister, who also disclosed that the cost of hiring an expat was around BHD 223k per month last year.
- **Fitch** affirmed **Bahrain's** long-term foreign and local currency Issuer Default Ratings (**IDRs**) at "BB+" with a stable outlook, supported by "developed financial sector and the boost to external financing flexibility from strong GCC support".
- Egypt's deputy finance minister stated that **investment in Egyptian treasuries** had increased to around EGP 44bn from around EGP 15bn in Jan. **Total inflows into the Egyptian banking system** reached USD 12.3bn since the pound was floated, reported the state news agency.
- **Egypt's** finance ministry sold USD 1.092bn in **one-year dollar denominated treasury bills** to local and foreign financial institutions at an average yield of 3.62%,

revealed central bank data.

- **Egypt's investments in oil, gas, and mining sectors** rose 3.9% yoy to USD 15bn in Q1 of the financial year 2016/2017, according to an official in the petroleum ministry.
- **Egypt** expects to be self-sufficient in **gas production** within the next two years, disclosed the minister of petroleum and mineral resources.
- **Egypt** is in talks to import 1mn barrels per month of **crude oil from Baghdad**, and is also looking to other countries to help secure supply of almost 1.012mn tonnes of gasoil for delivery in Feb and Mar.
- **British investments in Egypt** are worth around USD 5.5bn, including 350,000 projects, according to the head of the Federation of Egyptian Chambers of Commerce.
- **Exports of crude oil from Iraq** rose to 3.93 mn barrels per day in the first 15 days of Feb, almost 122k bpd more than the average for all Jan.
- **Japan** provided USD 17mn in **aid for displaced people in Iraq**: of this, USD 14.3mn is to be allocated to programmes for Iraqis recently displaced due to the Mosul offensive, with USD 2.6mn for the UNHCR's work for Syrian refugees, mainly in the Kurdistan Region of Iraq.
- **Jordan**, at a meeting for the Arab Social and Economic Council affiliated with the Arab League, proposed the establishment of a **pan-Arab agency for development and relief** to support Arab countries.
- Annual **bank loan growth in Kuwait**, at 2.5% in Dec 2016, was at its slowest since Jan 2012. Money supply growth was up 3.1% in Dec compared to 6.5% the month before and just 1.7% in Dec 2015.
- **Kuwait airport project** is now to be completed in the four years instead of the six announced previously, according to a decision taken at a ministerial meeting, and reported by local Arabic daily *Al Anbaa*.
- **Nominal GDP in Oman** declined by 9% yoy during the Jan-Sep 2016 period, according to the recent Central Bank

bulletin, which also noted that this was a result of a 29.4% dip in the oil sector and a marginal 0.2% drop in the non-oil sector.

- **Oman's budget deficit** stood at OMR 5.0bn in 2016, slightly under the OMR 5.3bn estimated by the government during this year's budget announcement. Total revenue stood at OMR 7.3bn, of which OMR 3.6bn came from net crude oil revenue, while total expenditure touched OMR 12.3bn.
- **Credit to the private sector** in **Oman** increased by 10.1% to OMR 19.7bn by end-2016, of which the household sector and non-financial corporates accounted for 46.5% and 45.2% of the loans respectively.
- The Central Bank of **Oman** dismissed rumours of a **depreciation of the Omani riyal**, stating that "there is no change in its value", and that monetary reserves were sufficient and enough to cover OMR.
- A new **customs duty** of 0.5% imposed on **bank notes** imported by exchange houses and banks in **Oman** was **withdrawn** four days after it was initiated. With the new levy, exchange houses were paying OMR 5,000 for every OMR 1.0mn worth of banknotes for three days.
- **Producer prices** in **Oman** declined by 4.9% yoy in Q4, with oil and gas products leading the drop (-5.3% yoy).
- **Oman** is considering **financing structures** that involve taking early payments for oil (to avoid borrowing more money from banks), in exchange for price discounts on the oil, reported *Reuters*.
- **Iran's gas pipeline to Oman**, which is expected to export one billion cubic foot of Iran's gas to Oman per day, will not cross the UAE, according to Oman's energy minister.
- **Oman** produced 29.93mn barrels of **crude oil** in Jan (-2.97% mom), equivalent to 965,617 barrels per day, according to the ministry of oil and gas.
- **Qatar** approved a draft law on "**selective tax**" which is to be imposed on specific goods "harmful to human health

and the environment, and the luxury goods produced domestically or imported”.

