Weekly Economic Commentary – Feb 18, 2018

Markets

Global equities recouped the previous week's large losses, with the S&P500 scoring the biggest weekly gain since 2014. Risk aversion and volatility subsided despite an increase in US inflation which sparked another bond sell-off. European and Japanese indices took the lead from Wall Street and the MSCI EM gained over 5% for the week. Regional markets were more subdued, except KSA and Kuwait which strengthened in the wake of rebounding oil prices. In currency markets the USD slid to a 15-month low against the yen and lost ground against all major crosses: as a result the dollar index fell to its lowest level in more than 3 years. Oil prices rebounded and took off after comments by Saudi Energy Minister Khalid al-Falih on Wed that KSA intends to prolong the OPEC-Russia deal on output cuts, even if it the market might be undersupplied. Gold prices were supported by the weaker dollar, but remained within their medium term range.

Global Developments

US/Americas:

- **US inflation shot up** 0.5% mom (2.1% yoy) in Jan, from 0.1% (2.1% yoy) in Dec. CPI increased 0.3% (1.8% yoy). Core inflation was stable at 1.8% yoy. Although seasonality issues and methodological changes blur the picture it is clear that prices are heating up.
- **US Fed Chairman Jerome Powell** reiterated that "we are in the process of gradually normalizing both interest rate policy and our balance sheet with a view to extending the recovery…".
- **US industrial production fell** by -0.1% mom (3.7% yoy) in

Jan vs 0.9% (3.4% yoy) in Dec, due to a -1% mom drop in mining. Manufacturing remained flat mom.

- **US retail sales** unexpectedly **decreased** -0.3% mom in Jan, vs expectations of a 0.2% rise.
- **Initial claims for US unemployment insurance rose** 7,000 to 230,000. The 4-week moving average rose 3,500 to 228,500. Continuing claims increased 15,000 to 1.942 mn.
- **The University of Michigan Consumer Sentiment Index** was 99.9, the **second highest reading since 2004**, thanks to optimistic current conditions, higher income and overall improvement in household finances. Confidence in the labor market and retirement plans also improved.
- **US housing starts surged** in Jan to the second highest rate of the expansion, at 1.326 million annualized vs 1.209 million in Dec, thanks to the multi-units segment and, to a lesser extent, single-family houses.

Europe:

- **The Eurozone's industrial production rose** by 0.4% mom (1.5% qoq in Q4) in Dec adding to a strong 1.3% mom (1.3% qoq in Q3) rise in Nov.
- **The Eurozone's trade surplus** was nearly **unchanged** in Dec at EUR 25.4bn vs EUR 25.6bn in Nov. A year earlier the surplus was EUR 27.6bn.
- **German GDP grew** by 2.9% yoy in Q4 **marginally up** from 2.8% in Q3, the fastest pace since Q3 2011.
- **UK inflation was stable** at 3% yoy in Jan. Core inflation accelerated to 2.7% from 2.5% in Dec.
- **UK retail sales rose** only 0.1% mom (1.6% yoy) in Jan, vs -1.4% mom (1.5% yoy) in Dec much below expectations of 2.6%. Falling food spending, in reaction to hefty price increases, offset a pick-up in non-food sales.

Asia Pacific:

- **Japan's GDP growth** in Q4 **decelerated** to 0.1% qoq from 0.6% in Q3, marking the 8th consecutive quarter of expansion. Private consumption and investments picked up. Furthermore, external demand and a debased yen continue to support exports, although imports are also on the rise due to higher commodity prices. In 2017 GDP grew 1.6%.

