

Weekly Economic Commentary – May 21, 2017

Markets

Wall Street last Wednesday suffered the worst daily plunge in 8 months as a political storm hit President Trump after the dismissal of FBI Director Comey and the innuendos that State secrets might have been passed to the Russian Foreign Minister. Towards the end of the week equity prices pared the losses helped by energy and commodity shares, but the post election rally is fragile: the VIX volatility index, on Wednesday soared 46% the largest daily surge in 11 months. Even the US bond market is mulling whether that Trump's troubled presidency could throw the Federal Reserve off its rate hikes course. Regional markets were mixed with Saudi and Kuwait benefitting from the oil price rebound and others hit by emerging markets weakness. The flight to safety effect stemming from the US affected other markets. In foreign exchange markets, the yen was the main beneficiary, while the dollar continued to slump vis-à-vis the euro, while gold, the quintessential investors' safe haven, gained strongly. Oil prices continued to regain strength after US oil inventories fell for the sixth consecutive week (a total of 7 mn barrels in just two weeks); while OPEC will meet next week to finalize a new agreement with other producers on production cuts.

Global Developments

US/Americas:

- **US industrial production** recorded a 2.2% yoy growth in Apr vs 1.5% rise in Mar, a top since Jan 2015, lifted by manufacturing (2.7%) and mining (7.3%), while utilities declined -0.5%.
- **US building permits fell** -2.5% mom in Apr to a sa

annualized rate of 1.3 mn from 1.26 mn in Mar. Single-family permits dropped -4.5% while multi-family permits rose 1.4%. **Housing starts** dropped 2.6% mom in Apr to a sa annualized rate of 1.17 mn vs 1,2 mn in Mar.

- **US initial claims for unemployment benefits** declined by 4,000 to 232,000. The four-week moving average also fell by 2,750 to 240,750 and continuing claims by 22,000 to 1.898 mn.
- **The Conference Board's index of US leading indicators** rose 0.3% in Apr the same as in Mar, with uniform contributions in most sub indices except housing permits and stock prices. **The coincident indicator** also grew 0.3% in Apr.

Europe:

- **Eurozone's GDP** jumped 1.7% yoy in Q1 (0.5% qoq) almost on par with 1.8% in Q4 (0.5% qoq). **GDP in Italy** gained a feeble 0.2% qoq (0.8% yoy) in Q1, the same as in Q4 (1.0% yoy), as external demand failed to counter anemic domestic demand.
- **The ZEW Economic sentiment indicator for the Eurozone** surged to 35.1 in May from 26.3 in Apr, a record since Aug 2015; 40% of the analysts surveyed expect a pickup in economic activity in the coming 6 months while 56% expect growth to remain stable.
- **The Eurozone trade surplus** reached a record high of EUR 30.9bn in Mar up from EUR 28.2bn Mar 2016. Exports grew 13% yoy to EUR 202.3 bn and imports gained 17% to EUR 171.4bn.
- **The ZEW Indicator of Economic Sentiment for Germany** rose to 20.6 in May from 19.5 Apr of 22. It was the highest reading since Aug 2015.
- **UK retail sales** surged 2.3% mom (4.0% yoy) in Apr rebounding from the -1.4% fall (2.0% yoy) in Mar. It was the biggest gain since Jan 2016, boosted by both food and non-food stores.

- **UK inflation** increased to 2.7% yoy in Apr from 2.3% in Mar and Feb. It is the highest level since Sep 2013.
- **Russian GDP** rose 0.5% yoy in Q1, vs 0.3% in Q4, confirming the slow exit from a 2-year recession caused by low oil prices and exacerbated by international sanctions.

