Weekly Economic Commentary – Oct 7, 2018

<u>Markets</u>

Last week Canada's decision to sign up to the USMCA, the revamped NAFTA deal with the US and Mexico initially propped up US stock markets and put the S&P 500 within striking distance of a record high. But by the end of the week the mood turned sour and Wall Street sold-off sharply. A similar dynamics developed also in Japan and more markedly in Euroland, where bank shares reacted negatively to concerns over the Italian budget and the risks it raises for the euro. In emerging markets, the sell-off intensified as rising US Treasury yields and escalating trade and political tensions between the US and China sapped investors' sentiment. Indian shares were particularly hit as the RBI refrained from a rate hike. Regional bourses felt the contagion of other emerging markets and ended mostly in the red despite rising oil prices. The U.S 10-year yield broke through the 3.11% resistance level to shoot to a 7 year high. In currency markets the euro was kept under pressure as the Italian budget saga evoked fears of a massive sovereign default. The oil price was on a roll despite Russia and KSA increasing production by one million barrel and US crude oil inventories increasing by 8mn barrels, smashing analyst predictions of a 877,000-barrel increase. The gold price edged up but remain trapped near multi-year lows as investors shrugged off fears of inflation and recession.

<u>Global Developments</u>

US/Americas:

- **US non-farm payrolls increased** by 134,000 in Sep, after rising by 270,000 in Aug. It is the lowest reading in a year, probably distorted by the effects of Hurricane Florence. Job gains were mainly in professional and business services, in health care, and in transportation and warehousing.

- **US, Canada and Mexico** reached a **trilateral trade agreement** that will replace the NAFTA and will be known as the US Mexico Canada Agreement (USMCA).
- **The US ISM manufacturing index declined** from 61.3 in Aug to 59.8 in Sep, still quite buoyant. New orders fell but remain perky. Production, employment and trade indices improved slightly. The supplier deliveries index dropped from 64.5 to 61.1 and the inventory index crawled back.
- **The ISM non-manufacturing index increased** from 58.5 to 61.6 in Sep. All major components, business activity, new orders and employment performed well.
- **The US Fed President Powell** in a speech underlined that monetary policy aims to maintain inflation around current levels and that a more aggressive stance is hardly warranted.
- The **US monthly trade deficit widened** in Aug by USD 3.2bn to USD 53.2bn, a 6-month high. Net exports will be a substantial drag on Q3 GDP growth.
- **US initial claims for unemployment benefits fell** by 8,000 to 207,000 after a spike due to Hurricane Florence. The 4-week moving average increased by 500 to 207,000 and continuing claims fell from 1.663mn to 1.650mn, near historical lows.

Europe:

- **The Eurozone's unemployment rate retreated** to 8.1% in Aug, from 8.2% in Jul, its lowest since Nov 2008, thanks mainly to a substantial fall in Italy's jobless rate.
- **Retail sales in the Eurozone dropped** -0.2% mom in Aug exacerbating a -0.6% decline in Jul, much below expectations. The dismal performance was attributed to lower sales of food, drinks, tobacco and automotive fuel (-0.6% vs -1.5%). Non-food trade was unchanged.
- **The budget proposal by the Italian government** confirms a

target of 2.4% in the **deficit** to GDP ratio for 2019, but unlike the preliminary version the ratio for 2020 and 2021 will be lower (2.1% and 1.8%). The EU Commission promptly criticised the target which as yet lacks any convincing analysis.

- **German industrial orders rose** 2% mom in Aug (smashing the market consensus of 0.5%), more than offsetting a -0.9% drop in Jul. It was the first rise in 3 months, as a consequence of a 5.8% jump in foreign demand. New orders from other countries surged 11.1%, while from the Eurozone declined -2.2%.
- **German retail sales** in Aug **dropped** -0.1% mom (1.2% yoy), adding to a -1.1% drop in Jul (0.9% yoy).
- The **Russian GDP expanded** by 1.9% yoy in Q2 thanks to higher oil prices (49% yoy).