- **Japan's industrial production** in Dec **surged** 2.7% mom, up from 0.5% in Nov. Transport equipment and general purpose machinery were the hottest sectors, but the gains were broad-based.
- **Japan's government reconfirmed Haruhiko Kuroda at the helm of the BoJ** for a new 5-year term. In all likelihood monetary policy will continue to be ultra-loose for the foreseeable future.
- **Japan's core machinery orders** tumbled -11.9% mom in Dec reverting the 5.7% rise in Nov.
- **China's M2 money supply increased** 8.6% yoy in Jan vs 8.2% in Dec mostly due to the Lunar Year's seasonal effects.
- **FDI in China edged up** 0.3% yoy to CNY 80.36bn in Jan, vs CNY 73.94bn in Dec, which 9.2% lower than a year earlier.
- **India's inflation decelerated** slightly in Jan to 5.1% yoy from 5.2% in Dec, in the wake of higher rental allowances for civil servants, as well as food and fuel prices.
- **India's industrial production expanded** 7.1% yoy in Dec down from 8.8% in Nov.
- Less than a month after he championed free trade in Davos, **India's Prime Minister Modi hiked import duties** to their highest level in 30 years, igniting a trade war with major countries.
- **Malaysia's GDP expanded** 5.9% yoy in Q4 vs 6.2% in Q3 thanks to perky domestic demand and strong manufacturing, especially in electronics. In 2017 full-year growth reached 5.9%, from 4.2% in 2016.
- **Singapore's exports grew** 13% yoy in Jan vs 3.1% in Dec, boosted by a 20.7% yoy surge in non-electronic exports.

Bottom line: While the macroeconomic data confirm the global positive conjuncture, the sustainability of stock market valuations, despite last week rebound, remains in doubt. Going forward delicate political issues looms. Fiscal profligacy in the US, at a time when austerity was in order, might further disrupt the bond markets. In Germany the Grosse Koalition saga is far from over after the resignation of the SPD leader Schulz and the uncertain vote by party members to approve the deal with the CDU/CSU. French president Macron said Europe needed a "political overhaul" and "an ideological clarification" when the new EU Parliament is elected next year. He added that traditional political forces display internal "incoherencies", leaving space for "reformist" and "progressive" alternatives. Finally the result of the Italian general elections on Mar 4th could redirect the attention to the Eurozone's unresolved governance framework.

<u>Regional Developments</u>

- **Bahrain's non-oil sector grew** by 4.8% yoy during the first nine months of 2017, with overall growth registering 3.6% for the same period (vs. 3.2% the previous year). During the full year 2017, non-oil growth is forecast to exceed 2016's 4.0% pace, according to the Bahrain Economic Development Board.
- The value of tendered projects in **Bahrain**, as part of the **GCC Development Fund**, rose from USD 3.9bn to more than USD 4.1bn; the cumulative amount of money disbursed almost doubled to USD 1.4bn in Q4 2017 from USD 751mn a year earlier.
- **GDP** in **Egypt grew** by around 5.3% in Q2 of the 2017-18 fiscal year, from 3.8% in the same period a year before, according to the Planning Minister.
- **Egypt**'s central bank **cut interest rates**, for the first time since the currency float, by 100 bps: the overnight deposit rate was lowered to 17.75% from 18.75% and its overnight lending rate to 18.75% from 19.75%. The bank

had raised overnight rates by 700 bps since the pound was floated in Nov 2016.

- **Egypt** raised USD 4bn in a dollar-denominated **Eurobond sale** last week, raising the country's stock of international bonds rose to USD 16.64bn. The issuance, which had attracted USD 12bn in bids, would be used to boost central bank reserves according to the finance ministry.
- **Tax revenues** in **Egypt grew** by 61% yoy to EGP 248.8 (USD 14.1bn) in H1 of the 2017-18 fiscal year.
- **Unemployment rate** in **Egypt fell** to 11.3% in Q4 2017 from 12.4% in the same period a year earlier.
- **New investments** in **Egypt increased** by 20.8% yoy to EGP 5.2bn in Jan 2018, disclosed the Investment and International Cooperation Ministry. The number of new firms rose by 9.3% yoy to 1780 last month.
- **Remittances** from **Egypt**'s expatriates **surged** by 29.3% yoy in Dec to around USD 2.6bn, according to the central bank. Remittances have jumped by 19.2% to USD 29.1bn since the pound was floated in Nov 2016.
- **Egypt** has issued executive regulations that will **allow the private sector to import natural gas directly**. This law, along with the gas regulatory authority established last year, will allow private sector companies to import and distribute gas within the country – currently undertaken only by the government.
- **Egypt** is in funding talks with the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD) for **Cairo Metro project**. The line will be undertaken in 3 phases, at a cost of about USD 1bn.
- At the **Iraq reconstruction conference** in Kuwait last week, pledges of USD 30bn were received, mostly in credit facilities and investment. Ahead of the conference, officials had disclosed that rebuilding would cost around USD 88bn, with about USD 23bn required in the short term. **Gulf allies provided support**: Saudi

