

# Weekly Economic Commentary – Jul 8, 2018

## Markets

Last week US equity markets started sluggishly due to the 4th of July long weekend, but when traders came back to work they set aside the trade war worries and focused on strong macro data (above all the US non-farm payroll) pushing the main indices firmly in positive territory. In Europe the main indices gained throughout the week thanks in part to a rebound in the automotive sector. However, in Asia the mood was verging on panic with the Shanghai bourse (the world's worst performer in 2018) at a minimum since Jan 2017 and losing 4% during the week. Even the Japanese Topix despite a rebound on Friday, recorded heavy losses. The broader emerging markets suffered contagion from the Chinese syndrome and the contagion extended to regional markets (where oil prices also depressed the mood) with the exception of Qatar and Bahrain (the latter still benefiting from the announced rescue package). In currency markets, the euro made a comeback vis à vis the dollar, in the wake of strong data from Germany for the first time this year; the yuan suffered its largest ever monthly fall against the dollar in Jun, but the Chinese central bank last week intervened successfully to support the exchange rate. Oil prices dropped as US crude inventories unexpectedly increased by 1.245 mn barrel, but after a 9.9 mn barrel decline in the previous week (the deepest plunge since Sep 2016); also talks of larger Saudi output (strongly advocated by Trump) contributed to the fall. Gold prices remained essentially stable at the lower end of the trading range.

## Global Developments

### **US/Americas:**

- **The US non-farm payrolls rose** 213,000 units in Jun, vs 244,000 in May, topping the rosiest forecasts. The best figures came from professional and business services, manufacturing, and health care, while employment in retail trade declined. The unemployment rate rose to 4.0% from 3.8% in May as hopes of finding a job induced more people, previously discouraged, to re-enter the labor force. In 2018 the payroll on average added more than 200,000 jobs a month.
- **The US FED's FOMC minutes** noted that the US economy is in good shape, but **underlined the risk to macro stability** stemming from higher custom duties. The flattening of the yield curve was deemed mostly as inconsequential.
- **The US ISM manufacturing index advanced** from 58.7 in May to 60.2 in Jun. Supplier deliveries soared from 62 to 68.2, while other subcomponents were mixed, as new orders and employment both slipped, while the production index gained substantially.
- **Factory orders in the US rose** 0.4% mom in May after a -0.8% drop in Apr. Core capital goods orders rose 0.3% mom.
- **The US recorded a lower trade deficit** of USD 43.1bn in May vs USD 46.1bn in Apr. It was the lowest figure since Oct 2016 thanks to exports rising 1.9% to a record high and imports rising only 0.4%. The goods trade deficit with China surged 18.7% to USD 33.2 bn.
- **US initial claims for unemployment benefits increased** by 3,000 to 231,000. The 4-week moving average went up by 2,250 to 224,500. Continuing claims increased by 32,000 to 1.739 mn, remaining anyway close to historical lows.
- **US imposed custom duties on USD 34bn worth of Chinese imports** starting last Friday.
- **Industrial production in Brazil collapsed** -10.9% mom in May, vs. a 0.8% gain in Apr. It was the worst performance since Dec 2008, caused by a series of truckers' strikes.

## Europe:

- **Retail sales in the Eurozone rose 1.4% yoy** in May after 1.7% in Apr. A -1% mom decline in non-food spending was the main cause of the slowdown.
- The **Eurozone's unemployment rate was unchanged** at 8.4% in May. Among member countries the best performances were recorded in Germany and Holland, but also laggards like Italy saw an improvement.
- **German industrial production rose** by 2.6% mom in May, following a -1.3% fall in Apr. It was the steepest mom increase since Nov with output surging for consumer (6.5%), and intermediate goods (3%). Also, energy production gained 0.8% and construction 3.1%.
- **German industrial orders rose** by 2.6% mom in May, wiping out the drops of -1.6% in Apr and -1.1% in Mar. It was the first rise in 2018, thanks to a 4.3% surge in domestic orders and a 1.6% in foreign orders. Orders from the Eurozone rose 6.7%, mom while those from the rest of the world fell by -1.3%.
- **UK PM Theresa May** assured that Britain will remain closely bound to the EU single market and customs union, fending off the Eurosceptic opposition to her "soft Brexit" strategy.
- **Turkish inflation soared** to 15.4% yoy in Jun from 12.1% in May (three times the central bank's target) the highest figure since Jan 2004 as a result of the sharp lira devaluation.