Asia Pacific:

- **The Bank of Japan's Tankan index for big manufacturers' sentiment fell** to +19 in Q3 from +21 in Q2. It was the third consecutive drop, caused by rising raw material prices and the consequences of natural disasters that disrupted production.
- **Japan's Consumer confidence index gained** a paltry 0.1 pts to 43.4 in Sep over Aug.
- The **People's Bank of China cut the reserve requirement ratio** (RRR) by one percentage point, releasing incremental funds of about CNY 750bn (USD 109bn).
- The **Reserve Bank of India kept its repo rate unchanged** at 6.5%, against expectations of a 25bp hike necessary to counter the devaluation of the rupee.
- The **Nikkei India Manufacturing PMI advanced** to 52.2 in Sep from a 3-month low of 51.7 in Aug. New orders were boosted by both domestic and foreign demand, while output rose for the 14th month in a row.
- **Industrial production in South Korea gained** 1.4% mom (2.5% yoy) in Aug, vs 0.5% (1.0% yoy) in Jul, way above

expectations. Manufacturing output rose 2.0% yoy vs -0.9% in Jul.

- **The South Korean trade surplus expanded** to USD 9.7bn in Sep, following the USD 6.9bn recorded in Aug. Exports fell by -8.2% yoy, the sharpest drop in over 2 years. Imports dropped by -2.2% yoy. Seasonal effects due to fewer working data in all likelihood have distorted the monthly figure.
- **South Korean inflation** in Sep **accelerated** to 1.9% yoy from 1.4% in Aug. Most of the rise was due to energy prices and, to a lesser extent, food prices. Hence, core inflation remained subdued.
- **Taiwan's inflation in Sep edged up** to 1.7% yoy in Sep from 1.5% in Aug, mainly as a consequence of higher food prices.

Bottom line: Global financial markets are at a critical juncture. The bond selloff is gathering pace, pushing the 10-year yield on US Treasuries close to levels last seen in 2011. Such yield is the benchmark rate around which revolve a global debt market worth trillions of dollars, so it has repercussions on every economy in the world. The crucial question is whether this breakout is the harbinger of the 30-year bull market reversal. Markets and policy makers seems to be blasé but at some point the additional basis point that breaks the camel's back will trigger a downward price spiral. Nominal growth in the US is above 5%. Rates cannot remain at just above 3% forever. And we should not forget that inflation has been tamed by e-commerce and China's imports, but at some point both effects will wane off. In this regard official data on wage growth in developed economies might be underestimating the real extent of the phenomenon: in aggregate figures on the actual remuneration of self employed, freelance, gig economy workers and consultants are hard to collect.

<u>Regional Developments</u>

- **Saudi Arabia, UAE and Kuwait have confirmed a USD 10bn aid package to Bahrain,** tied to a set of fiscal reforms. Bahrain's newly announced "fiscal balance programme" plans to abolish its budget deficit by 2022. This includes cutting public spending, a scheme to encourage early retirement for government employees, introducing changes to balance the budget of the utilities companies and redirecting state cash subsidies towards "eligible citizens". One specific target is to raise tariffs until the Electricity and Water Authority, which runs a BHD 189mn (USD 500mn) deficit, balances revenues and expenditure. The island nation had previously been bailed out in 2011, when a $10bn aid package was provided including funding for infrastructure construction.
- **Saudi Arabia, Kuwait and the UAE also deposited over USD 1bn in Jordan's central bank**, and also committed USD 500mn in budget support over five years.
- **Bahrain's nominal GDP grew** by 8.25% in Q2 this year, with the non-oil sector reporting real GDP growth of 2.4% (of which manufacturing sector and construction activity was up by 4.45% and 6.65% respectively in constant prices).
- **Bahrain introduced new laws in a bid to improve FDI flows:** including a bankruptcy law (which includes provisions for cross-border insolvency, and special provisions in relation to the insolvency of SMEs), a personal data protection law (to support the digital economy), new health insurance legislation and a competition law**.**
- In a regional first, the **Bahrain Credit Reference Bureau and the Saudi Credit Bureau**) have signed an agreement **to share credit information**. This denotes an important step in reducing credit risks, and towards improving transparency and disclosure across the MENA borders.
- **Egypt's non-oil private sector activity weakened**, with the PMI reading at a 9-month low of 48.7 (Aug: 50.5), as

new export orders fell. About 18% of survey respondents reported a decline in output due to weak market demand and unfavourable market conditions.