Arabia to provide USD 1bn through its Saudi Fund for Development and USD 500mn in export credit; Kuwait earmarked USD 1bn in loans to Iraq and committed another USD 1bn as investments; Qatar pledged USD 1bn in loans and investments while the UAE pledged USD 500mn (while highlighting efforts of the UAE's private sector investments in Iraq worth more than USD 5.5bn).

- **Iraq**, in a bid to expand refining capacity, needs USD 4bn for **new investments in its downstream oil industry**, according to the oil minister. This investment would raise refining capacity to 1.5mn barrels per day (bpd) by 2021, with 500k bpd earmarked for export.
- **Kuwait**'s National Assembly approved the proposal to amend the National Fund for Small and Medium Enterprises (**SMEs**) **Law**: with the amendment, the fund's role has been expanded such that it will sponsor projects rather than solely focusing on financing.
- The **IMF** continues to view **Lebanon**'s economic situation as fragile, given the slow GDP growth (1-1.5%), rising public debt (beyond 150% of GDP) and a persistent current account deficit (more than 20% of GDP) amidst higher vulnerabilities. *(More: http://www.imf.org/en/News/Articles/2018/02/12/ms021218-lebanon-staff-concluding-statement-of-the-2018-article-iv-mission)*
- **Fitch** affirmed **Lebanon**'s **long-term foreign-currency issuer default rating** at "B-" and maintained a stable outlook. A resilient banking sector and central bank regulations were the positive factors amidst concerns about "weak public finances, high political and security risks and anemic economic performance".
- The **Qatar Stock Exchange** plans **to list** some **5-8 SMEs this year** on its 'QE Venture Market', which is designed to attract smaller companies.
- **Saudi Arabia's central bank** has signed a deal with Ripple to use the latter's **blockchain technology** to instantly **settle payments** sent into and out of the

country, resulting in faster, cheaper and more transparent cross-border transactions.

- **Saudi Arabia** deposited SAR 2.2mn (USD 600mn), the third installment, into its **Citizen’s Account Program** in Feb; it is estimated that 46% of families and individuals have received their full allowance of SAR 934 as average support for each family in the third installment.
- The number of **foreign investors in Tadawul** more than doubled last year to over 120, according to Tadawul’s chairperson.
- **Saudi Arabia**’s energy ministry stated that Aramco’s **oil production** in Mar would be 100k barrels per day below Feb; crude exports will be kept below 7mn bpd in March as the country “remains focused on working down excess oil inventories”.
- The **Saudi Shura Council** is planning to discuss the Ministry of Labor and Social Development’s bill, which requires **payment of a monthly fee** (SAR 400) **for every expatriate employee**, given the financial burden imposed on SMEs.
- Further to a royal decree, a committee – headed by **Saudi Arabia**’s trade and investment minister – will create an inventory of all **delayed payments to the private sector**, and look into the reasons for said delay, and resolve the matter.
- According to the **Saudi** General Entertainment Authority, **consumer spending in the entertainment sector** is expected to touch SAR 36bn (USD 9.6bn) by 2030; estimates also indicate that the sector will generate 114k direct and 110k indirect jobs by 2030.
- **Oil producers** (including Saudi Arabia and Russia) plan to draft a **long-term alliance agreement** by end of this year, reported *The National* newspaper, quoting UAE’s energy minister.

