

Weekly Economic Commentary – May 6, 2018

Markets

So far over 80% of the companies included in the S&P 500 have reported Q1 profits above estimates, and profits are at their highest in 7 years according to FactSet. Nevertheless, investors on Wall Street are not encouraged by such bullish signals and feel that the cycle is coming to an end. Already, last week, it took some disappointing earnings reports combined with worrisome inflation data and lackluster payroll figures to send the main indices down. All other bourses in Asia, and in emerging markets followed the US lead, except Europe, where for the second week in a row stock prices advanced significantly despite the S&P 500 slide. Almost all regional markets ended in the red, with contagion from emerging market blues and uncertainty over the Iran nuclear deal. Tensions pushed up the USD, with Dollar Index hitting a high for the year and exceeding the 200-day moving average for first time since May 2017. Oil prices continued their relentless climb despite crude oil inventories rising 6.2 mb and smashing analyst predictions of an 840,000-barrel build. Counter-intuitively, the gold price lost ground again despite higher inflation in the US and geopolitical risks. In essence, gold prices lately have been negatively correlated with the USD's fluctuations.

Global Developments

US/Americas:

- **The US Fed kept the fed funds rate target range unchanged** at 1.5%-1.75%. Despite minor changes to the statement, the Fed did not dispel the idea that rates will be hiked again in Jun, Sep and Dec. The statement

underscored confidence that inflation will hit the “symmetric” 2% objective over the medium term, which implies that a rate slightly above 2% will be considered acceptable.

- **US non-farm payrolls** in Apr **rose** by 164,000 units up from 135,000 in Mar. The result is at the low end of expectations, but the unemployment rate fell to 3.9%, a rate last seen in 2000, as a consequence of a contraction in the labor force.
- **The US ISM manufacturing index fell** from 59.3 in Mar to 57.3 in Apr the lowest since Jul 2017, but well into expansionary territory. **The ISM nonmanufacturing PMI index fell** 2 points to 56.8 in Apr.
- **The US PCE deflator rose** by 2% yoy (0% mom) in Mar vs 1.7% yoy in Feb and Jan. The core PCE deflator increased 1.9% yoy (0.2% mom) in Mar vs 1.6% (0.2% mom) in Feb.
- **US nominal personal income increased** 0.3% mom in Mar, the same as in Feb. Nominal disposable income growth was also steady at 0.3% mom in Mar, while real disposable income growth accelerated from 0.1% in Feb to 0.2% in Mar. Wages and salaries rose by 0.2% in Mar, vs 0.4% in Feb. The **personal saving rate declined** to 3.1% in Mar from 3.3% in Feb
- **US real consumer spending grew** 0.4% mom in Mar after falling -0.2% in Feb and 0.1% in Jan. Durable goods spending led growth, but nondurable and service spending also grew at a healthy pace. Prices were almost flat, so nominal spending grew 0.4% as well.
- **US non-farm productivity in Q1 increased** 0.7% yoy vs 0% in Q4 as output rose 2.8% yoy and hours worked advanced 2.1%. Unit labor costs rose 2.7% yoy which will soon push up the inflation rate.
- The **US trade deficit narrowed** substantially in March, from USD 57.7bn (the highest since Oct 2008) to USD 49bn, thanks to a USD 7.5bn fall in the goods deficit. Exports increased 2% mom while imports fell -1.8%, as the one-off effect of payments for the 2018 Winter

Olympics broadcasting rights subsided.

- **US initial claims for unemployment benefits rose** 2,000 to 211,000. The 4-week moving average fell 7,750 to 221,500 the record low since Mar 3 1973. Continuing claims fell 77,000 to 1.756 mn.
- **Argentina's central bank stunned the markets** by raising three times in 8 days its policy rate to 40%, in an attempt to stave off the speculation against the peso and fight inflation that exceeds 25%.

