

Weekly Economic Commentary – Mar 19, 2017

Markets

Last week was an eventful one more for political developments than for the economic data flow. The UK Parliament approved the government request to invoke art 50 to exit the UE; the Scottish Prime Minister invoked a second independence referendum; liberals in The Netherlands defeated the anti-euro populists; President Trump unveiled his budget proposal and held a rather frosty meeting with German Chancellor Merkel; in India Modi obtained a massive victory in the elections in Uttar Pradesh. Markets' attention was concentrated on the Fed FOMC meeting which delivered the widely expected hike. After the announcement US stock and bond prices rose. The yield on the 10-year Treasury notes fell to around 2.509% that on the 30-year Treasury bond to 3.108% and on 2-year note to 1.312%. But soon the Wall Street rally lost steam and failed to pull up developed market bourses. On the contrary in emerging markets the relief for the dovish stance of the Fed boosted the MSCI. Regional markets were mixed but the main ones KSA, UAE and Kuwait benefitted from the euphoria in EM and the resilience of oil prices. In currency markets the USD had a lackluster week especially after the Fed decision and the JPY was the major beneficiary of such weakness. The GBP was buoyant, despite the news on the imminent Brexit negotiation. Oil prices recovered from three-month lows after data showed an unexpected drawdown in U.S. stockpiles. However, short positions in futures markets increased by 80,000 contracts the second largest build up in 34 years. Gold scored its highest finish in a fortnight.

Global Developments

US/Americas:

- **Trump released his outline for the next federal budget**, which hinges on major cuts to federal spending, especially to the Environmental Protection Agency, Department of State, and Department of Labour. Dozens of smaller agencies and programs were cancelled. The Defense and Homeland Security budgets on the contrary were expanded.
- **The US Fed lifted the interest rate** by 25bp as widely expected, and gave strong hints for two additional moves this year. The Fed reiterated that the risks to the outlook seem roughly balanced. The elephant in the room, however, is the USD 4.5trn assets that the US Fed has accumulated as part of successive QE programs and that are distorting asset valuations across the globe. The offloading of such massive portfolio will be the real test of monetary policy normalization.
- **US industrial production** remained flat mom in Feb with manufacturing and mining on the rise, and utilities production down 5.7% mom due to warm weather.
- **The preliminary University of Michigan Consumer sentiment index edged up** to 97.6 in Mar from 96.3 in Feb, recovering part of the 2.2-point drop in Feb. Current economic conditions recorded their highest level since 2000.
- **The Conference Board index of leading indicators** rose 0.6% in Feb as in Jan, with broad-based strength in all sub-indices.
- **US retail sales** increased by a paltry 0.1 % mom in Feb, down from 0.6% in Jan. Electronic sales tumbled (-2.8% mom) with disappointing performances also in appliances, restaurants, and groceries. Core sales, excluding auto and gasoline, were up 0.2% mom after rising 1.1% in Jan.
- **The US inflation rate** increased to 2.8% yoy (0.1% mom) in Feb exceeding the 2.5% rate (0.6% mom) posted in Jan. Core CPI increased 0.2% mom to reach 2.2% yoy.
- **US initial claims for unemployment insurance** fell by 2,000 to 241,000. The 4-week moving average rose from

236,500 to 237,250 still consistent with a strong labor market. Continuing claims fell 30,000 to 2.03 million.

- **US residential housing starts** in Feb increased 3% mom (6.2% yoy), confirming the buoyant state of the construction sector.

