

Weekly Economic Commentary – May 20, 2018

Markets

Last week trading on global equity markets started peacefully but by Wed a frenzy propagated due to security concerns in the Middle East, increasing risks in several emerging markets (mainly Turkey and Argentina), tumbling Italian assets (as a new populist government seems ready for a fight with the EU), Trump describing China as “very spoiled on trade” and a step back in the peace process between the two Koreas. Moreover, US macro data beat expectations and renewed worries that the US Fed might be more hawkish than anticipated. Government bonds were hit by a wave of selling orders which lifted the 10-year Treasury yield above 3.1%, a level last seen in 2011. The spread between the US and German 10-y government bonds widened to 250 bps. The contagion from Wall Street was more severe on emerging markets shares, while the bourses in Europe and Japan withstood the impact. In our region, stock markets of oil producing countries were mostly up or unchanged (with the exception of Oman affected by the US withdrawal from the Iran nuclear deal) in response to higher oil prices, while the other bourses were hit by the global weakness. In currency markets the US dollar continued to advance on major crosses pulled by higher long term interest rates. The oil price uptrend intensified after US crude oil inventories fell by 1.4 m/b and the Brent came within striking distance from USD 80 per barrel. The gold price, despite geopolitical tensions, fell sharply below USD 1300 per ounce.

Global Developments

US/Americas:

- **US industrial production growth was 0.7% mom (+3.5% yoy)**

in Apr, **the same pace** as in Mar (3.7% yoy), thanks to positive performances in all sectors. Mining gained 1.1% mom (thanks to hydrocarbons' extraction) and manufacturing advanced 0.5%. Utilities output was pushed up by cold weather (1.9% mom).

- **US retail sales rose** 0.3% mom in Apr vs 0.8% in Mar, pushed by apparel stores, gasoline stations, miscellaneous store retailers and furniture. Unusually cold weather may have affected some sectors like restaurants and sporting goods.
- **Housing starts in the US plunged** -3.7% mom to an annualized rate of 1.287 mn in Apr, erasing the 3.6% rise in Mar, due to a deep contraction in multi-family buildings.
- **Building permits in the US in Apr dropped** -1.8% mom to a s.a. annual rate of 1.352 mn, vs a 4.1% increase mom in Mar.
- **US business inventories were almost flat** in Mar after two gains of 0.6% mom in Jan and Feb. Wholesalers' and manufacturers' stockpiles added 0.3% mom, while retailers' fell -0.5%.
- **The US Conference Board's Leading Indicators Index rose** 0.4% mom in Apr following a similar increase in Mar. Only two components, building permits and stock prices displayed a decline.
- **US initial claims for unemployment benefits rose** 11,000 to 222,000, still close to historical lows. The 4-week moving average fell 2,750 to 213,250, the lowest level since Dec 1969. Continuing claims dropped 87,000 to 1.707 mn.
- **Inflation in Buenos Aires increased** 2.6% mom in Apr, after 2.5% in Mar and 2.6% a year earlier. Thus Argentina's inflation is likely to have exceeded 25% yoy in Apr, the highest since Apr 2017, accompanying the precipitous tumble of the Peso.

Europe:

- **Eurozone's inflation slowed** to 1.2% in Apr from 1.3% in Mar. Core inflation came down to 0.7% yoy from 1.0% in Mar.
- **Eurozone industrial production rose** by 0.5% mom (3.0% yoy) in Mar, offsetting in part the -0.9% drop (+2.6% yoy) in Feb. The pull came from durable and nondurable consumer goods but capital and intermediate goods output continued to fall.
- **The Eurozone's trade surplus shrank** to EUR 26.9bn in Mar from EUR 28.5bn a year earlier. Both exports and imports retreated from record highs.
- **The ZEW Indicator of Economic Sentiment for the Eurozone increased** to 2.4 in May from 1.9 in Apr. In May, 62.0% of the respondents expected no changes in economic activity over the next 6 months, 20.2% expect improvement while 17.8% are bracing for a worsening.
- **German GDP expanded** only 0.3% qoq (2.3% yoy) in Q1, half the pace in Q4 (2.9% yoy), a low since Q3 2016, due to weaker trade and a fall in government spending.
- **Germany's inflation receded** to 1.5% yoy in Apr, from 1.6% in Mar. Excluding energy prices, the inflation rate was 1.6% yoy vs 1.7% in Mar.
- **The German ZEW Indicator of Economic Sentiment was flat** at -8.2 in May, the lowest reading since Nov 2012. The current situation components lost 0.5 points to end at 87.4.
- **Russia's GDP grew** by 1.3% yoy in Q1 vs 0.9% in Q4. It was the sixth consecutive quarter of expansion after 2 years of recession.