- **Qatar** reported a 11% mom increase in **building permits** issued in Jan 2017, with new building permits (residential and non-residential) accounting for 57% (366 permits) of the total permits.
- **Saudi Arabia's** Capital Market Authority **approved public offerings** for two companies – Roya Real Estate Investment Company and Thob Al-Aseel Company – **on its parallel bourse**, dedicated to small and medium-sized businesses.
- **Saudi Arabia** has approved financial support for the **environment, water and agriculture sectors** worth SAR 92bn (USD 24.5bn), to meet strategic goals in line with the Vision 2030 plan, according to the minister handling these sectors.
- **Saudi Arabia's** Shoura council has formed a committee to study feasible solutions for **Article 77 of the Labour Law**, which states that employers in the private sector can terminate the contract of Saudi employees with compensation.
- **Sovereign investors** participated in 137 direct private equity deals in 2016 (versus just 77 in 2012) and the deal value has more than trebled to USD 45.2bn (2012: USD 14.8bn), according to Reuters data.
- **UAE and Qatar** ranked among the top 15% of countries for **productivity potential**, according to **KPMG** report on the “Variables for sustained growth 2016 index” which compares the productivity potential of 181 countries. *The full report can be accessed at:*
https://home.kpmg.com/uk/en/home/insights/2017/01/kpmg_s-variables-for-sustained-growth-2016-index.html
- **UAE** ranked on top regionally and eighth globally in the latest **Index of Economic Freedom** Qatar was 29th on the list, while Bahrain was 44th, Kuwait 61st, Saudi Arabia 64th and Oman 82nd.

UAE Focus

- **UAE** expects to issue the **federal debt management law** this year, which will allow the federal government to sell sovereign bonds in the future, according to the ministry of finance.
- **Dubai** is **expected to issue a USD bond** by end of Q1, reported Reuters, citing banking sources. The size of the deal is likely to be larger than a benchmark issue (i.e. higher than USD 500mn). Separately, Abu Dhabi, which completed a non-deal roadshow for investors in Asia, are unlikely to issue an international bond this year.
- The **UAE central bank** has issued **draft rules to support the SME sector**: as per the draft rules, all banks are required to maintain a dedicated SME unit, and banks should have set targets and limits for SME lending. In return for supporting SMEs, the proposed regulations would allow banks to lower the amount of risk-weighted assets they hold.
- **UAE central bank foreign assets** fell in Jan to AED 290.75bn from Dec's AED 310.91bn.
- The **UAE** government is not at present considering any increase of **VAT** above 5%, and would not raise it in the future without a thorough study of the economic and social impact, according to a finance ministry official. He also stated that parts of seven sectors – education, healthcare, renewable energy, water, space, transport and technology – might get special treatment on VAT. UAE expects a revenue of around AED 12bn (roughly 0.9% of GDP) from VAT in the first year.
- According the **UAE** Ministry of Finance website, **VAT registration** will open to qualified companies three months before the roll-out, which is slated for January 1, 2018.
- **Foreign investors** bought AED 3.13bn of shares in Abu Dhabi Securities Exchange (**ADX**) in Jan 2017, accounting

for 40.4% of total buy trades.

- With the latest **listing** of Dubai Islamic Bank's USD 1bn **Sukuk** on **Nasdaq Dubai**, Dubai is the world's largest venue for Sukuk by value, at USD 47.81bn.
- **Mubadala Investment Co.**, the USD 125bn state investment firm, is expected to start operating in May and will have four investment platforms – petroleum and petrochemicals, alternative investments and infrastructure, technology, manufacturing and mining, and aerospace, information and communications technology and renewables. (More: <http://www.thenational.ae/business/economy/mubadala-investment-company-names-new-divisions-and-pushes-ahead-on-122bn-merger>)
- **UAE** is studying plans to expand the **Fujairah oil refinery project** up to 400k barrels per day (bpd), from current planned level of 200k bpd, according to the energy minister.

Media Review

Trumpflation might be out of steam

<https://www.bloomberg.com/news/articles/2017-02-09/reflation-in-doubt-as-bastion-of-trump-trade-starts-to-falter>

Oman fiscal management problem

<http://www.agsiw.org/omans-fiscal-management-problem/>

Chances that oil prices might fall should not be discounted

<http://www.artberman.com/oil-prices-are-at-least-7-per-barrel-too-high/>

The top 100 in private equity

<https://www.preqin.com/docs/reports/Preqin-Special-Report-The-Private-Equity-Top-100-February-2017.pdf>

The French elections seen from the US

<https://www.thenation.com/article/lyon-the-capital-of-a-europe-in-crisis/>

Egypt making good progress in IMF programme, Lagarde says

http://www.zawya.com/uae/en/story/INTERVIEWEgypt_making_good_progress_in_IMF_programme_Lagarde_says-ZAWYA20170214041954/

Saudi Arabia debating shape of Aramco ahead of IPO – Reuters

<http://www.reuters.com/article/us-saudiaramco-ipo-restructuring-idUSKBN15W1ZB>

Expect a military splurge in the Middle East: IHS

<https://www.bloomberg.com/news/articles/2017-02-17/saudi-arabia-on-offensive-with-attack-minded-military-splurge>

<http://www.thenational.ae/business/economy/index-2017-mena-defence-spending-to-rise-this-year-as-conflicts-create-demand-for-arms>

Questions over exemptions add to complexity of GCC-wide VAT

<http://www.thenational.ae/business/economy/questions-over-exemptions-add-to-complexity-of-gcc-wide-vat>

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