Europe:

- **The UK Parliament** passed legislation to start Brexit negotiations as per Article 50 of the Lisbon Treaty by the end March. Scotland's First Minister Sturgeon is determined to call a second Scottish independence referendum to be held by the spring of 2019.
- **Eurozone's industrial production** jumped 0.9% mom (0.6% yoy) in Jan partially reversing Dec's -1.2% (2.5% yoy) stumble. Energy and capital goods were strong, but nondurable consumer goods dropped for the second month in a row. **Italy's** industrial production plunged by -2.3% mom (-0.5% yoy) in Jan, while **Germany's** output rebounded 2.8% mom from the -2.4% drop in Dec.
- **Eurozone's inflation** hit 2% in Feb above the ECB target for the first time since Jan 2013. Core inflation remained below 1% as it has done since 2014. **German inflation advanced** to 2.1% yoy in Feb vs 1.8% in Jan, a top from May 2012; **Italy Inflation rose** to 1.6% yoy in Feb from 1% in Jan.
- **The Eurozone's trade balance** in Feb was in deficit for the first time since Jan 2014 by EUR 600mn, versus a surplus of EUR 4.8bn in Jan 2016, as exports struggled while imports surged.
- **Germany ZEW indicator of investor's sentiment** was slightly up in Mar at 12.8 from 10.4 in Feb. The ZEW measure for the Eurozone in Mar climbed to 25.6 from 17.1 in Feb.

Asia and Pacific:

- **China's fixed investment growth** picked up to 8.9% yoy in

the combined Jan-Feb period from 8.1% yoy in Dec thanks to the impulse from the private sector, which offset weakness in the SOEs.

- **China's industrial production** advanced 6.3% yoy over the combined Jan-Feb period vs 6.0% in Dec. The performance was lifted by manufacturing, especially automotive. Mining and cement on the other side remain affected by overcapacity.
- **Chinese retail trade** growth declined to 9.5% yoy in the combined Jan-Feb period from Dec's 10.9% gain, as a result of lower auto sales impacted by base effects related to last year's energy efficiency subsidies.
- **Japan's central bank did not** take any new measure nor changed the pace of its asset purchases.
- **India's CPI inflation** was 3.7% yoy in Feb likely capped by demonetization. **WPI inflation** reached 6.6% yoy in Feb, from 5.3% in Jan, due to higher fuel costs. Food components were subdued after last season monsoons .
- **Singapore's non-oil exports** shoot up 21.5% yoy in Feb, after increasing 8.6% in Jan pushed by electronics and petrochemicals.

Bottom line: The signals that the global economy is firing on all cylinders were corroborated last week by data from China and Singapore. Looking ahead, the budget for 2018 sets the Trump administration on a collision course with a host of special interests and federal bureaucracies whose resources will be annihilated or curtailed. It is a powerful signal that business will not be as usual in Washington and it could unleash animal spirits held back by the red tape and the anti-business measures enacted by Obama. But the new tone in the US might not be all positive. For example the protectionist agenda surfaced in the communique' of the G20 finance ministers meeting in Germany: the importance of free trade to the global economy was again highlighted, but the vow to "resist all forms of protectionism" made last year was eliminated, probably to appease the US.

Regional Developments

- **Bahrain** and **Saudi Arabia** have signed on **agreements** to carry out projects in the former nation worth SAR 1bn (USD 266mn). The projects cover multiple sectors like housing, roads, electricity and water as well as infrastructure.
- **Egypt** expects to receive the **second tranche** of the **IMF loan** in May or June, according to the Finance minister.
- An official at **Egypt's** petroleum ministry disclosed that **oil products shipments from Aramco** would resume "very shortly". The ministry stated that commercial reasons related to global oil prices and reduced production were behind the suspension of shipments last Oct.
- **Population** in **Egypt's Cairo** is expected to grow by 500k this year – the fastest globally – while the Greater Cairo area is expected to gain another half a million, according to a recent Euromonitor report. This is likely to strain the country's existing infrastructure & resources.
- Business volume in **Egypt's construction, building materials, and investment sectors** touched EGP 160bn recently, according to the minister of housing, who expects to attract more than EGP 1 trillion into these sectors in the next 5 years.
- **Oil exports** from southern **Iraq** averaged 3.25mn barrels per day (bpd) in the first 14 days of Mar, while northern exports have averaged about 430k bpd, according to industry sources, together close to Feb's 3.27mn bpd.
- **Iran** overtook Iraq as **India's second biggest oil supplier** in Feb: imports from Iran were up 16.7% mom to 647k bpd, and almost treble compared to Feb 2016.
- The **Central Bank of Jordan** launched a set of **economic initiatives** last week to support growth and job creation. This included establishing investment companies for banks with a capital of JOD 125mn to invest in medium-sized enterprises, and an allocation of

JOD 100mn to a programme to support the national exports credit, among others.

