

Weekly Economic Commentary – Jun 4, 2017

Markets

Returning from a long weekend in New York and London traders were feeling a bit of summer mood and major indices in US and Europe were rather subdued, but closed in positive territory. In Japan, the mood was upbeat as data seem to indicate that the economy is on the mend. Emerging markets, on the other hand, were softer with the exception of regional markets. In the US stock valuations pose a problem: despite almost 80% of companies in the S&P500 beating earnings estimates, the median P/E ratio is near a record high if one excludes the dot.com bubble. Stocks of US banks and energy companies (last year's hottest sectors) are vulnerable. In particular banks' shares declined for the third consecutive month as the yield curve flattened to the lowest level since Sep. Wall Street is sustained by technology companies as never in the past 15 years, especially the giant tech companies such as Amazon and Alphabet. Despite a dovish stance by ECB's Draghi the euro continued to climb against the dollar most likely because expectations of further Fed rate hikes after June are fading. Oil prices are on the back foot as traders stay on the sidelines to see if the agreed output cuts between OPEC and other producers will show up in the actual data and not only on paper. Hence despite a whopping (and unexpected) drop in US oil inventories by 6.4 mn barrel, oil posted another weekly drop. Gold prices in the absence of risk-related news ended slightly up, amid directionless trade.

Global Developments

US/Americas:

- **The non-farm payroll data** increased by only 138, 000

jobs in May, after about 200,000 in Apr, with downward revisions of 66,000 units for both Mar and Apr. Calendar effects and seasonal quirk probably explain part of these disappointing figures.

- **US initial claims for unemployment insurance** rose just 13,000 to 248,000. The 4-week moving average had a blip up to 238,000. Continuing claims fell 9,000 to 1.915 mn.
- **The US ISM manufacturing index** advanced from 54.8 in Apr to 54.9 in May. Among subcomponents, new orders rose 2 points to 59.5 but production fell from 58.6 to 57.1 and both new export and import orders fell. The employment index improved marginally.
- **US nominal personal income growth** accelerated to 0.4% mom in Apr from 0.2% in Mar. Real disposable income growth retrenched from 0.4% in Mar to 0.2% in Apr. Wages and salaries increased 0.7% mom after a flat reading in Mar.
- **The US PCE deflator** rose 0.2% mom (1.5% yoy) in Apr, exactly offsetting Mar's decline (1.6% yoy). The core PCE deflator, also rose 0.2% mom recovering the -0.1% decline in Mar. Inflationary pressures on core PCE are rapidly subsiding from Feb's 1.8% yoy.
- **US consumer spending** advanced 0.2% mom after rising 0.5% in Mar, as a result of perky durable goods spending while services spending stalled. The saving rate held steady at 5.3%.
- **The US Conference Board's Consumer confidence index** lost 1.5 points in May to 117.9, its second consecutive monthly decline. Nevertheless, the three-month moving average remains at its highest since 2001 and the May decline is minimal compared to the yoy gain of 25.5 points.
- **The US Case-Shiller existing home price composite index** for the 20-city grew 5.9% yoy in Mar, the same rate as in Feb. The national index had a slightly better performance at 5.8% yoy in Mar, up from 5.7% in Feb.
- **According to the US Fed's Beige Book** economic activity

gained traction from Apr to mid-May. New job creation was modest to moderate tight labour markets are pushing wages higher. Consumer spending is subdued with auto sales down. Inflationary pressures are mostly unchanged.

- **US trade deficit** widened in Apr to USD 47.6bn from USD 45.3bn in Mar. Exports edged lower 0.3%, mom while imports gained 0.8% mom.
- **Canada's GDP** grew 3.7% yoy in Q1, vs 2.7% in Q4 thanks to stronger private consumption and investments, while net exports fell.
- **Brazil's GDP** dropped -0.4% yoy in Q1 after declining -2.5% in the previous period and 5.4% a year earlier. The situation is somewhat improving, but due to the political turmoil the outlook is bleak.

