

Weekly Economic Commentary – Feb 25, 2018

Markets

US and European equity markets faltered again at the start of last week, hit by disappointing earnings reports, but recovered towards the week's end closing almost unchanged. Meanwhile, Asian equities rallied on strong risk appetite and pulled also the emerging markets indices. In the fixed income market the US 2-year Treasury yield was at its highest in more than 9 years and the 10-year yield was close to 3% which is seen as a major threshold. Regional stock market (except Oman and UAE) benefited from the capital flows into emerging markets. The US dollar recovered from a three-year low, and the Bloomberg Dollar Spot Index, rose for five consecutive days (its longest daily gains sequence since Dec) and strengthened especially after the publication of the US FED meeting minutes which depicted a rosy picture of the US economy. Oil prices continued to rebound helped by another million barrel decline in US inventory and by the Saudi oil minister who asserted that: a) oil market inventories will keep declining and b) output cuts might ease in 2019 without affecting significantly oil prices. Gold prices ended the week on the back foot, while the volatility of gold futures touched a yearly record, as uncertainty over the dollar, higher bond yields and the path of the US rate hikes confounds traders.

Global Developments

US/Americas:

- **The minutes of the US Fed FOMC confirmed that the central bank is not envisaging an aggressive tightening** even though there was no consensus on the strength of current inflationary pressures. Most members forecast

higher growth due to accommodative financial conditions, better global conditions and recent tax changes. Most members believe that the improvement will push the neutral rate higher, while others ventilate that it might remain low in the absence of shifts in productivity growth, demographics, or demand for safe assets.

- **The IHS Markit US Composite PMI jumped** to 55.9 in Feb from 53.8 in Jan, the fastest rate of growth in almost 2.5 years, boosted by strong expansion in both manufacturing (55.9 vs 55.5 in Jan) and services (55.9 vs 53.3). Employment attained the top score since Aug 2015.
- **Existing-home sales in the US tumbled** in Jan by 3.2% mom (-4.8% yoy), most likely because fewer houses are available even though inventories went slightly up in Jan.
- **Sales of US new single-family houses shrank** by 9.3% mom to an annual rate of 625K in Dec from a 689K in Nov, which was the highest reading since Oct 2007.
- **The US Conference Board's Leading Indicators Index rose** 1% in Jan following a 0.6% increase in Dec with most components giving a positive contribution.
- **US initial claims for unemployment benefits fell** 7k to 222,000. The 4-week moving average slid 2,250 to 226,000. Continuing claims dropped 73,000 from the previous week's revised level to 1.875 million confirming that the US job market is tightening.

Europe:

- **The Minutes of the ECB's Governing Council** revealed that the hawks are demanding that the ECB underscores that the economy is in good health and that the commitment to boost the QE in case of a slowdown should be dropped. The ECB officials are concerned over the weakness of the dollar and fear that the US are deliberately trying to

engage in currency wars.

- **The IHS Markit Eurozone Manufacturing PMI touched a 4-month low** of 58.5 in Feb vs 59.6 in Jan, nevertheless the index shows that growth remains vibrant.
- **The IHS Markit Eurozone Services PMI fell** to 56.7 in Feb from 58 in Jan. Notwithstanding this minor hiccup, services are experiencing their best period of expansion in 7 years, jobs creation is at the highest in a decade and business optimism is on the rise.
- **The eurozone's consumer confidence index** in Feb **dropped** to 0.1, 1.3 below the 17-year high in Jan.
- **The eurozone's ZEW Indicator of Economic Sentiment declined** to 29.3 in Feb from 31.8 in Jan; 65.9% of the analysts surveyed expect stable economic activity in the coming 6 months and 31.7% expect an improvement.
- **The ZEW Indicator of Economic Sentiment for Germany** in Feb **fell** 6 points to 17.8.
- **The Ifo Business Climate Index for Germany** in Feb unexpectedly **fell** by 2.2 points to 115.4, the lowest reading since Jun, as the current conditions index fell to 126.3 from 127.8 in Jan and the gauge of future expectations unexpectedly plunged to 105.4 from 108.3. Most likely the drop is due to political uncertainty over the protracted negotiation to form a Große Koalition government.

Asia Pacific:

- **Japan's inflation rose** to 1.4% (0.4% mom) in Jan from 1.0% (0.2% mom) in Dec, the highest rate since Mar 2015, due primarily to a jump in food prices. However core inflation was 0.9% yoy in Jan, unchanged from Dec.
- **The Nikkei Japan Flash Manufacturing PMI retreated** to 54.0 in Feb from 54.8 in Jan. It was the first drop in 4 months.
- **The Trade Surplus in Japan decreased** to JPY 943bn in Jan from JPY 1,092bn a year earlier. Exports jumped 12.2%

yoy (the 14th straight month of gains) while imports rose 7.9% yoy.