UAE Focus

- The **Dubai Economy Tracker** in **reported the strongest improvement. In 5 month**s, thanks to faster output and employment growth. The Jan reading increased to 56 from the 14-month low of 54.7 in Dec. Sector-wise, wholesale & retail (index at 56.1) performed best, followed by travel & tourism (55.7) and construction (55.2). Linked to VAT, the rate of input price inflation accelerated to the highest since Oct 2011 while selling prices also rose at the fastest pace in 3 years.
- The **UAE has ruled out increasing VAT and excise taxes** over the next 5 years, revealed the Minister of State for Financial Affairs. He also confirmed that the ministry was working on **corporate tax** but at an early stage of preparatory work.
- The **value of fund transfers among UAE's banks** amounted to AED 604.33bn during Jan 2018, up by AED 60.9bn from Dec, according to central bank data. During 2017, total money transfers stood at AED 8.7trn, up 14.5% yoy.
- **Abu Dhabi**'s **Global Financial Market** Financial Services Regulatory Authority (FSRA) is considering creation of a **regulatory framework** for **virtual currency exchanges**. The FSRA already issued a Guidance on its regulatory approach to Initial Coin/Token Offerings and virtual currencies under the Financial Services and Markets Regulations on 9 Oct 2017.
- The Dubai Multi Commodities Centre (**DMCC**) has added "**Proprietary Trading in Crypto-commodities**" as a licensed activity within the free zone. All business plans require approval (given this is as yet an unregulated activity) and the setting up of exchanges and brokerage services are strictly not permitted in the DMCC.
- **Dubai World Central** welcomed 904,940 **passengers** in 2017, growing by 6.4% yoy. Supported by the easing of visa regulations for Russian visitors, Russia emerged as the single largest contributor to traffic from Eastern Europe with a growth of 955.4% yoy totaling 279,100

passengers last year.

- **UAE's Emirates** airline signed a contract to **buy USD 16bn worth A380 superjumbo aircrafts**, with deliveries to start as soon as 2020; **Airbus** would have end production of the A380 had this deal not come through.
- **Dubai** reported a 64% yoy increase in the number of **business events and international conferences** to 212 last year. This is estimated to have attracted about 95k participants and collected AED 715mn in revenues.
- **UAE hotels** saw an **occupancy rate** of 86.4% in Jan (up +1.5% yoy), according to STR Global, with both supply and demand rising by 3.6% and 5.5% respectively. Average daily rate fell 0.6% to AED 814.51 (USD 221.7), while revenue per available room improved 1.0% to AED 703.89 (USD 191.5).

Media Review

The mixed bag of Trump's economic policy

https://fee.org/articles/trump-s-economic-policy-is-a-mixed-bag

The US PE market in 12 charts

https://pitchbook.com/news/articles/detailing-the-us-pe-industry-in-12-charts

What Shaped the Stock Market's $3 Trillion Trauma

https://www.bloomberg.com/news/articles/2018-02-16/weak-hands-and-strong-shaped-stock-market-s-3-trillion-trauma

The Tech Race: China vs. America

https://www.economist.com/news/business/21737075-silicon-valley-may-not-hold-its-global-superiority-much-longer-how-does-chinese-tech

https://www.economist.com/blogs/graphicdetail/2018/02/daily-chart-11

Norway asks wealth fund to clarify risk from Saudi Aramco IPO

https://www.reuters.com/article/us-norway-swf-saudi-aramco/norway-asks-wealth-fund-to-clarify-risk-from-saudi-aramco-ipo-idUSKCN1FX1XG

The World's most miserable economies

https://www.bloomberg.com/news/articles/2018-02-14/most-miserable-economies-of-2018-stay-haunted-by-inflation-beast