

Weekly Economic Commentary – May 28, 2017

Markets

The S&P 500 closed on Friday beating a record high for the third consecutive day but the weekly gain was just 1.4%. Most other global equity markets displayed mildly positive or stable performances thanks to buoyant economic data and positive earnings reports, but Shanghai fell to a seven-month low after Moody's China downgrade. Regional markets however (with the notable exception of Egypt, where fiscal and monetary policy are improving) were mostly negative after oil prices slumped. In currency markets the dollar had some respite from the slide that has persisted for weeks and the GBP dropped as a result of the terrorist attack in Manchester. The price of Brent on Thurs collapsed by -4% – the sharpest daily decline in 3 weeks – as traders were disappointed that the agreement between OPEC and Russia did not include steeper cuts to oil output. US crude production rose to 9.32mn bpd last week, an increase of 550,000 this year to the highest since Aug 2015, according Energy Information Administration. This amounts to almost a third of the supply reduction by OPEC and its allies. Gold prices edged up on renewed fears of possible actions by terrorist groups.

Global Developments

US/Americas:

- **Trump administration presented its first budget proposal**, which includes cuts over 10 years of USD 3.6tn and unrealistic economic growth forecasts. However the power over public finances rests with Congress and the President's plan usually falls prey to partisan politics and vested interests.

- **The US Fed minutes** revealed that another rate hike is imminent, most likely in June, and that the preparations to offload the central bank's balance sheet are well under way, expected to reduce liquidity.
- **US GDP growth** in Q1 was revised up to 1.2% qoq ann., up from an initial estimate of 0.7%, but still below 2.1% in Q4. The boost was attributed to revisions in nonresidential fixed investment, private consumption and public spending, offset by a downward revision to private inventories.
- The **IHS Markit Flash US Composite PMI output index** rose to 53.9 in May from 53.2 in Apr, thanks to strong services. The **IHS Markit US Manufacturing PMI** was almost stable at 52.5 in May vs 52.8 in Apr.
- **New orders for US durable manufactured goods** plunged -0.7% mom in Apr, the first loss since Nov after a 0.7% growth in Mar. Nondefense aircraft was the main cause, but orders were flat in core capital goods. Inventories rose 0.1%.
- **US new-home sales collapsed** in Apr by -11.4% mom (+0.5% yoy), while **existing-home sales** fell by 2.3% mom (1.6% yoy) confirming that the real estate market is stalling.
- **US wholesale inventories** decreased -0.3% mom in Apr after a paltry 0.1% in Mar. Even retailers are offloading their shelves (-0.3% mom) for the first time in 2017.
- **US initial unemployment claims** rose 1,000 to 234,000. The 4-week moving average fell 5,750 to 235,250. Continuing claims rose 24,000 to 1.923 mn close to historical lows.
- **Mexico's GDP** grew 2.8% yoy in Q1 vs 2.3% in Q4 and 2.2% a year earlier, confirming that the Trump effect South of the border has not materialized.

Europe:

- The **IHS Markit Eurozone Composite PMI** stood at 56.8 in

May the same as Apr's 6-year high. Manufacturing led the increase with a 6-years record (57 from 56.7) while services were marginally low (56.2 from 56.4). The orders' pipeline registered the second-largest rise in 6 years and the jump in employment was the second-largest since Aug 2007 before the subprime crisis.

- The **German Ifo Business Climate Index** hit an all-time high in May at 114.6 from 113 in Apr. Optimism about the current situation, and the outlook for the near future also improved strongly from the previous month.
- The **IHS Markit Flash Germany Composite index** went up to 57.3 in May from 56.7 in Apr, the fastest rate of expansion in German private sector since Apr 2011 thanks to new business growth and the fastest job creation in 6 years.

Asia Pacific:

- Moody's cut the **sovereign rating on China** by one notch to A1 from Aa3, for the first time since 1989 challenging the prevailing view that economic policy can successfully pursue the incompatible objectives of reducing leverage and pushing growth.
- **Chinese industrial profits** rose 14% yoy in Apr to USD 83.6bn, as global trade recovered. In Mar profits jumped 23.8% in March compared to 8.5% for the whole of 2016.
- **China's consumer prices** rose 2% yoy in Apr, following a 0.9% rise in Mar.
- **China's trade surplus** fell to USD 38.5bn in Apr from USD 39.16bn a year earlier, as exports rose less than imports.
- **Inflation in Japan** rose 0.4% yoy in Apr, following a 0.2% rise in Mar, reinforcing the inflationary push after massive monetary injections. Core inflation was unchanged at 0.3% yoy.
- **Japan's trade surplus** nosedived -40.6% yoy to JPY 481.7bn in Apr. In two months the surplus has almost

halved from JPY 811bn in Feb.

