Weekly Economic Commentary – Mar 4, 2018

Markets

Last week two events took center stage: 1) the first congressional testimony by the new US Fed Chairman Powell and b) the opening salvo of a trade war by President Trump. Both triggered a negative reaction on Wall Street, and especially the second caused a rout also in all other major bourses, despite strong retail earnings that had lifted prices early in the week. Wall Street recorded three consecutive days of declines above 1% in wake of Trump's tariff announcement and the S&P500 ended Feb with the worst monthly drop (4%) since Jan 2016. European bourses, where blue chips are heavily dependent on export, suffered a wave of sell orders. In Asia, compounding the trade war tensions, a dismal PMI reading disarrayed Chinese indices. Regional markets felt the contagion from main stock exchanges especially Qatar, but others displayed quite robust gains. In bond markets the 10-year US Treasury yield retracted below 2.8% as a result of a flight to safety. The dollar index against a basket of six major currencies reached the highest level in 6 weeks, in the wake of Powell's testimony which reiterated the interest hike plan. Conversely, the yen strengthened as the Bank of Japan hinted at monetary tightening. Oil prices were not immune to the general turmoil and slid further, as data indicated a higher than expected buildup in US inventories. Surprisingly, despite such a frantic trading week in most asset classes, gold prices remained remarkably stable, an indication that the yellow metal is not considered a safe haven.

Global Developments

US/Americas:

- **President Trump announced** that the US will enact substantial **tariffs** on steel (25%) and aluminum (10%) following a commerce department's report asserting that those imports threaten national security. The fear of a trade war has sent shock waves worldwide.
- The **new US Fed Chairman Powell** in a congressional testimony stressed two main messages: (1) the rates hikes in 2018 and beyond will be gradual (as envisaged by his predecessor) and (2) the US economy will continue to expand without overheating.
- The **US PCE deflator increased** by 0.4% mom (1.7% yoy) in Jan vs 0.1% gain in Dec boosted by energy prices. Food prices increased 0.1% for the second consecutive month. Core PCE inflation was 1.5% yoy, the same as in Dec.
- **The US ISM manufacturing PMI** reached 60.8 in Feb, 1.7 point higher than in Jan. Most of the 18 industries surveyed only apparel, leather and allied products and furniture and related products declined. The employment index surged from 54.2 to 59.7.
- **US nominal disposable income soared** 0.9% in Jan compared to an average 0.3% monthly gain in Q4, thanks to the early effects of the tax cuts. Wages and salaries rose 0.5% vs 0.4% in Dec. **Nominal personal income** growth was stable at 0.4% mom in Jan.
- **US consumer confidence jumped** in Feb by 6.5 points to 130.8, its strongest mom gain in 11 months and top level since 2000. Improvement was notable in present situations and in economic expectations. Consumers were bullish on the job market while firms reported good current conditions. Average yearly inflation expectations rose by 0.1 point to 4.7%.
- **US Case-Shiller national house price index rose** 6.3% in Dec compared with 6.1% in Nov.
- **US new orders for durable manufactured goods tumbled** -3.7% mom in Jan vs a 2.6% gain in Dec. Marked weakness was recorded in the nondefense aircraft and defense segments. Core capital goods orders fell -0.2% mom,

while shipments gained 0.2% and shipments in core capital goods 0.1%.

- The **US goods trade deficit widened** to USD 74.4bn, from USD 72.3bn in Dec. Goods exports fell -2.2% mom and imports -0.5% mom.
- The **US wholesale inventories surged** 0.7% mom in Jan vs 0.6% in Dec.
- **US initial jobless insurance claims decreased** by 10k to 210K, the lowest since Dec 1969. The 4-week average fell by 5,000 to 220.5K (also the lowest since 1969).
- **US real personal spending fell** -0.1% mom in Jan after growing 0.2% and 0.5% in the last two months of 2017. Durable goods spending dived, nondurable goods spending was stable, service spending grew weakly.
- **Brazil's GDP rose** 2.1% yoy in Q4 vs 1.4% in Q3, corroborating the view that the recovery is firming.