## Asia Pacific:

- **The Caixin China Manufacturing PMI was almost steady** at 51.0 in Jun from 51.1 in May. Operating conditions are improving as output rose the most in 4 months and new orders increased moderately. New export sales fell for the third month in a row, optimism over future conditions dropped to a 6-month low and employment declined the most since Jul 2017.

- **The Caixin China General Composite PMI increased** to 53.0 in Jun from 52.3 in May the highest reading since Feb, as the services sector expanded at the strongest pace in 4 months (53.9 vs 52.9 in May) and manufacturing PMI was buoyant (51.0 vs 51.1).
- **The Bank of Japan Tankan business sentiment index** for large manufacturers **fell** to 21 in Q2 from 24 in Q1 to mark the second quarter of decline from a recent peak of 26 in Jan.
- **Household spending in Japan tumbled** -3.9% yoy in May three times worse than the -1.3% drop in Apr. It was the fourth consecutive yoy drop.
- **The Leading Economic Index in Japan crawled up** to 106.9 in May from 106.20 in Apr.
- **The Nikkei India Manufacturing PMI rose to a 6-month record** of 53.1 in Jun from 51.2 in May. Both output and new orders increased at the fastest pace in 2018 and new order growth picked up to its fastest rate since Feb.
- **South Korean inflation** in June was 1.5% yoy for the second month in a row. Excluding fresh food and energy, consumer prices were up 1.2% yoy, down from 1.4% in the prior 3 months.
- **South Korean current account surplus rose** to USD 8.7bn in May from USD 5.9bn a year earlier. The goods account surplus widened to USD 11.39bn vs USD 8.6bn a year earlier, while the services account deficit widened to USD 2.1bn USD 1.64bn in May 2017.
- **Inflation in Taiwan retreated** in Jun to 1.3% yoy from 1.6% in May. Tobacco prices are still impacted by the increase in the cigarette tax, while fuel prices are pushed higher by global crude prices.

**Bottom line: Tensions generated by stolid protectionist tactics show no sign of abating and furthermore the classic signs of a late-cycle in the US are increasingly evident: productive capacity struggles to keep up with demand, wage growth accelerates, prices go up and the central bank tightens**

its policy. When the impact hits corporate profit margins, equity prices enter a bear phase. In Europe there would be much more room for further expansion, but it is doubtful that its growth rate could decouple from the US performance. China is once again hitting a bump on the road to its transition. Stocks remain under pressure and sentiment has turned negative awaiting the impact of the custom duties. The central bank has belatedly propped up the renminbi, but many suspect that the depreciation is being used as a weapon in the trade war.

### Regional Developments

- **Bahrain's net foreign assets at the central bank fell** by 13.9% mom to BHD 671.1mn (USD 1.78bn) in May (worth roughly 40 days of imports); the net foreign assets of the central bank and retail banks sank to minus BHD 526.1mn – a record low.
- **The value of Bahrain-origin exports declined** by 4% yoy to BHD 1818mn (USD 474mn) in May; the value of imports also declined by 3% to BHD 489mn.
- **Egypt's GDP grew by 5.4% yoy in 2017-18 fiscal year** (2016-17: 4.2%), posting the fastest growth rate in over a decade, disclosed the country's new PM.
- **PMI in Egypt edged up** to 49.4 in Jun (May: 49.2), but still below the 50-point mark, as output contracted for the second consecutive month.
- **The IMF praised Egypt in its 3rd review but urged that tight monetary policy be maintained** to avoid inflation. The central bank had refrained from raising rates as the latest round of subsidy cuts rekindled inflation worries.
- **Egypt posted a primary budget surplus for the first time in 15 years:** the country reported a 0.2% primary budget surplus, worth EGP 4mn (USD 223mn) in its 2017-2018 fiscal year. Primary budget figures do not factor in interest payments on government debt.
- **Egypt's foreign reserves increased** to USD 44.258bn at

end-Jun, from USD 44.139bn a month ago, according to the central bank.