Asia Pacific:

- **Japan's GDP** advanced 0.5% qoq (2.2% yoy) in Q1, accelerating from 0.3% (1.4% yoy) in Q1, thanks to private consumption, exports and unexpectedly investments. This was the fifth straight quarter of expansion, which had not happened for the past 11 years.
- **Core machinery orders in Japan** rose 1.4% mom (-0.7% yoy) in Mar after a 1.5% increase in Feb (5.6% yoy). Orders for manufacturing grew only 0.6% compared to a 6% increase in Feb. Orders for non-manufacturing dropped 3.9% mom vs 1.8% in Feb.
- **Non-farm fixed asset investment in China** rose 8.9% yoy in the first 4 months of 2017, following a 9.2% rise in Q1. Investment growth slowed from a 10-month high, sapped by central government investments' plunge (-9.2% vs -7.1% in Q1). Domestic-financed investments slowed to 9.6% from 10.0% in Q1; foreign investments retrenched by -0.3% vs +0.3%; investment in new construction projects went down -5.9% (from -6.5%).
- **Industrial production in China** rose 6.5% yoy in Apr, following a 7.6% gain in Mar. Manufacturing expanded 6.9% vs 8.0% in Mar, while mining production fell slightly.
- **Retail sales in China** rose 10.7% yoy in Apr almost similar to the 10.9% rate in Mar. Growth fell sharply in auto sales to 6.8% from 8.6% and in building materials (13.4% from 17.8%).
- **Singapore's trade surplus** decreased to SGD 5.4bn in Apr from SGD 6.2bn a year earlier.

- The **Philippines' GDP** continued its sustained growth at 6.4% yoy in Q1 after 6.6% in Q4, lifted by export, while domestic demand growth decelerated.

Bottom line: The tumultuous developments in the Russiagate (which per se is an overblown issue) might turn out to be the catalyst for a reassessment of stretched equity valuation resting on a narrative of imminent tax cuts, infrastructure projects, cash repatriation and deregulation. The VIX snap is also a reminder that the suppression of volatility by central banks cannot be granted indefinitely. As to the global macro picture the unexpected strong GDP figure in Japan and healthy growth in South Asian countries corroborate early signals that after the negative impact of China's slowdown a recovery is underway. In Europe the latest data led ECB President Draghi to declare that the crisis in the Old Continent is over.

Regional Developments

- Many countries have voiced support for **extending the OPEC-cut**, including ministers of Iraq and Kuwait. Saudi Arabia's energy minister said on Bloomberg TV that all oil producers were "on board" for a 9-month OPEC-cut extension. The OPEC meeting is scheduled on May 25th.
- **Egypt** is expected to receive the **IMF's** second loan instalment of USD 1.25 bn in a few weeks; the IMF also backed the country's plan to remove fuel subsidies in 3 years. As to price pressures, the IMF expects the country to see single-digit inflation within 3-4 years.
- The Central Bank of **Egypt** is expected to launch a **microfinance initiative** on May 23. As per this plan, banks will not be obliged to establish a special unit for microfinancing as they can already provide both direct and indirect lending to clients.
- **Egypt's** recently discovered **oil fields** will save the country about USD 3.6 bn yearly as they start production, reported state-run newspapers citing the President.

- **Egypt** will make a debt **payment** of USD 750 mn to international **oil companies** on Jun 1, according to the central bank governor. Outstanding dues to international oil and gas companies are around USD 3.5bn.
- **Egypt** will cancel the USD 100k **limit on individual bank transfers** “soon”, according to the central bank governor.
- **Egypt** will apply the **stamp duty on stock exchange transactions** – set at 1.25 Egyptian pounds per 1,000 for the first year of the tax’s introduction – from early next month, according to the deputy finance minister.
- **Unemployment in Egypt** eased to 12% in Q1, from 12.4% the previous quarter; the labour force grew by 71k persons to 29.15mn in Q1 while total number of unemployed was 3.5mn persons.
- **Egypt** will issue new **international bonds** ranging between USD 1.5-2.0bn at the end of the next week, revealed the country’s finance minister.
- **Iraq** replaced Saudi Arabia as **top crude supplier to India** in Apr: India’s oil imports from Iraq grew by 8% yoy topping 1mn barrels per day (bpd) last month versus Saudi Arabia’s 750k bpd.
- **Jordan** will receive a USD 100mn **soft loan** from the Islamic Bank for Development to fund an urgent **health project** in the country.
- **Kuwait’s** Legislative and Legal Affairs Committee approved the proposal to **regulate electricity, water and fuel subsidies** for government agencies and their employees.
- **Lebanon’s** finance minister is seeking the **extension of the central bank governor’s term** by 6 years – his term is currently set to expire at the start of Aug. Separately, the central bank governor stated at a conference that the country’s forex reserves are stable for now and the central bank could intervene again if needed, to guarantee monetary stability.
- **The Omani government** plans to sell USD 2 bn worth of