- **Egypt's current account deficit narrowed** by 58.6% yoy to USD 6bn in the 2017-18 fiscal year. FDI inflows touched a total of USD 7.7bn in this period, with USD 4.5bn going into the oil sector. Remittances increased by 21.1% yoy to USD 26.4bn.
- **Egypt attracted USD 600mn in non-oil FDI in Q2**. This compares to Q1 reading of USD 956mn and USD 1.51bn in Q4 2017.
- **Egypt's central bank** revealed the **sale of** EGP 904mn (USD 50.6mn) worth of **three- and seven-year treasury bonds** last week, after sales were shelved in the previous four consecutive weeks.
- **Egypt spent around USD 30bn on oil subsidies in the past five years**, disclosed the nation's petroleum minister. As the subsidies get phased out gradually, the savings would be spent towards improving public services.
- **Egypt's non-oil trade increased** by 11.8% yoy to USD 59.68bn in Jan-Aug this year. Trade with the EU was up 3.9% yoy to USD 18.33bn; trade with Arab nations grew by 9% to USD 8.9bn, and bilateral trade with non-Arab African nations increased by 19.5% to USD 1.63bn. Non-oil exports were up 10% yoy to USD 16.54bn during the same period.
- **Egypt launched a new national manufacturing programme**, aimed at supporting local manufacturing. It was also disclosed that of the USD 43.5bn non-oil imports registered in Jan-Aug this year, around 63% of these imports could be replaced with local industries.
- **Egypt banks' foreign deposits increased** by 9.6% yoy and 0.54% mom to EGP 728.8bn in Aug. Foreign reserves increased to USD 44.41bn at end-Aug (Jul: USD 44.31bn).
- The **mortgage finance initiative** launched by **Egypt**'s central bank in Feb 2014 has seen banks' mortgage financing touch EGP 16bn so far. The total funding

process, of approximately EGP 20bn, will be completed by Jan 2019, according to the deputy governor of the Apex bank.

- **Oil exports from Iraq edged down slightly** to 3.56mn barrels per day in Sep (Aug: 3.583mn bpd), due to “necessary technical maintenance” at some facilities, according to the oil ministry. With an average sale price of USD 74.091 per barrel, revenues touched USD 7.9bn in Sep.
- **Iraq plans to boost the production and export of light oil output** to 1 million barrels per day in 2019, according to the oil minister.
- The GCC Interconnectivity Authority is in talks **to link Iraq up to its electric grid,** according to a UAE official. He also added that of the 100 GW GCC produced annually, only 30% is consumed in winter.
- After months of delay following the May 12 election, **the Iraqi parliament elected a President, who immediately named former oil minister as the prime minister-designate**. The prime minister is tasked with bringing together the rival blocs to forming the next Iraqi government.
- **Jordan’s real estate trade volume declined** by 12% yoy to JOD 3.96bn in Q3 this year, after real estate sales to non-Jordanian investors dipped by 25%.
- **Jordan**’s Equal Pay Committee disclosed that the **gender wage gap** reached 13.8% in the public sector and 14.2% in the private sector. The gap was widest in the health sector (31.8%) and in private education (30.2%).
- **Kuwait’s trade surplus widened** by 81.3% yoy to KWD 2.7bn in Q2 2018, thanks to higher oil prices. Exports were up 8.6% qoq and 37.7% yoy to KWD 5.4bn.
- **Banks operating in Kuwait raised short-term deposit interest rates** by 25bps to 2.5% – to be implemented on new deposits. This move followed the decision by the central bank to hold rates at 3% after the Fed’s 25bps hike.