Europe:

- **Annual Eurozone inflation slowed** to 1.2% in Feb, from 1.3% in Jan thanks to lower energy inflation and tumbling fresh food inflation. Core inflation was stable at 1%.
- The **Eurozone's economic confidence indicator** in Feb **fell** slightly to 114.1 from 114.9, following a similar drop in Jan. Confidence remains high by historical comparison and hovers close to the 17-year high touched in Dec. All main sectors fell except for services. Confidence rose in Italy and the Netherlands, but fell in Germany, France and Spain.
- **German inflation slowed** to 1.4% yoy in Feb from 1.6% in Jan.
- **German retail sales sunk** -0.7% (2.3% yoy) mom in Jan, after a -1.1% (0.2% yoy) drop in Dec, foiling consensus expectations of a 0.7% rise. German consumers are not opening their wallets.
- The referendum among the German SPD rank and file

members **approved the Grosse Koalition agreement** with the Christian Democrats, paving the way for Chancellor Merkel's 4th consecutive term.

Asia Pacific:

- **China's official PMI lost** 1 point in Feb falling to 50.3. Sentiment about production and new orders drove the decline, probably due to Lunar New Year effect. Business activity expectations improved, while manufacturing output was down almost 3 points at 50.7 and new orders fell 1.6 points to 51. The last time the index approached 50 (the divide between growth and contraction) it was in Aug 2016.
- The **official Non-Manufacturing PMI in China fell** to 50.3 in Feb from 51.3 in Jan. Employment and orders in hand remained in contractionary territory 49.6 from 49.4 and 43.8 from 44.4, respectively.
- **Japan's industrial production plunged** -6.6% mom (2.7% yoy) in Jan after the 2.9% gain in Dec and three consecutive gains in the final months of 2017. The worse performance were recorded in transport and electrical production.
- **Japan's retail sales shrunk** by 1.8% mom (1.6% yoy) in Jan with losses broad-based, but notable in general merchandise and autos.
- **Japan's consumer confidence slipped** in Feb 0.4 point to 44.3, with mixed results across the various categories.
- **Japan's unemployment rate dipped** to 2.4% in Jan from 2.8% in Dec, the lowest level since Apr 1993. However the jobs-to-applicants ratio stayed at 1.59%, confirming the worst labour shortage in 40 years.
- **India's GDP growth accelerated** to 7.2% yoy in Q4 from 6.5% in Q3. Consumption was the main driver, but investments are rebounding after years of stagnation thanks to a clean up in the banks' balance sheets.
- **Hong Kong's GDP grew** 0.8% qoq (3.4% yoy) in Q4 vs 0.5%

qoq (3.7% yoy) in Q3, pulled by exports which offset a decline in government spending and sluggish private consumption. Growth for 2017 was 3.8%, the fastest pace in 6 years.

Bottom line: As we have repeatedly pointed out, US asset valuations do not look particularly attractive and US corporate balance sheets are increasingly stretched. Therefore the worst monthly drop on Wall Street since Jan 2016 highlights the fragility of financial markets and could be <u>the harbinger of a transition from a low volatility bull market to a high volatility bear market.</u> While the global economic situation is relatively solid some minor (for now) cracks have emerged last week in China (PMI), Japan (industrial production) and the US (new orders and real spending). Politics remains a source of uncertainty globally. In the US, the investigations into the alleged relations between Trump and Russia feed a poisonous climate; in China the elimination of term limits for the President is considered a step back towards a more authoritarian rule; in Europe, the debate on European reforms is still unresolved and the results of Italian general election could open a new fault line within the EU. A precious good news came from Germany, where the SPD and the CDU-CSU more than 5 months after the elections will form a new coalition government with a minutely detailed agenda.

<u>Regional Developments</u>

- **Fitch downgraded Bahrain** to BB- from BB+ previously, citing the lack of a clear “medium-term strategy” to reduce high deficits. Fitch projects government debt/GDP to rise above 100% in the medium term and places fiscal break-even at close to USD 100 per barrel.
- **Bahrain** awarded BHD 143.4mn (USD 378mn) worth projects in Jan this year; three projects will cover the roads sector, seven the sanitary sector and two the construction sector.