Europe:

- **ECB President Draghi** made dovish remarks on the phasing out of the QE and underscored that a lax monetary policy is necessary until deflationary pressures are quelled and the recovery solidifies.
- **Eurozone's M3 money supply growth** decelerated to 4.9% yoy in Apr vs 5.3% in Mar. Growth in M1 i.e. currency in circulation and overnight deposits was unchanged at 9.2%.
- The **Eurozone's Economic sentiment index** lost 0.5 points to 109 in May. Business sentiment has surged in France and Germany after Macron's election and as German polls predict a victory for Chancellor Merkel. Notably, the sentiment index for Portugal, one of the countries rescued by an emergency plan of the Troika in 2011, rose from 111.6 to 113.8, a top since 2000.
- **Eurozone inflation** slowed to 1.4% yoy in May from 1.9% in Apr, thanks to low oil price growth. Core inflation also retreated to 1% yoy in May from 1.2% in Apr.
- **German retail sales** in Apr were down -0.2% mom vs 0.1% in Mar, but increased slightly in yoy terms.

- **The EU Commission** in a paper advocates the **creation of “sovereign bond-backed securities”** market by consolidating member countries’ public debts into a new instrument. Such plan could boost demand for weaker economies, while avoiding old frictions over the issuance of common bonds.
- **UK consumer confidence** rose in May to -5 from -7 in Apr. Consumers display pessimism about the economic outlook, but they remain confident over their personal finances, despite declining real wages.
- **The UK nationwide housing price index** rose only 2.1% yoy in May vs 2.6% in Apr, marking the lowest rate of expansion in almost 4 years. In mom terms, the indicator fell for the third month in a row, a sequence not seen since 2009.
- **Italy’s GDP growth** was revised to 0.4% qoq from 0.2% initial estimate. Private and public consumption supported the economy, while net exports and total investments were a drag.

Asia Pacific:

- **Chinese official manufacturing sentiment** was unchanged in May at 51.2, but operating conditions improved.
- **Japan’s industrial production** rose 4% m/m sa in Apr following a -1.9% decline in Mar. Tech and auto output led the rebound.
- **Japan’s household expenditure growth** slumped unexpectedly -2.4% yoy in Apr, after rising 0.7% in Mar.
- **Retail sales in Japan** increased 3.2% yoy in Apr, vs 2.1% in Mar, due to fuel prices, while other spending remains anemic.
- **Consumer confidence in Japan** crawled up to 43.6 in May from 43.2 in Apr, when it sunk due to tensions with North Korea. Surprisingly inflation expectations fell.
- **India’s GDP growth** slowed to 6.1% yoy in Q1, from 7% in Q4 in part as a result of the demonetization. The

slowdown was broad-based, though construction took a hit. Consumption drove the performance, while investments are being affected by rising bad bank loans.

- **South Korea's GDP** surged 1.1% qoq in Q1, double the 0.5% rate in Q4, propelled by export and investments, while consumption is impaired by household debt and a lackluster labour market.
- **South Korea's inflation** crawled up to 2% yoy in May, from 1.9% in Apr, due mostly to food and transport costs. Core inflation stayed at 1.4% yoy.
- **Thailand's industrial production** contracted -1.7% y/y in Apr after a flat reading in Mar.

Bottom line: US data after a very soft start in 2017 continue to be mixed, with positive data on real estate and personal income counterbalanced by two ominous signs: the flattening of the yield curve and declining auto sales (still below 17 million vehicles) that are harbingers of cyclical weakness. The deteriorating job creation adds to pessimism, and many are revising their forecasts on the tightening cycle by the Fed after Jun. Looking ahead unusual uncertainty prevails about economic measures cooked up by Trump and his team. In the area of fiscal policy, the Administration has outlined a budget which Congress does not seem to appreciate. On international trade, protectionism is giving way to a pro trade agenda on the NAFTA and even the TTIP. The withdrawal from the Paris climate deal puts the US on a collision course with many of its allies, after the diplomatic skirmish at the G7 meeting. These dark clouds in the US contrast with the clearer skies in the Eurozone and Japan where positive signal from macro data are intensifying.

Regional Developments

- The non-oil sector in **Bahrain** grew 3.7% in 2016, supporting overall **GDP growth** of 3% (and slightly higher than 2015's 2.9%). Finance (growing at 5.2%), construction (+5.7%) and social and personal services

(+9.1%) supported growth in the non-oil sector.