- **Thailand's GDP expanded** by 0.5% qoq in Q4, half the rate in Q3, the weakest pace of expansion since Q2 2015.

Bottom line: The US Fed is upbeat on the economic outlook and the monetary policy normalization is likely to be more aggressive than markets anticipate especially if the inflation pick up (on which the FOMC members do not hold unanimous views) intensifies. So far both US stocks and bonds markets' reaction underscores a confidence that the Fed will be able to engineer a "painless normalization" i.e. higher rates and declining balance sheet without major disruptions to the economy and asset prices. On the other side of the Atlantic Draghi was visibly irritated by the US Treasury cavalier "weak dollar" attitude and reminded Washington the good practice of the international monetary system, which eschew the deliberate debasing of currencies.

Regional Developments

- **Bahrain** will proceed with implementing the **value-added tax**, revealed the finance minister, stating the "aim to have everything set up by the end of 2018".
- **Bahrain** has selected banks for a planned, upcoming **international bond issue**, reported *Reuters*. The same banks had previously helped arrange the country's bond issuances in Sep last year.
- The **Bahrain FinTech Bay** – a 10k sqft facility with co-working spaces for 30 start-ups – was launched last week. Separately, according to the chief executive of the Economic Development Board, **Bahrain** plans to establish a USD 100mn **venture capital 'fund of funds'** by next month.
- **Bahrain's** sovereign wealth fund **Mumtalakat** is in talks to invest in **Softbank's** private equity fund targeting the technology sector. Saudi PIF and Abu Dhabi's Mubadala have already invested in the fund.

- A new plan is in the offing to **boost Bahrain's SMEs' share of exports** to 20% in five years, from 8% currently. The plan will provide SMEs the right ecosystem, including supportive legal framework that includes the development of laws like bankruptcy and insolvency, as well as channels of financing and support for exports.
- **Egypt** plans to issue new USD 3-4bn **Eurobonds** in the next financial year (2018-19), revealed the deputy finance minister.
- **Iraq southern oil exports** stood at around 3.5mn barrels per day so far in Feb, reported *Reuters* Thurs last week citing oil industry officials.
- **Kuwait's** 2018-19 development plan includes 20 large **projects** worth nearly KWD 21.7bn, with around 55% of the projects in the oil sector, reported the Arabic language newspaper *Al-Nahar*.
- **Bank credit in Kuwait** continued to contract for the third consecutive month, slowing to a reported 3.2% yoy in Dec, according to the National Bank of Kuwait. Money supply (M2) growth accelerated to 3.8% yoy while bank reserves increased to KWD 5bn or 7.9% of bank assets.
- **Lebanon's foreign currency reserves** have risen to over USD 43bn, disclosed the central bank governor, after falling to about USD 41.5bn after Hariri announced his resignation in early Nov last year.
- **Lebanon** needs to pass the **2018 budget** before it can ask for support at upcoming donor conferences, stated the finance minister. He also said that the budget could be referred to the parliament for approval by end of the month.
- **Lebanon's** prime minister and the Investment Development Authority unveiled a USD 48mn **fund to support startup companies** involved in technology and software programming.
- **Oman will raise "sin taxes"** on tobacco, alcohol, soft drinks and energy drinks up to 100% from next Jun,

according to the National Tobacco Control Committee.

- **Oman's trade surplus** in the first 10 months of 2017 was OMR 1.5bn vs OMR 1.0bn in the same period of 2016.
- **Qatar's** Emir proposed last week that the Middle Eastern states should **forge a security pact** modelled on the EU. **Saudi Arabia's** foreign minister stated that Saudi had **no interest** in participating in such a regional security pact, while also stating that "we already have a structure in place" referring to the GCC bloc.
- **Qatar's** Commercial Bank has agreed in principle to **sell** its 40% **stake in** UAE-based **United Arab Bank** to UAE-based Tabarak Investment, reported *Reuters*.
- **Saudi Arabia** approved a **bankruptcy law**, taking a step further in the reform process already underway. Outlining bankruptcy procedures for settlements and liquidation for individuals, local and foreign companies, the law also has a provision whereby the approval of a debt restructuring deal could be achieved if at least two-thirds of creditors approved the plan.
- **Saudi women no longer need the permission of a male guardian to start their own business**, according to the ministry of commerce and investment.
- **Saudi Arabia's** finance ministry sold SAR 7.22bn (USD 1.93bn) of **domestic sukuk** in its monthly sale. Last month, the ministry had sold SAR 5.85bn of domestic sukuk.
- **Saudi Arabia's** oil minister stated that the **oil markets are rebalancing** and that inventories are expected to continue declining this year.
- US-based **augmented reality startup Magic Leap** is reportedly in talks with **Saudi Arabia's** Public Investment Fund for a USD 400mn investment, reported *FT*.
- **Non-Saudi households** are expected to **decrease domestic spending** by 13.5% over the period 2017-2020, given the impact of VAT, dependent fees, and the rise in utility prices, according to a new report by Al Rajhi Capital. Additional support for citizens mean that Saudi