- **The Nikkei Japan flash manufacturing PMI** declined to 52.0 in May from 52.7 in Apr, marking the ninth straight month of expansion in manufacturing, despite weak job creation.
- **Taiwan's GDP** expanded 2.6% yoy in Q1, a tad below 2.8% in Q4. An uplift in domestic demand helped the performance.
- **Taiwan's Industrial production** fell -0.6% yoy in Apr from 3.2% in Mar, due to a drop in electricity and gas production, but manufacturing advanced a little.
- **Singaporean GDP** expanded 2.7% yoy in Q1, vs 2.9% in Q4.
- **Singapore's industrial production** grew 6.7% yoy in Apr vs 10.2% in Mar with biomedical output weakening and electronics still strong.
- **Hong Kong's trade** balance increased in Apr to HKD -34.13bn from HKD -42.3bn in Mar.

Bottom line: The GDP upward revision was a rare positive news (except for the labour market) coming out from the US lately. Most data point to a lackluster performance, while political dark clouds are on the horizon. On the contrary in Europe the economy is gradually gathering pace, with Germany firing on all cylinders. The downgrade of China's sovereign debt is a reminder that leverage is an impending threat, while local government financing vehicles and state-owned enterprise debt need to be curtailed sharply. The angry rebuttal by the Chinese government highlighting the reform drive will not dispel worries.

Regional Developments

- **OPEC** and non-members led by Russia decided to **extend cuts in oil output** by nine months to March 2018.
- **Egypt** expects **IPO's of state-owned companies** to raise EGP 5-7bn during the 2017-18 fiscal year, according to the deputy finance minister.
- **Budget deficit** in **Egypt** fell to 8% of GDP during the

first nine months of the 2016-17 fiscal year (Jul 2016-Mar 2017) compared to 9.4% during the same period a year ago.

- **Egypt's** central bank raised **interest rates** by 2% in a surprise move – the bank had previously hiked rates by 300bps in Nov – to curb inflation and also demand-side pressures. Overnight deposit rate increased to 16.75% from 14.75% and its overnight lending rate moved to 17.75% from 15.75%.
- **Egypt** launched a USD 3bn **triple-tranche bond** last week: the USD 1.75bn bond is scheduled to mature in 2022, the USD 1bn notes are due in 2027 and the USD 1.25bn notes due in 2047.
- **Iraq's** oil minister disclosed that the country had achieved its share of the **oil production cuts** – under the deal agreed to last year, Iraq had agreed to cut its production by 210k barrels per day.
- Germany announced it is extending USD 100mn **grant to Jordan**, as part of a pledge during a donors' conference in Brussels, to support development-oriented projects.
- **Kuwait Investment Authority** announced a **loss** of KWD 312mn (0.2% of total assets) in the financial year ending Mar 2016. The sovereign wealth fund does not usually disclose financial performance; this was revealed in a statement released after local media reported bigger losses.
- **Lebanon's central bank governor** was **reappointed** for another six-year term, after the cabinet unanimously agreed to an extension.
- **Net profits** of the six **commercial banks listed on the Muscat Securities Market (MSM)** increased to OMR 87.4mn in Q1 from OMR 85.9mn during the same period last year. The banks also posted growth in their assets, customer deposits and loan portfolios.
- **Moody's** **downgraded Qatar's credit rating** by one notch to Aa3 from Aa2, citing increasing external debt and growth uncertainty, but changed its outlook to stable from

negative on optimism around the implementation of fiscal and economic reforms.

- **Foreign investments into Qatar** grew by a robust 11% yoy to QAR 537.3bn in 2015, with FDI accounting for 25% of the total, according to the report 'Qatar Foreign Investment Survey 2015' published by the Ministry of Development Planning and Statistics. Total overseas investments expanded about 12% yoy to QAR 378.3bn.
- An estimated 5,800 **housing units** will be added in **Qatar** by the end of 2017, as per a report by ValuStrat, which also disclosed that the country added nearly 1500 units in Q1 this year (comprising about 17% villas and 83% apartments).
- According to local media, the **Saudi** General Authority of Zakat and Tax will publish the **value-added tax (VAT) draft** on its electronic portal within the next two weeks. All private sector companies in Saudi Arabia with revenue of over SAR 375,000 will be covered by the new VAT taxation rules (businesses with revenues of SAR 185k have the option to pay the tax) and registration for VAT is mandatory in Q4 this year.
- **Bilateral trade between Saudi Arabia and the US** reached SAR 142bn last year, and exceeded SAR 2 trn in the last decade.
- **Saudi** Arabia's **Aramco** plans to spend USD 18bn over the next five years to **expand its operations in the US**, according to the Aramco-owned US oil refining subsidiary Motiva Enterprises.
- **Saudization at Jeddah malls** has reached 50%, according to a senior official at the Jeddah Chamber of Commerce and Industry.
- The **GCC unified selective excise tax** and the **VAT agreements** have come into effect, after UAE became the second State to submit the two ratification documents to the Secretariat.
- Only 30% of **Middle East businesses** have a comprehensive **encryption strategy** to secure data within enterprise and