- **Bahrain's** sovereign wealth fund **Mumtalakat's** annual investments were in the range of USD 250mn in recent years, and hopes to be part of the upcoming Aramco IPO, according to its CEO. The SWF has an "impressive" pipeline of promising investment deals in Russia where it currently has projects worth some USD 135mn.
- **Egypt's** cabinet approved **raising the minimum income tax threshold** to EGP 7,200 (USD 398) a year from EGP 6,500, revealed the deputy finance minister; this is yet to be approved by the parliament.
- **Egypt's** President Sisi **ratified the investment law** last Thursday, after the parliament had passed it last month.
- The next IMF review **IMF of Egypt's reform progress** will be in either Nov or Dec, according to the Finance minister. Egypt is expected to receive the USD 1.25bn payment this month, following the review where the IMF stated that the country was "off to a good start".
- **Egypt's M2 money supply** grew by 38.7% yoy to EGP 2.783trn in Apr.
- According to **Egypt's** central bank governor, the country attracted nearly USD 1bn in **new foreign investment** following the last rate hike (on May 21). Since the currency float in Nov, foreign currency inflows into the banking system have reached about USD 25bn. Meanwhile, foreign investment in Egyptian government securities touched EGP 136bn in the week of the rate hike (up 13% from the week before).
- The European Bank for Reconstruction and Development (**EBRD**) is currently assessing whether to provide around USD 200-300mn **loans for Egyptian banks** – to support the development of small and medium-sized businesses as well as trade activities.
- **Public debt in Jordan** stood at JOD 26.5bn as of Q1 this year, equivalent to 95.1% of GDP, compared with JOD 26.1bn at end-2016. Public spending declined by 0.7% yoy to JOD 1.75bn.

- As **Lebanon** continues to discuss the new **parliamentary election law**, the Interior minister stated that there needs to be at least 6 months preparation time before a parliamentary election can be held under any new law. Parliament's term is set to expire on Jun 20.
- Lebanon's FFA Private Bank is expected to launch the **Lebanon Infrastructure Fund**, which aims to raise USD 1bn to finance infrastructure projects in the country, according to its Chairman. The financing could happen either through debt or equity financing.
- **Qatar** posted a QAR 9.8bn **trade surplus** in Apr (105% yoy increase, but -0.3% mom decline), with total exports touching QAR 18.8bn (+25.1% yoy).
- The **Qatar** Investment Authority increased its **stake in Credit Suisse** to 5.01% of shares and now holds 17.98% of the voting rights.
- **Qatar's** central bank sold QAR 690mn (USD 190mn) of **Treasury bills** at its **monthly auction** on Jun 1, down from the QAR 1.55bn at last month's sale.
- Women accounted for 24.6% of total **population** in **Qatar** (which has 2,675,522 residents) in Apr. Around 26.75% of the total population were below the age of 24 while just over 1% were above the age of 65.
- **Saudi Arabia's** General Authority for Zakat and Tax launched a **public consultation** on the **draft law governing Value Added Tax**. The deadline for feedback submission is 29 June, following which the by-laws will be developed and agreed in Q3 before implementation next year. *The draft law can be accessed at https://www.gazt.gov.sa/dzit_logon/MenuItems.jsp?menu_id=vatform&portalapp=x&ume.logon.locale=en*
- According to an official at the General Authority for Zakat and Tax, **Saudi** commercial and residential real estate sector will be **subject to value-added tax** (with some exceptions) while VAT will not be imposed on bank loans. Also, VAT collection related to capital assets for big entities will be delayed while e-commerce will

be subject to VAT.