Asia Pacific:

- After 8 quarters of growth, **Japan's real GDP fell** -0.2% qoq (-0.6% yoy) in Q1, down from 0.1% (0.6% yoy) in Q4 (growth was revised down from 1.6% yoy). Nominal GDP fell -0.4% qoq, mostly due to dwindling domestic demand, as both consumption and investments were flat.

- **Japan's inflation retreated** to 0.6% yoy (-0.4% mom) in Apr from 1.1% (-0.4% mom) in Mar, the lowest rate since last Nov, as food and transport inflation crawled back. Core inflation rate, ex fresh food, eased to 0.7% yoy from 0.9% in Mar, the lowest since Sep 2017.
- **Core machinery orders in Japan tumbled** -3.9% mom in Mar compared to a 2.1% mom jump in Feb, hit by a slump in manufacturing and private sector orders.
- **China's industrial production gained** 7% yoy in Apr vs 6% Mar, driven by automotives and electronics.
- **China's retail sales** in Apr grew 9.4% yoy vs 10.1% in Mar.
- **China's fixed assets investments increased** 7% yoy (0.5% mom) in the first 4 months of 2018, down from 7.5% rise in Q1. Growth in both public investment (6.5% vs 7.1% in Q1) and private investment (8.4% from 8.9%) slowed down.
- **Foreign direct investments into China increased** by 0.1% yoy to CNY 286.78 bn in Jan to April 2018. In April alone, FDI declined by -1.1% yoy to CNY 59.24 bn.
- **Malaysian GDP in Q1 rose** 5.4% yoy vs 5.9% in Q4 All components recorded healthy growth and manufacturing, thanks to tech demand, expanded by 5.3%.

Bottom line: US macro data confirms that the economy is proceeding at cruising speed, inflation is heating up and the labor market is tight. However major economies both in Asia and Europe are losing steam, in particular Germany (influencing the entire Eurozone) and Japan where inflation remains stubbornly low. China's figures were a mixed bag, as the transition to a modern consumption led economy continues at snail pace. The broad picture is confirmed by the OECD composite leading indicator which eased to 100 in Mar from 100.1 in Feb. Meanwhile anxiety surrounds vulnerable emerging markets which could be severely impacted by the normalization of US interest rates. The most vulnerable are those, like Argentina and Turkey, with large current account imbalances that therefore require large capital inflows to sustain their

growth and service their external debt.