- **Tourism revenues in Jordan** picked up by 16.2% yoy to USD 652mn in Jan-Feb this year.
- **Kuwait** issued its inaugural dual-tranche USD 8bn **bond offering**: the bonds were significantly oversubscribed with 778 investor orders totaling over USD 29bn, from both regional and international accounts. The five-year bonds were allocated across Asian (4%), European and UK (46%), investors from the Americas (24%) and 26% to MENA investors.
- **Kuwait** will support the **extension of OPEC's deal** beyond Jun, according to the oil minister, who also stated that the "rebalancing process... requires more effort and time".
- **Lebanon's budget impasse** continues: following street protests against proposed taxes to offset the public sector salary bill, the PM assured that there would be no new taxes. He stated that "the taxes or levies imposed [to fund] the salary scale have been known since 2014 and there is nothing new".
- **Oman's consumer inflation** in Feb rose to 2.38% yoy mainly due to a 9.33% price hike in the transport sector and a 2.05% rise in housing, water, electricity, gas and other fuel related items.
- **Qatar**, following the Fed, raised its **overnight lending rate** by 25bps to 5.0%; it also reduced banks' reserve requirement by 25bps to 4.5%. Saudi Arabia, UAE, Kuwait and Bahrain also raised their key policy rates by 25bps.
- The CEO of the **Qatar Financial Centre** disclosed that the centre was on track to licence 1,000 **new firms** and create 10,000 jobs by 2022. He also stated that two **exchange-traded funds** would be listed on the exchange in the next two months.
- **Qatar** Red Crescent completed more than 90 development projects – covering health, water, sanitation, and higher education – for **Palestinians** at a cost of QAR

415mn, according to a report released by them.

- **Saudi Arabia** and **China** inked MoUs and letters of intent worth almost USD 65bn (across investment, energy, space and other areas) during the Saudi King's visit to Beijing.
- In a meeting with **Saudi Arabia's** Deputy Crown Prince, the **US** President pledged support for the development of a new US-Saudi program focused on energy, industry, infrastructure and technology that would provide potentially more than USD 200bn in investments in the next four years.
- **Saudi Arabia** raised **oil output** back above 10 million barrels a day in Feb, reversing about of a third of the cuts it made the previous month, reported *Bloomberg*, citing an OPEC report. The energy ministry meanwhile clarified that the volume of crude supplied to markets fell by 90k barrels a day to 9.9mn, as the extra supplies were moved into storage.
- **Moody's** raised its outlook for **Saudi Arabia's banking system** to "stable" from "negative", on the economy's gradual recovery supported by government spending which is therefore likely to improve banks' liquidity and funding conditions.
- **Saudi Arabia's** "work from home" program is expected to generate about 141k jobs by 2020; the ministry of labour and social development forecasts that the **women in the workforce** will increase to 28% by 2020.
- The volume of **e-commerce** transactions in **Saudi Arabia** was around SAR 2.25bn (\$600 million) in 2016, disclosed the secretary-general of the Consumer Protection Society.
- **Saudi Arabia** has **shelved around 6,000 projects** considered non-beneficial to its diversification efforts, reported the Arabic daily *Al-Riyadh* quoting the Chairman of the Saudi Contractors' Commission.
- Total **assets** of the **Arab banking sector** stood at USD 3.4 trn at the end of 2016, equivalent to 140% of Arab GDP,

according to a report by the World Union of Arab Bankers. Arab bank deposits, at USD 2.2 trn, equals around 89% of the value of the overall economy.