cloud applications, revealed the Middle East edition of 2017 Global Encryption Trends Study (*The report is available at: <http://go.thalesecurity.com/rs/480-LWA-970/images/2017-Global-Encryption-Trends-Report-Middle-East-Edition-ar.pdf>*

UAE Focus

- **Deposits** in the **UAE** grew by 1.3% mom to AED 20.6bn in Mar (Feb: +1.2%), driven by domestic deposits. **Credit growth** grew at a faster pace of 0.7% mom (Feb: 0.5% mom), the fastest rate of growth since Sep 2016. The loan to deposit ratio fell to 99.7% in Mar – the lowest since May 2015 and down from 100.3% the month before.
- The **UAE** Ministry of Finance revealed that all UAE businesses subject to the Value-Added Tax (**VAT**) have to **submit** their **tax declaration statements** on a quarterly basis starting Jan 2018.
- The **demand for business credit** in the **UAE** has increased moderately in Q1 (+7.6), according to the recent central bank survey. Survey results disclose that +22.8% of respondents reported a decrease in demand, +37.7% reported an increase in demand, and +39.5% reported no change. On credit availability for business loans, respondents reported a higher level of tightening for SMEs relative to large firms.
- **FDI** flows into **Abu Dhabi** grew by 8% yoy to AED 95bn in 2016, according to the acting undersecretary of the Abu Dhabi Department of Economic Development. He also stated that government spending on projects (especially tourism and infrastructure related) would aid in recovery, thereby facilitating growth rates of 3% this year and 4% next year.
- **Moody's** revised the **rating outlook** on the Government of **Abu Dhabi** to stable from negative, while the long and short-term issuer ratings have been affirmed at Aa2/P-1.

- The Dubai Financial Services Authority (**DFSA**) announced a new class of license called the “**Innovation Testing License**” (ITL) which will support **FinTech firms** to register at the Centre, without being subject to all the regulatory requirements applied to regulated firms.
- **UAE fuel prices** are set to decline next month: the Ministry of Energy announced that petrol prices will decline by 2.5-2.7% mom while diesel prices will drop by 3.6% to AED 1.90.
- **Dubai** is considering the creation of a USD 1bn **investment fund focused on shipping** to further develop the maritime industry; a source states that this idea is still at a “fact finding” stage.
- The **UAE** will continue to **expand oil and gas production capacity**, while complying with the OPEC output cut target, according to the UAE’s energy minister.
- The **Abu Dhabi Water & Electricity Authority** closed a AED 3.2bn financing package for the construction of an independent **solar plant** with a capacity of 1177 megawatts. The project is scheduled for completion in Q2 2019.
- According to a new **survey** by Hays (a recruitment consultancy firm), 61% of the respondents plan to introduce the new tax (**VAT**) using their current workforce, without increasing headcount. The firm also found that over 60% of 100 senior decision makers and finance professionals in both the public and private sectors in the UAE have not allocated a budget for the application of the new tax, while 52% said they have not set an implementation strategy for the new tax.

Media Review

Rebalancing China’s foreign investments

<https://www.omfif.org/media/2340465/omfif-dm-presentation-the-great-china-investment-hub.pdf>

Clarity missing from SoftBank’s \$100 bln Vision: Reuters

<http://www.reuters.com/article/uk-softbank-visionfund-launch-b>

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How Saudi Arabia played Donald Trump

https://www.washingtonpost.com/opinions/global-opinions/saudi-arabia-just-played-donald-trump/2017/05/25/d0932702-4184-11e7-8c25-44d09ff5a4a8_story.html

UAE minister sees chance for Iran to reset “troubled” ties with neighbours

<http://af.reuters.com/article/energyOilNews/idAFL8N1IN0UB>

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