Islamic bonds this month to cover the budget deficit caused by lower oil revenues.

- The **IMF at the end of its annual mission to Oman** issued a statement where it remarked how improving the business environment by streamlining regulatory processes and increasing the level of vocational skills will support efforts to increase private sector employment. The IMF advised the authorities to further strengthen their framework for debt and asset management, while further fiscal reform would also help limit borrowing costs.
- **Qatar's banks** saw a doubling in overall **gross external funding** to QAR 441bn at end-2016 from QAR 216bn at end-2014, reported S&P. The rating agency cautions about two main risks arising from this surge in external funding: an outflow of liquidity and a large open position.
- **Qatar's construction market** is projected to grow at 12.1% between 2017 and 2021, thanks to investments ahead of the FIFA World Cup 2022, according to BMI Research.
- **Saudi Arabia's** Public Investment Fund (PIF) will invest overseas only slowly, according to the fund's managing director. Separately, the fund and US private equity firm Blackstone announced a plan to create a USD 40 bn vehicle to invest in infrastructure projects, mainly in the US. *(More details on Saudi Arabia-US deals in media review section)*
- The **Softbank-PIF backed private equity fund** has raised over USD 93bn to invest in technology sectors; new investors include Abu Dhabi's Mubadala (which committed USD 15bn) and Apple.
- **Saudi Arabia's** holdings of **US government bonds** climbed to a one-year high of USD 114.4bn in Mar, from a low of USD 89.4bn last Sep.
- The **IMF** advises **Saudi Arabia** of a more gradual consolidation to achieve balance, stating that it would "give households and businesses more time to adjust". *(Press Release after completion of IMF's Article IV*

mission to Saudi Arabia:
<http://www.imf.org/en/News/Articles/2017/05/17/pr17178-imf-staff-completes-2017-article-iv-mission-to-saudi-arabia>)

- **Consumer price deflation** in **Saudi Arabia** continues into April, with prices down by -0.6% yoy. Food and beverage prices and transport costs fell by 2.6% and 2.2% yoy respectively, while housing and utilities prices were up by 0.5%.
- **Saudi Arabia's crude oil exports** rose by 275k barrels per day (bpd) to 7.232mn bpd in Mar, according to data from the Joint Organizations Data Initiative, though shipments were down by 300k bpd compared to a year ago. Saudi crude inventories rose to 267.854mn barrels in Mar (Feb: 264.704mn barrels).
- Saudi Arabia has launched the **Saudi Company for Military Industries**, expected to provide up to 50,000 jobs and contribute more than SAR 14bn to GDP by 2030, reported *Ekhbariya TV*.
- Ten **smart cities** are to set up in **Saudi Arabia**, as part of the NTP 2020, according to the Minister of Municipal and Rural Affairs.
- **Saudi Arabia** is planning to introduce a new "**flexible work**" system of employment for Saudi citizens, reported *Al Madina* This would provide both employee and employer flexible work contracts, allowing them to be employed hourly and paid weekly.
- **Saudi Arabia**-based power and water project developer **ACWA Power** plans an **IPO** in late 2018, according to its CEO. The listing will be on both Tadawul and a foreign market bourse.
- **Tourism revenues** in **Saudi Arabia** rose to SAR 166.8bn at end-2016 from SAR 57.3bn (USD 15.3bn) in 2004, according to the president of the Saudi Commission for Tourism and National Heritage. The sector now employs 936k workers and job opportunities are expected to rise to 1.2mn by 2020. Separately, Saudi **Aramco** announced that it will

establish a centre to train workers in Saudi Arabia's tourism industry.