Europe:

- **Eurozone GDP growth declined** to 0.4% qoq (2.5% yoy) in Q1 vs 0.7% (2.8% yoy) in Q4. Some one-off factors, including bad weather, played a role in the slowdown, but it is unlikely that 2018 will match the performance of 2017.
- **Eurozone inflation decelerated** to 1.2% yoy in Apr from 1.3% in Mar. Core inflation fell to 0.7% yoy from 1% in Mar due to plunge in the services index to 1% yoy, from 1.5%, caused by Easter seasonal effects. Food and energy inflation rose strongly and core goods prices were also quite perky.
- **Retail sales in the Eurozone increased** by only 0.1% mom (0.8% yoy) in Mar down from 0.3% (1.8% yoy) in Feb, mostly due to sluggish non-food spending.
- **German inflation was unchanged** at 1.6% yoy in Apr.
- **German retail sales in Mar unexpectedly plunged** -0.6% mom (-1.1% yoy) vs -0.2% in Feb (1.4% yoy), marking the first yoy contraction since mid-2014.

Asia Pacific:

- **China's official Caixin manufacturing PMI** stood at 51.1 in Apr, almost **unchanged** from 51.0 in Mar.
- **Japan's consumer confidence index** in Apr was **down** to 43.6, down 0.6 point from Mar with all major sub-components on the back foot, especially employment

prospects.

- **South Korean inflation rebounded** to 1.6% yoy in Apr from 1.3% in Mar.

Bottom line: The sustained and synchronised cycle of global growth appears more fragile going into the summer and this will inevitably call into questions the expectations of a weak dollar, a firming recovery in the Eurozone and sustained growth across emerging markets which has underpinned the investment strategy of large asset managers so far. In short, as the Fed's quantitative tightening intensifies, the reduction in financial system liquidity, alongside a stronger dollar, will tighten financial conditions globally, hitting hard indebted emerging markets. In fact US Treasury yields are being pushed up by the fiscal stimulus, a tightening jobs market and rate hikes by the Fed. It is anybody's guess what will be the effects in a world with a global debt of USD164tn (half issued by the US, Japan and China) at 225% of global GDP, which has eclipsed the peak of the financial crisis a decade ago.

Regional Developments

- **The IMF forecasts growth in the MENA region at 3.2% this year**, from an estimated 2.2% in 2017. The region is yet to benefit from the global recovery, and for oil-exporting countries, more effort and reforms are needed to diversify away from oil. Accelerating structural reforms – improve the business environment, labour market and education reforms, strengthening governance and transparency etc. – are key for stronger recovery.
- **Bahrain's GDP grew** by 3.9% in 2017 (2016: 3.2%), with the non-oil economy growing at a much-faster 5%. Private sector growth was supported by tourism, a strong pipeline of infrastructure projects, as well as a record year for foreign direct investment (+161% yoy to USD733mn). Separately, **the IMF called for the country to accelerate fiscal adjustment** to reduce the budget

deficit, given the low level of buffers versus its regional counterparts.

- **Egypt's net foreign reserves increased** to USD 44.03bn at end-Apr, from USD 42.611bn at end-Mar.
- **PMI in Egypt edged up to 50.1** in Apr (Mar: 49.2), crossing the 50-threshold for only the second time in 31 months, as output stabilised and total new orders grew, amidst an ease in input cost inflation (weakest since May 2015).
- **Saudi Arabia's investments in Egypt** touched USD 6.3bn in 2017 (from over 4274 projects) amounting to over 22% of total Arab investments in the country. According to Egypt's trade and industry minister, Egypt has invested about USD 1.1bn in Saudi Arabia (over 1043 projects) last year.
- **Egypt's parliament will begin budget discussions this week:** the draft estimates revenues of EGP 770bn (vs. EGP 624bn this fiscal year), expenditures are set to EGP 1.4trn and expected deficit is at 8.4%.
- **Egypt's money supply (M2) growth accelerated** by 21.85% yoy to EGP 3.34trn in Mar (Feb: 25.4%).
- **Egypt's central bank governor disclosed that Kuwait had agreed "in principle" to renew USD 4bn in deposits.**
- **Iraq's crude oil exports** (from the southern ports) averaged 3.34mn barrels per day (bpd) in Apr, reported Reuters. This is lower than Mar's 3.45mn bpd, largely due to maintenance works at the loading terminals, according to sources.
- **Fitch affirmed Kuwait's AA rating** with a stable outlook, citing its fiscal strength and one of the lowest breakeven oil prices among oil-exporters.
- **Kuwait accounts for about 6% of all global Islamic banking assets**, according to a central bank official. He also stated that conventional banks held more than 60% of the total banking assets in the country.
- **Lebanon's private sector performance continued to slide** in Apr: the BLOM PMI slipped to 46.2 in Apr 2018, as

regional tensions led to a drop in the firms' future output expectations to an 11-month low.

