

Weekly Economic Commentary – Oct 14, 2018

Markets

Last week global equity markets were hit by a selloff which was particularly intense in the tech sector (where careless or reckless investors have inflated a bubble for years). US equities on Wed had their sharpest daily drop in months and the Nasdaq entered correction territory having plunged more than 10% since the top on August 29th. Also the other main US indices took a beating and the rout extended to Japan (the Topix lost almost 100 points) and Europe where the Italian budget crisis exacerbated investors' fears. It is hard to pinpoint a single catalyst for the global equity tumble of the last two weeks: most likely several intertwined factors are at play. a) Some large asset managers have come to realize that around 80% of global trade involves multinational companies which are the backbone of many bourses. In the US almost 50% of the earnings by companies in the S&P500 come from activities outside the US. Hence equities are vulnerable to a prolonged and intensified trade war even though listed companies are only 25% of the US economy. b) The normalization of the Fed monetary policy has woken up the bond markets numbed by years of ultra loose stance. c) The IMF has reduced its growth forecasts and underlined the geopolitical clash as a downside risk. d) The bull run cannot continue forever: valuations were already stretched before Donald Trump won the elections, and the ensuing rally was hard to justify even in an economy that runs at a healthy pace. Anyway the next sessions with the US mid-term election coming into focus will be volatile, and in fact the Vix has reached 23 from 12 in a few days. In regional markets the selloff hit Egypt and KSA (also under the spot for the alleged killing of a journalist), while other markets contained the losses. In currency markets the yen strengthened on major crosses,

probably due to a safe haven effect, while the euro was stable vis à vis the dollar. Oil prices fell victim of the concerns over global growth (and reserve build-up in the US) but remained close to USD 80/b. Gold was rather volatile, jumping in reaction to the equity slide, but then lost much of the gains.

Global Developments

US/Americas:

- **Inflation in the US fell** to 2.3% (0.1% mom) yoy in Sep from 2.7% (0.2% mom) in Aug, the lowest rate in 7 months, mainly thanks to a sharp slowdown in gas prices and smaller increases in fuel and shelter costs. Food prices were unchanged. Core inflation crawled back to 2.2% yoy in Sep from 2.3% in Aug.
- **US wholesale inventories increased** 0.8% mom (5.1% yoy) in Aug vs 0.6% in Jul. Stocks grew faster for nondurable goods (0.8% mom vs 0.4% in Jul) and durable goods (0.9% vs 0.7%).
- **The University of Michigan's US consumer sentiment index fell** to 99 in Oct from 100.1 in Sep. The decline was due to a worse assessment of personal finances and higher 12-month expected inflation.

Europe:

- **Industrial production in the eurozone gained** 0.9% yoy in Aug (-0.8% mom), vs 0.3% (0.4% mom) in Jul. Production was quite perky for non-durables, but continued to fall for energy and durable goods.
- **German industrial production unexpectedly fell** -0.3% yoy in Aug, exacerbating a -1.3% tumble in Jul. Manufacturing output fell -0.1% vs -1.9% in Jul. Capital goods output plunged again (-0.7% vs -2.5% in Jul), partially offset by consumer (1.4% vs -0.7%) and intermediate goods (0.1% vs -1.6%) production.
- **The German trade surplus declined** to EUR 17.2bn in Aug from EUR 20.0bn a year earlier, as exports rose by 2.2%

to EUR 105.2bn, while imports recorded a 6.2% rise to EUR 88.1bn.

- **The UK trade deficit shrunk** in Aug by GBP 0.83bn to GBP 0.11bn, as both exports and imports hit all-time highs.
- **UK industrial production rose** 0.9% yoy in Aug adding to the 1.1% rise in Jul.