- **Egypt owed USD 1.2bn to foreign oil companies at the end of Jun** – the lowest amount since 2010 – according to the petroleum minister.
- **Egypt's finance ministry is in discussion with the central bank to activate the secondary market for trading government bonds** on the Egyptian stock exchange, revealed the finance minister.
- **Iraq's oil exports from the southern ports averaged 3.521mn barrels per day (bpd) in Jun**, above the May average, according to the oil ministry. In May, the nation exported 3.49mn bpd of crude oil.
- **Jordan reiterated its commitment to the IMF-supervised reform plan**, with its finance minister also stating that the nation needs around JOD 5bn annually in financing to cover debt and Eurobonds.
- **The European Investment Bank (EIB) is currently studying 15 projects in Jordan, and has allocated investments worth EUR 850mn** towards a few sectors including water, sewage, public transport, and renewable energy.
- **Kuwait's cabinet rejected the proposal to tax expats' remittances**. The government has included the **value-added tax (VAT) bill on its priorities' list** during the parliamentary term, which begins in Oct.
- **The Kuwait Investment Authority will adopt a new strategy in the management of cash** of the State's Public Reserve Fund, focusing on short-term investment of assets and investments to facilitate withdrawals from this reserve, reported *Al Jaridah* This is to safeguard the liquidity of the General Reserve Fund.
- **Kuwait's crude oil exports to Japan fell 9% yoy to 6.3mn barrels**, or 203k barrels per day, in May, registering the first decline in two months. Saudi Arabia continues as Japan's top oil supplier, with imports up to 1.14mn bpd (+1.0% yoy), followed by UAE with 618k bpd (-0.6%).
- **A total of 1629 expatriate workers were removed from**

**State department jobs in Kuwait during H1 2018.** This compares to a total 666 non-Kuwaiti employees last year.

- **The IMF estimated a further uptick in Oman's non-oil sector real growth** over the medium term to 4% and projected a narrower deficit to GDP ratio of 4% of over the next 2 years.
- **Qatar's GDP increased by 1.4% yoy to QAR 199.2bn in Q1 this year**, though shrinking by 3.6% from the previous quarter. The nominal gross value added estimate of mining and quarrying activities grew by 4.3% yoy to an estimated QAR 51.07bn in Q1.
- **Qatar's central bank sold QAR 800mn (USD 220mn) of Treasury bills** in its monthly auction, though yields dropped compared to the previous sale.
- **Saudi Arabia's GDP grew 1.2% yoy in Q1 this year helped by higher oil prices**; this compares to a 0.8% decline in Q1 2017.
- **Saudi Arabia's PMI posted a 6-month high reading of 55.0 in Jun** (Apr: 53.2), supported by new order growth to 58.7 (the fastest rate in 6 months) and an acceleration in output to 59.1 (at the strongest pace since Dec 2017).
- **Saudi Arabia's international reserves picked up 1% yoy to SAR 1.892trn (USD 517bn) in May.**
- **Saudi Arabia pumped 10.488mn barrels per day (bpd) of crude oil in Jun**, an increase of 458k bpd from May's reported level, and supplied 10.579mn.
- **Non-oil exports from Saudi Arabia grew by 26.5% yoy to SAR 19.6bn in Apr** while oil exports surged 33.4% to SAR 68.9bn. Total exports rose by 31.8% yoy and 8.8% mom to SR 88.5bn.
- **Total unemployment rate for Saudis (15+ years) increased to a record 12.9% in Q1**, though the quarter also reported a slight decline in the unemployment rate of female Saudis to 30.9% (Q4 2017: 31%). Employed expats decreased to 10.18mn (Q4 2017: 10.42mn; Q1 2017: 10.85mn). **Economic participation rate for the overall**

**population in Saudi Arabia** grew to 55.5% in Q1 this year, versus 55.6% in Q4 2017.

- **Saudi Aramco plans to change the formula used to price its long-term crude oil sales to Asia** starting from Oct. This is the first change in benchmarks for its official selling prices since the mid-1980s. The formula will be based on the average settlement prices for the DME Dec Oman contract and the Dec Dubai cash price assessed by Platts (both set in Oct).
- **Saudi Arabia's** sovereign wealth fund, Public Investment Fund (PIF), announced taking up a 15.2% **direct stake in ACWA Power**, a developer and operator of power and water plants.
- **Local tourism trips in Saudi Arabia** reached 44.5mn in 2017, with total spend of around SAR 47.9bn (USD 12.7bn), according to the Saudi Commission for Tourism and National Heritage.
- **IMF approved a USD 249mn loan tranche to Tunisia** as part of the economic reform program, bringing total disbursements to USD 1.14bn of a total USD 2.9bn. With inflation touching record levels since 1990 (reaching 7.7% yoy in Apr), the central bank hiked rate by 100bps to 6.75% in Jun.