- **Saudi Aramco** agreed **to supply Egyptian refineries** with 500k barrels of crude oil per month for six months, starting Jan 2018, according to Egypt’s petroleum minister.
- **Egypt**’s **new customs law** is likely to be presented to the parliament soon: new law **reduces the combined tax on capital equipment** to 2% instead of the current 5%, and reduces the duration of the temporary permit system to one year instead of two, among others.
- **Egypt**’s government will publish a **timetable of the state-controlled/ governmental IPOs** for the Egyptian Exchange this week, according to the deputy minister of finance for financial policies. The expectation from these listings is for market capitalisation to be raised to 50-60% of GDP (from 20-21% currently).
- **Iraq**’s **crude oil exports** from its southern ports **fell** to 3.426mn barrels per day (bpd) in Feb, according to the oil ministry. Exports generated USD 5.7bn in revenues, at a price of USD 60.137 per barrel.
- **Remittances into Jordan increased** by 4% yoy to USD 308.2mn in Jan, as per the central bank
- **Jordan** launched a **new mobile money initiative** – Mobile Money for Resilience – targeting low-income Jordanians and refugees, to focus on financially empowering these vulnerable groups by providing access to more advanced digital financial services, such as payment transfers, savings and credit.
- **Renewable energy projects** in **Jordan** provided the national power grid with 402 megawatts of electricity in 2017, revealed the energy minister. This is expected to increase to 1700 MW by 2019.
- **Kuwait** government has proposed a **re-evaluation** of the new **health fees** stipulated for **expatriates**: a committee has been formed to conduct the study which will highlight both negative and positive aspects of the fee increase, while also responding to questions raised by hospitals and health centres.

- **S&P** Global Ratings affirmed **Lebanon**'s "B-/B" ratings with a stable outlook, citing "deposit inflows will remain sufficient to support Lebanon's large twin-deficits" while cautioning about the high general government debt burden.
- **Lebanon**'s **2018 budget** will likely be approved by cabinet before mid-Mar, disclosed the country's finance minister; he also stated that reducing the deficit and a set of incentives to prop up growth are focus points.
- **Demand for properties** in **Lebanon increased** by 13.7% to 47.6 points in 2017, as per the Byblos Bank Real Estate Demand Index. However, the index's average monthly score last year was 56.7% below the annual peak of 109.8 points posted in 2010.
- **Total bank loans and financing in Oman grew**4% yoy to OMR 23.55bn at end of 2017 compared to OMR 22.13bn a year earlier. The average interest rates on bank loans grew to 5% at the end of 2017 from 4.8% in the same period in 2016. Private sector deposits (including Islamic windows) at end 2017 stood at OMR 13.94bn, 5.2% higher than OMR 13.25bn at end 2016.
- **Total foreign assets at the Central Bank of Oman** declined 20.6% yoy to OMR 6.18bn at end 2017.
- **Qatar** central bank's **international reserves and foreign currency liquidity** increased to USD 37.7bn in Jan (Dec: USD 37.6bn).
- **Saudi Arabia**'s Debt Management Office disclosed that it is **expanding the refinancing of a USD 10bn international loan** to raise USD 16bn due to strong demand, and also that a "significant" Islamic tranche would be introduced to the transaction.
- **Inflation** in **Saudi Arabia** was 3% yoy and by 3.9% mom in Jan, thanks to the introduction of VAT and hike in domestic fuel prices. Food and beverage prices grew by 6.7% yoy, restaurants and hotels gained 5.8%, and transport costs soared 10.5%.
- **Saudi Arabia**'s **net foreign assets edged down** by 5.8% yoy

to USD 486.7bn in Jan (Dec: USD 488.9bn). There was a shift in the composition of reserves: foreign securities shrank by USD 5.4bn to USD 326.5bn, its lowest level for at least five years while the portion held in deposits at banks abroad rose by USD 2.4bn to USD 103.2bn, the highest level in a year.