Regional Developments

- **Bahrain's net foreign assets fell to a 7-month low of BHD 533.2mn (USD 1.41bn) in Mar (Feb: BHD 604.8bn).** The central bank's reserves totaled close to BHD 2bn before 2014, when oil prices began to plunge.
- **Egypt's GDP grew by 5.4% yoy in Jan-Mar 2018 (Q3 of the 2017-18 fiscal year) – the best growth rate in 7 years,** according to the planning minister – from 4.3% growth recorded in the same period a year ago, supported by the implementation of economic reforms.
- **Unemployment rate in Egypt declined to 10.6% in Q1 2018,** compared to 11.3% recorded in Q4 2017, thanks to a decline in the labour force (-0.3% qoq to 29.2mn) and in the number of unemployed persons (-6.5% qoq to 3.1mn). The percentage of unemployed youth (15-29 years old) was 75.2% of the total unemployment rate.
- **Egypt's central bank governor was quoted by state newspaper Al-Ahram stating that foreign inflows had exceeded USD 120bn** since its currency was floated in Nov 2016. He also disclosed that a debt payment of USD 850mn would be made to international oil companies, without mentioning when.
- **Egypt's central bank left its main interest rates unchanged:** deposit rate remains at 16.75% and the overnight lending rate at 17.75%.
- **The IMF is on track to approve the payment of a further USD 2bn of a USD 12bn loan to Egypt,** as the country begins to “reap the benefits of its ambitious and politically difficult economic reform program”.
- **Exports from Egypt increased to USD 4.5bn in Jan-Feb 2018,** and compares to the USD 4bn recorded in the same period a year ago. Exports to the top 5 importers (UAE, China, Saudi Arabia, Turkey and Italy), at USD 1.598bn, accounted for 35.5% of total exports.

- **Protests continued** earlier in the week following the **more than tripling of some Cairo metro fares**. From a base fare of EGP 2 before, base fares were increased to EGP 3 or USD 0.17 for the 1st 9 stops and EGP 5 and 7 for up to 16 and more than 16 stops respectively. According to the state news agency, the metro system has accumulated losses of EGP 618.6mn (USD 35mn).
- **Investments in Egypt's automotive industry** totaled about USD 3bn, according to the trade minister. There are about 170 companies in this space, with 19 involved directly in the manufacturing and assembling of vehicles while the others manufacture car components.
- **Iraq's parliamentary election results are in**: a political bloc led by Shia cleric Muqtada al-Sadr (a long-term adversary of the US) won, with the bloc headed by the incumbent PM managing only third place.
- According to **Jordan's deputy PM**, the **new amendments to the Income Tax Law** will “effectively” combat tax evasion and enhance collection as it seeks to expand the taxpayer base to include 10% instead of 5% of its citizens.
- **Jordan-based startup Liwwa**, a **peer-to-peer lending platform**, announced the **issuance of over USD \$11mn in debt to small businesses** across more than 300 loans since its operations started in 2015.
- **Kuwait will not implement value added tax (VAT) before 2021**, disclosed the parliament's budget committee. However, it will expedite the introduction of excise taxes on select products like tobacco and energy drinks – no details about timeline were provided. The new excise tax is expected to boost revenues by KWD 200mn (USD 662.6mn).
- **Lebanon completed the USD 5.5bn debt swap** with the central bank (i.e. issuing Eurobonds to the central bank in exchange for Lebanese pound T Bills), according to the finance minister, aiming to achieve its foreign currency financing needs until end-2018.

- The Central Bank of **Oman**'s narrow money stock **M1 registered a marginal drop** of -0.7% yoy to OMR 5bn by end of Feb, while **quasi-money** witnessed a growth of 5.5% yoy. Broad money supply **M2** grew by 3.5% yoy to OMR 16.4 bn.
- **Commercial banks' private deposits in Oman rose** by 0.85% yoy to OMR 12.5bn by the end of Feb.
- **Saudi Arabia's crude oil exports fell** to 7.122mn barrels per day (bpd) in Mar from 7.251mn bpd in Feb.
- **S&P Dow Jones**, which ranks **Saudi Arabia** as a "standalone country", is consulting investors on whether to upgrade the nation to emerging market status. S&P Dow Jones estimated Saudi Arabia could ultimately have a 2.57% weighting in its emerging benchmark index (excluding the potential privatisation of Aramco).
- **Saudi Aramco's trading arm has started supplying US condensate** – an ultra-light crude oil – to the UAE, reported Reuters, citing unnamed sources. Aramco sells almost all its crude under long-term contracts, but decided last year to trade in non-Saudi crude in the short-term spot market.
- **Saudi British Bank and Alawwal Bank have agreed on a merger** – the first major banking tie-up in almost 20 years – and will create Saudi's third largest bank with assets around USD 77bn.
- **Saudi Arabia** has announced that **females holding a foreign or international driving license** will be exempted from the driving test for beginners.
- The **Saudi energy minister** reiterated commitment towards market stability and **assured adequate oil supply to support global economic growth** on growing concerns over disruptions to Iranian oil exports and plummeting output in Venezuela. So far, the OPEC has stated it saw no need to ease output restrictions despite global stocks falling to its desired levels.