## **UAE Focus**

- **UAE's PMI increased to 57.1 in Jun** (May: 56.5), supported by a 7-month high in output growth (64 in Jun vs. 62.1 in May) and stronger growth in new orders (63 vs. 62.8). Business confidence hit a fresh-survey high though purchasing activity growth eased to a two-year low.
- **UAE's Federal Tax Authority added three new free zones** – Al Ain International Airport Free Zone, Al Bateen Executive Airport Free Zone in Abu Dhabi, and International Humanitarian City – Jebel Ali in Dubai – **to the list of designated zones that will be exempt from**



**the 5% VAT.**

- **The UAE central bank withdrew AED 7bn (USD 1.9bn) of surplus liquidity from the market during May** – this follows an injection of AED 16.1bn in Apr.
- **Interbank fund transfers through the UAE Fund Transfer System, UAEFTS, touched AED 2.8trn (USD 762bn) in Jan-May this year.** The gross value was at AED 6.9trn for the full year 2017.
- **Over 12 million cheques worth AED 592bn were passed through the UAE cheque clearing system in H1 2018;** nearly 4.3% of the cheques, worth AED 26.2bn, bounced during this period.
- **UAE-China bilateral trade** grew by 15.1% yoy to USD 53.3bn in 2017: re-exports were up 37.4% to USD 3.5bn while imports grew by 14.7% to USD 48.3bn.
- **Dubai approved the new Human Resource Law,** which introduces a new “working from afar” option to work remotely, as well as more days off for certain grades, and ticket allowances for children up to the age of 21 (as opposed to 18 before).
- **New businesses and companies can be setup in the UAE in just 15 minutes now** through the ‘Bashr’ online platform: the service is currently available only in Ras Al Khaimah, Fujairah and Ajman for registering onshore companies.
- **The Ruler of Ajman issued a decree to reduce tourism fee to 7%** from 10% previously, effective 1 Jul 2018 to 31 Dec 2018.
- **Real estate transactions in Dubai touched AED 111bn in H12018** from a total of 27,642 transactions: this includes 18,191 sales worth about AED 40bn, 7,668 mortgage transactions worth over AED 57.6bn, and 1,783 other transactions valued at AED 13.4bn.
- **Passenger traffic through the Dubai International Airport fell** for the second month in May, down 3.8% yoy to 6.6mn persons; the number of flights at the airport also fell 5.6% to 32,620. Passenger traffic is down 0.1%

to 36.9mn during the Jan-May period.

### **Media Review**

**The GCC stock market could soon be added in the MSCI emerging market index**

<https://www.ft.com/content/709f7ad0-7df1-11e8-8e67-1e1a0846c475>

**Saudi Arabia dilemma on oil production boost**

<https://www.bloomberg.com/news/articles/2018-07-02/saudis-weight-lure-of-higher-oil-prices-with-u-s-call-for-more>

**Saudi Aramco's \$2 Trillion Zombie IPO: will investors buy into this valuation?**

<https://www.bloomberg.com/news/articles/2018-07-07/saudi-aramco-s-2-trillion-zombie-ipo>

**A bull's case for oil**

<http://www.goldmansachs.com/our-thinking/pages/bulls-case-for-oil.html>

**The selloff in the Chinese stock market**

<https://www.wsj.com/articles/this-years-selloff-in-chinese-markets-isnt-like-2015-it-looks-worse-1530869403>

**McKinsey Has a Plan for Lebanon's Economy**

<https://www.bloomberg.com/news/articles/2018-07-06/banking-to-cannabis-mckinsey-has-a-plan-for-lebanon-s-economy>

**Globalization in reverse**

<https://www.wsj.com/articles/as-trade-barriers-go-up-global-supply-chains-unravel-1530100987>

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