- **Saudi Arabia**'s General Investment Authority (SAGIA) announced the **extension of the licensing period for foreign investors** to five years from one year at present.
- **Saudi Arabia** reshuffled top military posts last week, with no reasons given for the removal of key officials; changes also included the appointment a female deputy labour minister.
- **Saudi Arabia** approved **regulations for licensing cinemas** in the country. Three licenses were specified: setting up a cinema hall, license for operating cinemas, and license for operating both kinds of mobile and fixed cinemas.
- S&P forecasts that **sovereign borrowings in the MENA region would decrease** by 6% yoy to USD 181bn this year, largely due to fiscal consolidation measures alongside the slight uptick in oil prices. According to their estimates, Egypt remains the largest borrower with USD 46.4bn, or 26% of the region's gross commercial long-term borrowing, followed by Iraq (USD 35bn or 19% of the total) and Saudi Arabia (USD 31bn or 17%).
- **Middle East sovereign wealth funds** are investing more in **alternative assets** (including real estate, infrastructure, private equity, hedge funds and commodities), according to a PwC-World Gold Council report: over the 5-year period to 2016, SWFs from the region have increased their average allocation to the alternative asset class to 6.1% of total assets (from 3.7%) while their average target allocation rose to 8.6% (from 6.5%). This however pales in comparison to the global allocation of funds allocated to alternative

assets at 23%.

- The **HSBC Expat Explorer** survey results place **Dubai** at the top of the MENA region in terms of average salary for expats. With salary at USD 138,177 per annum, the city ranked 11th among top 30 global cities, in a list that was topped by Mumbai (USD 217,165). Around 72% of Dubai expats claimed to have more disposable income here than back home.
- **OPEC output fell** in Feb to a 10-month low, revealed a Reuters survey, with the countries pumping 32.28mn barrels per day (bpd), down 70,000 bpd from Jan. The biggest decrease in supply came from the UAE, where output was down by 50k bpd, followed by Libya (output fell by 30k bpd).

UAE Focus

- **UAE's** Federal Tax Authority announced that businesses late in **registering** with the authority would be **exempt from administrative penalties** until Apr 30. About 260k companies had registered for VAT, versus an expected 350k entities.
- The UAE central bank and the Federal Tax Authority signed a MoU last week to facilitate **tax collection through the UAE Funds Transfer System:** this would permit transfer of payments electronically via the taxpayers' bank accounts.
- **UAE will not hike federal fees for the next three years**, disclosed Dubai's Ruler, with the aim of improving economic and social stability.
- **Total currency assets** held by the **UAE** central bank **increased** by 12.1% yoy to AED 326bn in Jan this year, thanks to the rise in current account balances and deposits with banks abroad.
- **Normalisation of interest rates** remains one of the main **challenges for investors**, according to a senior **ADIA** official (from the Strategy and Planning department).

- **Dubai International airport** welcomed 7.96mn passengers in Jan (-1% yoy), from fewer flights compared to a year ago. Passenger numbers were also affected by the fact that Chinese New Year was celebrated in Jan last year versus in Feb this year.
- **Indian nationals** bought **properties** worth AED 83.65bn (USD 22.7bn) in **Dubai** during the 2013-17 period.
- The **Dubai Gold and Commodities Exchange** reported its best month ever in Feb, trading its highest **monthly volume** of 2,097,739 contracts (+67% yoy) valued at USD 47.0bn.
- **Etihad Rail** is planning to begin the **second phase** of the **UAE federal railway network** – which will connect UAE's seaports and the first phase. Project management and engineering consultants will be appointed to start the tendering process for construction, according to officials, though no details were provided about a timeline either for tendering or contract awards.

Media Review

US debt held by foreign entities

https://www.federalbudgetinpictures.com/u-s-debt-held-foreign-entities/

China will curb one trillion of money market funds

https://www.bloomberg.com/news/articles/2018-02-28/china-is-said-to-plan-curbs-on-1-trillion-in-money-market-funds

Economists vs. Scientists on long-term growth

https://www.project-syndicate.org/commentary/artificial-intelligence-long-term-economic-growth-by-kenneth-rogoff-2018-03

Theresa May's latest Brexit speech: a more conciliatory tone

https://www.economist.com/news/britain/21737938-prime-minister-makes-some-small-concessions-soft-brexiteers-missing-details-her

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