- In a televised interview, **Lebanon**'s prime minister disclosed that a new **government would be formed "within a week to 10 days"**.
- **Oman's Alizz Islamic Bank and Oman Arab Bank have signed an MoU ahead of the merger** after receiving the regulatory permissions from the CMA and Central bank.
- **Oman Oil is set to raise an USD 850mn revolving credit facility** from a consortium of 10 banks; this loan was part of a dual-tranche USD 1.85bn financing the company was granted in 2014.
- **Hotels in Oman received 1.53mn guests last year**, generating total revenue of OMR 194.6mn, according to a NCSI report.
- The **number of bounced cheques in Oman increased** by 16.9% yoy to 436,022 last year, according to the central bank, largely due to insufficient funds in bank accounts (77% of the cases) and non-operation of account due to closure (10%).
- **Oman** unveiled plans for the procurement of a **second utility-scale solar power plant** (with a capacity between 500-1000 MW), due for commercial launch in 2022.
- **Qatar's central bank sold** QAR 500mn (USD 137.4mn) of Treasury bills with maturities of three, six and nine months last week.
- The **Saudi Crown Prince**, in an **interview with Bloomberg**, revealed that the PIF would meet its target to increasing its assets to USD 600bn by 2020. One of PIF's biggest investments – NEOM- would be completed by 2025, he stated, with the first town ready by 2019 or 2020. He also said that more than 20 companies would be privatized in 2019, supporting diversification plans. On the Aramco IPO, the Crown Prince revealed plans to sell shares in late 2020 or early 2021. *Read the full transcript of the interview: https://www.bloomberg.com/news/articles/2018-10-05/saudi-crown-prince-discusses-trump-aramco-arrests-transcript*
- **Saudi Arabia's GDP expanded** by 1.6% yoy and 1.2% qoq **in**

Q2 this year, supported by a 4.0% increase in the government sector (authorities boosted spending). The private sector growth edged up slightly to 1.8% in Q2 (Q1: 1.1%). Separately, according to the ministry of finance, real GDP growth will rise to 2.3% in 2019, compared to an estimated 2.1% this year.

- **Saudi Arabia's PMI slowed in Sep:** the headline reading fell to 53.4 in Sep (Aug: 55.1) as output growth slowed (to 56.7 from 59.7) and new orders slipped (55.1 from 59) amidst employment posting a 10-month low of 50.7.
- **Saudi Arabia's finance ministry plans to increase state spending** by over 7% in 2019, with projected revenues climbing 11% to SAR 978bn (USD 260.8bn). The finance minister, without providing any details, also stated that the government would "soon" announce policies to support the private sector. **Saudi Arabia plans to eliminate its budget deficit by 2023**, supported by revenue diversification measures amidst the recovery in oil prices.
- **More consolidation in Saudi Arabia**: Saudi British Bank and Alawwal bank agreed to merge – subject to shareholder and regulatory approval – to create the third biggest lender in the nation.
- **Trade surplus in Saudi Arabia grew** 86.6% yoy to SAR 269.97bn (USD 71.99bn) in H1 this year, supported by a 32.5% pickup in exports to SAR 397.1bn.
- **Saudi Arabia**'s government sold SAR 4.78bn (USD 1.27bn) of local currency Islamic bonds (Sukuk) in its **monthly auction** last week.
- **Saudi Tadawul** approved the Ministry of Finance's request to **list debt instruments worth SAR 4.78bn** (USD 1.27bn).
- **Saudi Arabia denied a Wall Street Journal report** that its USD 200bn **solar project** with Softbank had been shelved.
- **Saudi Arabia plans** to invest USD 20bn in the next few years **to maintain and potentially expand spare oil production capacity**, stated the energy minister. The

nation's oil production capacity currently stands at 12mn barrels per day.

- **Saudi Arabia made a donation of USD 200mn to Yemen's central bank** to support its currency, which has lost more than half its value (versus the dollar).
- According to the General Secretariat of the Union of Arab Banks, the **volume of assets of the Arab banking sector grew** by 1.6% fromend-2017 to USD 3.39 trillion at the end of H1 2018 (roughly 140% of Arab GDP).