- One in four **children** in the **Arab world** live in **poverty**, according to a study released by UNICEF. About 29 mn children were living in poverty in about 11 countries in the region studied including Egypt, Iraq, Morocco and Yemen.

UAE Focus

- The **IMF** expects **non-oil GDP** in the **UAE** to expand at 3.3% this year from 2016's 2.7% while overall GDP is forecast to slow to 1.3% given the shrinking oil sector. According to the IMF, UAE will effectively eliminate its fiscal deficit around 2022.
- **Foreign currency assets** at the **UAE** central bank fell by 2.3% mom and 1.9% yoy to AED 317.4bn in Apr.
- **GDP** from **construction** in **Abu Dhabi** rose by 3.3% yoy in 2016, while the real estate sector grew by 8.1%. Together (at more than AED 266bn), construction and real estate activities accounted for 25% of non-oil sector production. Additionally, the real estate sector received AED 24bn in FDI last year, out of the total AED 95bn in Abu Dhabi.
- **Dubai** government has secured USD 3bn in **long-term financing** for the expansion of its **airports**. The deal includes a USD 1.63bn, seven-year conventional loan and a USD 1.48bn-equivalent, seven-year Ijara facility denominated in dirhams.
- **Dubai's** trade with **Qatar** grew 92% during the period 2011 to 2016, according to the DP World Group Chairman and CEO; external trade with Qatar touched AED 15bn last year from 2011's AED 7.8bn.
- Total number of **business licenses** issued in **Dubai** increased by 12% yoy in Q1 this year to 5387.
- An expansion of **Dubai's Al Maktoum airport** has been delayed until 2018, due to the completion of

construction and to allow time for trials and testing. Separately, the CEO of Dubai Airports stated that Dubai's two airports are likely to welcome a combined total of 100 mn passengers by the end of 2017.

- **Open data** is expected to add AED 10.4bn to **Dubai's** economy every year, with the public sector alone accounting for AED 6.6bn, reveals the Dubai Data Report. The government sectors providing the largest value would be transport storage and communication (AED 1.85bn) and public administration (AED 1.57bn).
- **Digital investments** in the **UAE** have grown to USD 799mn last year, from USD 35mn in 2013, according to the State of Digital Investments in MENA report. The report finds that 90% of all dollars invested in the MENA region last year went in to the UAE. Majority of investments in MENA were made in the transactional, or eCommerce, sector.
- **Expo Centre Sharjah** announced a 7% yoy increase in visitors (to 302,474) to the exhibitions and events organised in the centre in Q1 this year.

Media Review

KSA's "Whatever it takes" moment

<https://www.bloomberg.com/gadfly/articles/2017-05-15/opec-production-cuts-oil-market-listens-for-now>

Online shopping will keep a lid on global inflation

<https://www.bloomberg.com/news/articles/2017-05-16/amazon-effect-means-global-inflation-just-ain-t-what-it-once-was>

Against frackers it will be trench warfare

<https://www.bloomberg.com/news/articles/2017-05-17/opec-prepares-for-long-battle-to-see-off-shale-quicktake-q-a>

London's empty office space

<https://www.bloomberg.com/gadfly/articles/2017-05-17/we-need-a-killer-app-for-london-s-empty-office-space>

Trump and Iran

<http://www.economist.com/news/leaders/21721381-only-weeks-decide-confusion-reigns-why-trump-should-not-ditch-deal-iran>

Hard-time for hardliners

<http://www.economist.com/news/middle-east-and-africa/21722416-having-won-ballot-box-irans-president-begins-his-battle-control>

Deals signed by U.S. companies in Saudi Arabia: Reuters

<http://www.reuters.com/article/us-saudi-usa-trump-deals-factbox-idUSKCN18G0JY>

Saudi Arabia's privatisation plans

<http://in.reuters.com/article/saudi-economy-investment-idINL8N1IG0C0>

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