- **UAE is expected to post a fiscal surplus** of about 0.5% of GDP this year, and a slightly higher 1% of GDP next year, according to the IMF. This is as a result of the higher-than-expected oil prices which offset an increase in government spending. Oil prices are estimated to come down below USD 60 per barrel.
- **Changes are in the pipeline for Abu Dhabi's residency regulations**, reported the state news agency WAM: the moves are likely to encourage expats to invest in the capital. Some of the expected changes include amendments to residency regulations for retirees, longer residency visas, new types of visas and longer student visas.
- **Dubai's Jebel Ali Free Zone** (Jafza) generated 29.4mn metric tonnes of **trade** last year, valued at USD 83.1bn (up +4%), accounting for 23% of total value of Dubai's trade and 70% of Dubai's free zone trade. Over 77% of Jafza's trade volume was generated by three sectors, oil and gas, foodstuff, livestock and agricultural products, and metal, steel and construction material.
- The **UAE Cabinet approved a resolution on VAT refunds for exhibitions and conferences**, in a bid to support the country's status as a meetings, incentives, conferences and exhibitions (MICE) hub. As per recent statistics, MICE's annual contribution to UAE economy stood at AED 2.39bn and is anticipated to grow to AED 5.1bn by 2020.
- **Dubai Financial Services Authority** (DFSA) announced an **expansion of the Innovation Testing License (ITL)** programme (which was launched in May 2017). Six companies have formed a new Cohort (Cohort 1) and have already begun the ITL application process, which includes the development of a regulatory test plan describing the proposed business model, product or service.
- A **Dubai Chamber of Commerce and Industry survey** revealed **robust trade in 2018** to be supported by price competition, accessibility and global demand. They respondents identified efficiency and cost cutting, e-

commerce, supply chain management, use of market information and product diversification as key areas to improve their operations.

- **Technological improvements** are likely to bridge the existing USD 1.5trn trade finance gap, according to DMCC's 'The Future of Trade'
- **Bilateral trade between the UAE and India is expected to reach USD 100bn by 2020**, disclosed the director of Investment Promotion in Dubai Investment Development Agency. India has been ranked as the second largest investor in Dubai over the last three years, including in the property sector.
- The **Islamic economy generated 8.3% of Dubai's GDP in 2016**, rising from 7.6% in 2014, according to the Dubai Statistics Centre.
- **Electronic media outlets** including news websites, digital content providers and social media influencers who are paid for promotions **need to register their activities** by end of the month, as per the National Media Council of the UAE. Licensing fees range from AED 1,000 (USD 272) up to AED 15k, depending on the category.

Media Review

Price earnings valuation for developed and emerging markets
<https://www.topdowncharts.com/single-post/2018/05/16/Global-Equity-Valuations-Big-changes-but-some-things-stay-the-same>

How Bahrain is driving Islamic fintech forward

<http://cpifinancial.net/features/post/44980/how-bahrain-is-driving-islamic-fintech-forward>

The Sanctions Standoff: Project Syndicate

<https://www.project-syndicate.org/bigpicture/the-sanctions-standoff>

Iraq's elections results & US policy

<https://www.brookings.edu/blog/order-from-chaos/2018/05/18/what-iraqs-election-results-mean-for-u-s-policy-there/>

The winners & losers from \$80 a barrel crude

<https://www.ft.com/content/8f7bd948-5a89-11e8-bdb7-f6677d2e1ce8>

500 days and a billion barrels of lost oil pushes crude to \$80
<https://www.reuters.com/article/us-oil-barrels/graphic-500-days-and-a-billion-barrels-of-lost-oil-pushes-crude-to-80-idUSKCN1II1QD>

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