- **Lebanon needs to narrow its “unsustainable” budget deficit gap** and work on structural reforms to grow the economy, according to the **IMF**. Currently, the economy is growing at a sluggish 2-2.5%.
- **Oman's nominal GDP edged up** by 8% qoq in Q4 recording OMR 27.75bn versus OMR 25.69bn in Q3, driven mainly by hydrocarbons revenues.
- **Oman's** conventional banks' total outstanding **credit disbursement** grew 5.6% yoy at the end of Feb with **credit to the private sector** up by 4%. Conventional banks' overall investments in securities grew by 11.7% to OMR 3.4 bn. Investment in Government Treasury Bills stood at OMR 1.35 bn.
- The total value of **Oman's real estate transactions** in Q1 increased by 6.8% qoq to OMR 776.3mn vs OMR 726.8mn in the same period of last year.
- **Qatar PMI fell to 51 in Apr**, down from 52.5 in Mar, with new order growth easing while purchase price inflation softened to an 8-month low. The Qatar Financial Centre, which has been collecting PMI data since Apr 2017, released this information publicly for the first time.
- **Qatar's central banks sold** QAR 1.5bn (USD 399.98mn) of Treasury bills; this compares to last month's QAR 1bn sale.
- **Qatar** central bank's **international reserves and foreign currency liquidity edged up** in Mar, rising to USD 37.8bn from Feb's 37.6bn.
- **Saudi Arabia's PMI** reading **dipped** to 51.4 in Apr (Mar: 52.8), as output growth and new orders deteriorated (the contraction in demand for goods & services was the first ever recorded since the survey's inception in Aug 2009); employment however ticked up.
- **Saudi Arabia plans to become one of the top 20 nations in ease of doing business by 2020** (it currently ranks 92 out of 190 countries in the World Bank's Doing Business

report). The head of SAGIA highlighted the new arbitration and insolvency laws, the efficiency of the Kingdom's ports, and the ease and speed of getting a business visa as steps towards achieving this goal.

- **Saudi Arabia is on track to reduce its budget deficit** to 7% of GDP this year, stated the finance minister. According to him, Q1 showed "significant progress" in raising non-oil revenues, and savings in spending totaled SAR 12bn.
- **Saudi Arabia Monetary Authority total assets declined** by 3.1% yoy to SAR 1.91 trn (USD 520bn) in Mar 2018, largely owing to a 7.5% dip in investments in securities abroad.
- **Saudi Arabia's Capital Market Authority** disclosed that there are **140 qualified foreign investors** in the market, with 40 registering in Q1.
- The Chairman of Saudi Arabia's **Capital Market Authority** warned investors of the **dangers of "speculative" cryptocurrencies** – very often a "source of fraud". He underscored meanwhile that the **blockchain technology** behind it can be **"truly transformational"**.
- The head of **Saudi Arabia's debt office** stated at a conference that though **able to issue long-dated bonds** (like 50- or 100-year bonds), they are **not "keen to take that step at the moment"**.
- The **Saudi** government will **transfer ownership of the financial district** in Riyadh to the Finance ministry (from the Public Pension Agency), with the PIF having operating rights, reported Reuters, citing sources aware of the matter. It was also reported that the government was planning to commit SAR 2.3bn (USD 613.3mn) to complete the project, including existing payment claims.
- An independent external audit of **Aramco's proven oil reserves showed a higher than previously reported number**, according to Reuters. The audit found proven oil reserves to be at least 270bn barrels, higher than the 260.8bn barrels reported in its 2016 annual review.