- **Saudi Arabia** will start imposing **taxes on cigarettes, energy drinks and carbonated drinks** from June 10, revealed the General Authority for Zakat and Tax. A 100% tax will be imposed on cigarettes and energy drinks, and 50% on carbonated drinks. Revenues from these selective taxes are estimated to reach SAR 7bn in six months.
- **Net foreign assets** in **Saudi Arabia** declined by USD 8.5bn to USD 492.9bn in Apr – the lowest level since 2011.
- **Saudi Arabia's Aramco** signed a joint venture agreement with three firms to **build a shipyard** on the country's east coast; while no financial details were given, it had been stated previously that the project would cost over SAR 20bn.
- The value of **point-of-sale transactions** in **Saudi Arabia** grew by 11.4% yoy to SAQ 16.5bn in Apr, indicating a recovery in consumer spending, according to Al Rajhi Capital.
- **Population** in **Saudi Arabia** touched 32.6mn in H1 this year, up by 870k from end of 2016. One-third of the population is aged between 25-44 years, while Saudi citizens (at 20.4mn) form 63% of the total population.

UAE Focus

- **UAE** featured among the top ten most **competitive nations**, according to the 2017 IMD World Competitiveness Yearbook. While UAE improved its position to 10 from 15 last year, Qatar ranked 17 (from 13 last year) while Saudi Arabia and Jordan were ranked at 36 and 56 respectively. *The rankings can be accessed at <http://www.imd.org/wcc/world-competitiveness-center-rankings/competitiveness-2017-rankings-results/>*
- **Short-term deposits** (less than 3 months) in the **UAE** accounted for 55.2% of total deposits by end-Apr, while 3-5 month term deposits and 6-12 month term investments claimed 16.4% and 22.5% of the total. Additionally,

deposits in **AED**, which accounted for 70% of value of total banking deposits, increased by AED 32.5bn to AED 965.3bn in Jan-Apr this year.

- The value of **Sharjah's healthcare sector** is estimated to rise to USD 2.4bn in the next two years, from USD 2bn registered last year, according to estimates from the Sharjah Investment and Development Authority (Shurooq).
- The **DIFC's FinTech Hive** has received over 100 applications from more than 32 countries for its accelerator programme, set to begin in Aug 2017 for 12 weeks.
- The Abu Dhabi Global Market (ADGM) has issued a consultation paper inviting public comments (by Jul 5th) on the Board's proposal to issue **regulations governing the establishment and operation of foundations in ADGM**. *This document can be accessed at http://adgm.complinet.com/net_file_store/new_rulebooks/c/o/Consultation_Paper_No_3_Foundations_Regulations.pdf*
- **Dubai International airport** received 7.6mn **passengers** in Apr, up 9.2% yoy, bringing the year-to-date total to 30.1mn (+7.8% yoy). The Indian sub-continent topped in terms of volume with 1.7mn passengers in Apr; London was top destination city (350k passengers).
- The **UAE** was ranked the **third most peaceful country in the MENA region** in the annual Global Peace Index, issued by the Institute for Economics and Peace. Ranked 65th globally, the nation scored high in security and policing as well as military hardware.
- The **UAE** ranks 18th globally in the IMD's **Digital Competitiveness** Ranking, and topped the region, with the global list topped by Singapore, Sweden and the US.
- **Mobile phone usage** in the **UAE** increased to 228.3 phones per 100 people as of Mar. Telecom subscribers also grew, with more than 132k new subscriptions (including 104k pre-paid services) registered in Mar vis-a-vis Feb.
- The **Abu Dhabi Fund for Development** disclosed that it financed 31 projects worth AED 5.7bn in **Jordan**.

Media Review

A guide to the 5 investigations into Russiagate

<https://www.washingtonpost.com/graphics/national/trump-russia-investigations>

America's Broken Democracy: Jeffrey Sachs via Project Syndicate

<https://www.project-syndicate.org/commentary/trump-political-masters-koch-brothers-by-jeffrey-d-sachs-2017-05>

Future oil demand is likely to trend downward

<https://www.bloomberg.com/graphics/2017-oil-projections/>

The rebalancing of China's foreign assets

<https://www.omfif.org/analysis/commentary/2017/may/china-rebalances-foreign-assets/>

Saudi Arabia releases details on what items will be subject to VAT

http://www.zawya.com/uae/en/story/Whats_in_whats_out_Saudi_Arabia_releases_details_on_what_items_will_be_subject_to_VAT-ZAWYA20170530040543/

Saudi Arabia's fiscal reforms to remain on track: IIF

<http://gulfnnews.com/business/sectors/banking/fiscal-reforms-expected-to-remain-on-track-1.2034361>

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