UAE Focus

- **UAE non-oil private sector activity held steady in Sep**, with the PMI reading at 55.3 (Aug: 55) – supported by output and new orders though employment remained below the 50-mark.
- The **IMF raised its growth forecast for the UAE**: growth is to expand by 2.9% this year, and by 3.7% in 2019. Following the annual consultation, the IMF also highlighted critical pain points: "non-oil activity remains subdued amid continued corporate restructuring, real estate overhang, and tightening financial conditions". *More: https://www.imf.org/en/News/Articles/2018/10/01/pr18369-imf-staff-completes-2018-article-iv-mission-to-the-united-arab-emirates*
- The UAE cabinet approved a 17.3% yoy **increase in the UAE federal budget for 2019** to AED 60.3bn (USD 16.4bn): of this 42.3% is earmarked for community development programmes, while education and health care account for 17% and 7.3% respectively. Defence spending was hiked by around 41% to AED8.6bn. Around AED 1.6bn was allocated to the Sheikh Zayed Housing Programme, which ensures decent housing for local families of different economic and social levels.
- **FDI into Dubai grew** by 26% yoy to USD 4.84bn (AED 17.76bn) in H1 this year, with the number of projects

rising 40% to 248, as per data from the Dubai Investment Development Agency. Last year, FDI had picked up 7% to AED 23.7bn (for the full year).

- The **UAE public debt law**, which has been long delayed, will be issued "very soon", according to a senior ministry of finance official.
- **UAE federal ministries revenues** grew by 4.2% yoy to AED 39bn (USD 10.6bn) in H12018, while expenditures were up 8.2% to AED 33.2bn.
- **Assets of the UAE's sovereign wealth funds** will rise by 8.3% yoy to USD 785.6bn in 2018 and further increase to USD 807.5bn by next year, according to the IIF.
- The **Statistical Yearbook of Abu Dhabi 2018** was released last week: Abu Dhabi's nominal GDP increased to AED 832.5bn in 2017 (+9.5% yoy); Abu Dhabi's foreign trade in goods accounted for 12.8% of the GDP in 2017; Abu Dhabi exported 0.48bn barrels of crude oil in 2017, with Japan the top importer receiving around 31.4% of the Emirate's total crude oil exports. *(More data and information: https://www.scad.gov.abudhabi/Release%20Documents/SYB_2018_EN_9Sep%20_Chart%20Correction.pdf)*
- **Dubai International Airport welcomed record-high 8.37mn passengers in Aug** (+1.7% yoy), surpassing the prior record of 8.23mn set in Aug 2017. This brings the year-to-date number to 60.3mn.
- Dubai approved the "**Dubai Tourism Strategy**" which aims to attract 21-23 million tourists by the year 2022 and 23-25 million visitors by 2025.
- **Dubai's real estate sector attracted 9500 new investors** and investments more than AED 19bn (USD 5.17bn) from Jan-Aug this year, according to the Dubai Land Department.

Media Review

The Saudi Crown Prince speaks to Bloomberg

https://www.bloomberg.com/news/articles/2018-10-05/saudi-crown

-prince-discusses-trump-aramco-arrests-transcript

Russia and KSA boost production by one million barrels but prices keep climbing

https://www.bloomberg.com/news/articles/2018-10-03/saudis-and-russia-open-the-oil-taps-while-the-market-just-shrugs

Bahrain gets a jolt from a new oil discovery

https://www.ft.com/content/d757dba2-9c8a-11e8-88de-49c908b1f264

Fiscal Freedom in the Eurozone?

https://www.project-syndicate.org/commentary/italy-new-budget-eurozone-fiscal-rules-by-lucrezia-reichlin-2018-10

NAFTA To USMCA

https://www.economist.com/the-americas/2018/10/04/canada-joins-north-americas-revised-trade-deal

Brazil’s moment of truth

https://www.project-syndicate.org/bigpicture/brazil-s-moment-of-truth

Egypt faces borrowing crunch as foreign debt market sours

https://www.reuters.com/article/us-egypt-economy-analysis/egypt-faces-borrowing-crunch-as-foreign-debt-market-sours-idUSKCN1MB3LJ

Lebanon bond rout ramps up currency concerns, pressure for fiscal reform

https://www.reuters.com/article/us-mideast-debt-lebanon-analysis/lebanon-bond-rout-ramps-up-currency-concerns-pressure-for-fiscal-reform-idUSKCN1MA0JU

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