- **The number of jobseekers in Saudi Arabia declined** by 11.8% qoq to 1.09mn in Q4 2017, with females accounting for 84% of job seekers, according to the General Authority for Statistics. The **average monthly wage for Saudi employees decreased** slightly to SAR 9,939 (USD 2650.4) while the pay gap rose to SAR 1165.
- **Around 466k expats left on exit visas from Saudi Arabia in Q4 2017**, according to the General Authority for Statistics. There were a total of 3.16mn Saudi employees in the public and private sector combined, while the number of expat employees fell to 10.42mn in 2017 from 2016's 10.88mn.
- **Saudi Arabia published draft rules for foreign insurers and reinsurers** wanting to establish branches in the country. It however remains unclear whether a local partner would be required for foreign insurers looking to set up branches: currently, foreign insurers need to establish fully capitalised subsidiaries or own a limited share of a local insurance businesses.
- **MENA IPO activity was relatively slow in Q1 this year**, with 6 deals (-45.5% yoy) raising USD 629.6mn (+57.1%), according to EY. Of the six deals, five were real estate investment trusts (REITs) in Saudi Arabia, while Egypt had one IPO in the financial services sector.
- **Spending on blockchain solutions in Middle East and Africa** is predicted to more than double to USD 80.8mn by end-2018 from USD 38.9mn spent in 2017, according to a report from IDC.

UAE Focus

- **UAE PMI increased to a 34-month high** of 55.1 in Apr (Mar: 54.8), thanks to stronger output, new orders and recovery in job creation.
- **Inflation in Abu Dhabi was higher** at 3.9% in Q1 2017, with the Mar reading at 2.7% yoy and -1.0% mom. Inflation was largely due to the 10% pickup in transport

costs, contributing 35.7% of the overall increase in the CPI.

- Dubai launched the **Dubai Blockchain Business Registry Project**, the first blockchain-enabled trade license repository, to store and update company registration information issued by DED as well as the free zone authorities in Dubai. Dubai Silicon Oasis will be the first free zone to implement the pilot project
- **Abu Dhabi** financial free zone's regulator **Financial Services Regulatory Authority (FSRA)** has issued a **consultation paper proposing a new set of rules to oversee spot crypto asset activities** including the buying and selling of crypto assets. (The paper can be accessed at: <https://www.adgm.com/doing-business/adgm-legal-framework/public-consultations/2018/consultation-paper-no-2-of-2018-introduction-of-crypto-asset-regulatory-framework-in-adgm/>)
- **Bank loans in the UAE** grew by 2% yoy to AED 1.61trn in Mar; loans to the private sector grew by 4% yoy while to the government loans, were up by 2%.
- The **UAE** cabinet adopted a **law** to introduce the **VAT Reversed Charge mechanism for investors in gold, diamond and precious metals**. This exemption for wholesale has not been extended to the retail segment.
- **Price of petrol in the UAE increased** in May: the latest upward revision sees prices increase between 6.8-6.9% depending on the type of petrol. Diesel prices have been revised upward to AED 2.56 (USD 0.70) per litre from AED 2.43 per litre last month.
- **Two Dubai free zones** – Dubai Airport Free Zone Authority (Dafza) and Dubai Silicon Oasis Authority – are **considering a reduction in fees and other costs** to be more competitive and attract more foreign companies.
- **Passenger traffic at the Dubai International Airport increased** by 4.5% yoy in Mar to 7.85mn passengers, bringing the year-to-date to 22.7mn (+1.1%).

- The **UAE hospitality sector** contributed more than AED 150bn to GDP (~4.6% of GDP) and supported 570k jobs (4.8% of total) last year, according to a Knight Frank – Oxford Economics report.
- The **value of retail sales in Dubai** is expected to reach USD 43.8bn by 2021, while the retail market is projected to grow at an average 5.6% over the 2018-2021 period, reported UAE news agency Wam.

Media Review

Artificial Intelligence is not human enough

<http://businessweekme.com/2018/04/26/programming-human-factor-ai/>

Life after easy money

<https://www.ssga.com/global/en/our-insights/publications/cios-view-life-after-easy-money.html>

Trump's Normal Fed

<https://www.project-syndicate.org/commentary/donald-trump-federal-reserve-appointees-by-kenneth-rogooff-2018-05>

The 2017 results for Mubadala

<https://www.swfinstitute.org/swf-news/mubadala-releases-2017-results/>

Does the US gain from trade: a symposium by the AEA

<https://www.aeaweb.org/issues/507>

Growth improves in the MENA region: IMF

<http://www.imf.org/en/Publications/REO/MECA/Issues/2018/04/24/mreo0518>

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