UAE Focus

- **UAE's** President is expected to issue the **VAT law** within the next two to four months, according to a source familiar with the procedures. The **Federal National Council** already approved a draft law regarding the introduction of taxation procedures last week. The UAE finance ministry announced that a series of **workshops** would be organised from this month onwards to educate the business community on the management of the VAT system. Businesses that meet the requirement criteria will be able to start **registering for VAT** in either end of Q3 or beginning of Q4 this year i.e. roughly three months before the new tax is launched.
- The value of **non-oil exports** in the **UAE** grew by 5.6% yoy to AED 128.7bn in Jan-Sep 2016. Total foreign trade was up 2.8% yoy to AED 813.7bn during this period. Trade with other GCC nations represents 9% of total foreign trade (decline by 7.3% to AED 73.4bn).
- **Dubai's non-oil trade** touched AED 1.276trn (USD 347.4bn) in 2016; China, India and the US were the **top bilateral trade partners**, accounting for 13%, 7.4% and 6.7% of total trade respectively. Saudi Arabia maintained its position as the top Arab and GCC trading partner and fourth globally with AED 52bn (4.1%) of total trade. While **free zones** accounted for 32% of Dubai's trade, the biggest items traded overall were mobile phones (AED 167bn, 13%), gold (12%), diamond (7.6%), jewelry (4.9%) and cars (4.7%).
- **Non-oil trade** between **UAE and Germany** was USD 10.9bn in Jan-Sep last year (versus USD 15.5bn in 2015), according to a ministry of economy official. He also added that the UAE had attracted USD 2.8bn in **FDI** from Germany in

2015.

- **Net foreign investment** on the Abu Dhabi Exchange (ADX) reached AED 148mn in Feb, whereas institutional investments reached AED 31.8mn. The real estate sector had the lion share of trades (AED 2.227bn or 44.6%), followed by banking (26.7%) and consumer staples (11.1%) sectors.
- **Dubai** has officially launched a **citywide implementation** of **blockchain**, with IBM and Consensys as partners in the programme.
- A **low-income housing policy** was approved for Dubai last week: the policy will include families' income levels, place of residence, and public benefits and will compare them with requirements at the time and the extent of challenges families are facing.
- **Dubai was Middle East's top destination for expatriates** in the annual global city index published by Mercer. Dubai moved to 75th overall (& 51st in terms of infrastructure), followed closely by Abu Dhabi at 79th.

Media Review

Investment valuation: using percentage rather than absolute return is deceptive

<https://realinvestmentadvice.com/the-worlds-second-most-deceptive-chart/>

Q&A on the US Fed renormalization path

<https://www.bloomberg.com/news/articles/2017-03-14/federal-reserve-ponders-how-to-do-the-big-unwind-quicktake-q-a>

Why Trump Doesn't Have to Do Anything to Stop Iran's Gas Plans

<https://www.bloomberg.com/news/articles/2017-03-15/iran-s-natural-gas-rush-won-t-bring-export-riches-for-now>

A new breed of sovereign wealth fund – without the wealth

<http://www.reuters.com/article/us-usa-businesswatch-17march-idUSKBN1602R2>

Saudi Arabia & China's loveless marriage

<https://www.bloomberg.com/gadfly/articles/2017-03-17/china-and-saudi-aramco-would-be-a-marriage-of-convenience>

Funding pressure of GCC banks to ease in 2017: Moody's

<http://gulfnews.com/business/sectors/banking/funding-pressure-of-gcc-banks-to-ease-in-2017-1.1994371>

GCC corporates could face multiple VAT challenges in the short-run

<http://gulfnews.com/business/sectors/banking/gcc-corporates-could-face-multiple-vat-challenges-in-the-short-run-1.1992385>

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