household spending will grow by 8.2% to SAR 811bn in 2020.

- **Saudi Arabia** issued **12mn visas last year**: about 1.5mn were visit visas and around 0.5mn were business visas, reported the Arabic daily *Al-Watan*.
- **Saudi Arabia** moved up 5 places to 57 in the latest **Corruption Perception Index** compiled by Transparency International. Saudi ranks third in the region, behind UAE and Qatar, and scored 49 out of 100 – higher than the regional score of 33.
- 60% of Saudi and UAE respondents expressed rising **concern about data protection and data privacy compliance**, and 82% still do not have a plan in place to comply with the EU's General Data Protection Regulation which comes into force on 25 May this year, according to the third biennial EY Global Forensic Data Analytics Survey.

UAE Focus

- **Inflation in Dubai** increased to 2.7% in Jan from Dec's 1.5%; housing and utility costs fell by 0.7% yoy. Inflation is likely to pick up in the coming months given the introduction of VAT.
- **UAE foreign trade** touched AED 1.7trn (USD 462bn) in 2017, revealed the minister of economy.
- **Abu Dhabi's non-oil foreign trade** grew by 3.4% yoy to AED 159.9bn in 2017: non-oil exports were around AED 22.6bn, with re-exports touching AED 21.7bn and imports at AED 115.5bn.
- The **UAE** has announced a **new initiative** called "**100 days for Emiratisation in three fields**" – which aims at creating jobs for Emiratis in fields of communications, construction and property development, aviation and transportation.
- UAE-based banks' total assets surged to AED 2.693trn (USD 734bn) at end-2017 from AED 2.642trn by Q3 2017;

First Abu Dhabi bank assets touched USD 182bn by end of 2017.

- S&P Global Platts will use the **blockchain**-distributed ledger technology to allow market participants to submit **weekly oil storage data** to **Fujairah** Oil Industry Zone (Foiz) and the regulator, FEDCom. The Foiz hosts the Middle East's largest commercial storage capacity for refined oil products.
- New supply, geopolitical risks and VAT could result in a 10-15% decline in **Dubai real estate prices** over the next two years, according to **S&P**.
- Around 150 **projects** worth AED 82bn (USD 22.34bn) were registered in **Dubai** last year, and 90 were completed, according to the Dubai Land Department. Separately, according to industry sources, the real estate regulator is proposing that developers can launch **sales on off-plan projects** only after 50% of the construction has been completed.
- The value of **Dubai's external food trade** touched AED 70.2bn (USD 19.1bn) in Jan-Sep 2017: this comprises imports of AED 44.6bn, exports of AED 12.6bn and re-exports worth AED 12.9bn.
- The **Jebel Ali desalination project** is likely to cost around AED 800mn (USD 217.8mn) according to the head of Dubai Electricity and Water Authority. The project will use the reverse osmosis technology – a purification process which requires less energy to remove salt from water – to desalinate 40mn gallons of seawater per day by 2020.

Media Review

The US federal budget red ink

<http://federalbudgetinpictures.com/debt-projection-worsens/>

The death of low volatility strategies

<https://www.bloomberg.com/news/articles/2018-02-19/how-one-of-the-most-profitable-trades-of-the-last-few-years-blew-up-in-a-single-day>

Sustaining the GCC currency pegs: The need for collaboration

<https://www.brookings.edu/research/sustaining-the-gcc-currency-pegs-the-need-for-collaboration/>

UAE launches first fully-featured digital wallet

<http://wam.ae/en/details/1395302668463>

Disrupting the trust business

<https://www.economist.com/news/world-if/21724906-trust-business-little-noticed-huge-startups-deploying-blockchain-technology-threaten>

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