Asia Pacific:

- **The People's Bank of China** announced a **cut in its reserve requirement ratio (RRR)** by 100 bps for almost all banks, except for rural commercial banks and rural credit unions, effective tomorrow.
- **The Caixin China services PMI unexpectedly advanced** to 53.1 in Sep (a 3-month high) from 51.5 in Aug. New orders in particular underscored a robust pick up in demand. Employment contracted for the first time in over 2 years, while outstanding workloads continued to fall. Input costs rose the most since Jan, which will weigh on profit margins.
- **China's trade surplus widened** to USD 31.7bn in Sep from USD 27.4bn a year earlier against market consensus of USD 19.4bn. Exports gained 14.5% yoy and imports 14.3%. The trade surplus with the US touched a fresh record of USD 34.13bn in Sep from USD 31.05bn in Aug.
- **Japan's current account surplus narrowed** to JPY 1.84tn in Aug from JPY 2.40tn in Aug 2017. The goods account shifted to a deficit of JPY 0.22tn from a JPY 0.33tn surplus a year earlier, as imports jumped 17.5% yoy and exports rose only 7.6%.
- **Core machinery orders in Japan**, ex ships and electrical equipment, **soared** by 6.8% mom (12.6% yoy) in Aug, after an 11.0% jump (13.9% yoy) in Jul, while most analysts expected a decline. It was the third gain in 6 months. Manufacturing orders rose 6.6% mom after surging 11.8% in Jul.
- **India's industrial production expanded** by only 4.3% yoy

in Aug, vs 6.5% in Jul. Manufacturing growth slowed down (4.6% yoy from 7.0% in Jul) and mining production fell (-0.4% from 3.4%).

- **Inflation in India edged up** to 3.77% in Sep from 3.69% in Aug as food inflation remained subdued.
- **Wholesale prices in India rose** by 4.5% yoy in Aug after a 5.1% gain in Jul. It is the lowest WPI inflation since Apr, as fuel inflation dropped and food prices declined.

Bottom line: The macrodata flow last week did not change much the short-term outlook. The IMF World Economic Outlook, reduced the forecasts for world's real growth in both 2018 and 2019 by 0.2% to 3.7%. For advanced economies the figure was left broadly unchanged, but for the US next year growth is projected slightly lower, at 2.5%, than in the Jul's forecasting exercise. For emerging markets and developing economies the revision was deeper: 4.7% in 2018 and 2019, respectively 0.2% and 0.4% lower. The medium term outlook is disrupted by the crash in the global bond markets, caused by the normalization of the US monetary policy. While this process is both natural and desirable, the adjustment process will hit economic activity and markets worldwide. The 10-year UST yields is close to its highest level since 2011 having risen since mid-Aug by almost half a percentage point. The full impact on the US economy will take time to assess, but the risk is that investors will try to guess future Fed hikes in a disorderly manner. Trump has embarked on fiscal stimulus at a time when unemployment was already very low and the risk of an spike in inflation is making markets and central bankers increasingly nervous. Indeed St. Louis Fed President Bullard warned that the sustained US growth rates are set to dissipate unless productivity picks up.

Regional Developments

- The IMF has forecast growth to increase to 2.0% this year in the MENA region, edging up from last year's 1.8%, in its latest edition of the World Economic

Outlook. In Saudi Arabia, growth is expected to pick up by 2.2% this year, driven by non-oil economic activity and revisions in the OPEC Plus agreement.

- **Bahrain will receive up to USD 2bn** before end of this year from its Gulf counterparts' 5-year USD 10bn aid package; this would also support the 2019 budget.
- **Bahrain's parliament approved the VAT law**; VAT will be implemented from the start of 2019, at the standard rate of 5%.
- A central bank official clarified that **Bahrain does not plan to issue new US dollar-denominated bonds this year**, in light of the recent fiscal balance programme.
- **Foreign holdings of Egyptian treasuries** stood at USD 14bn at end-Sep, down about 20% from end-Jun.
- **Egypt's net foreign reserves increased** to USD 44.459bn at end-Sep (Aug: USD 44.42bn).
- **Inflation in Egypt increased** to 16% yoy in Sep (Aug: 14.24%), largely driven by a 4.8% mom pickup in price of food and non-alcoholic beverages. Core inflation slipped to 8.55% last month, from 8.83% recorded in Aug.
- **Egypt launched a pan-Asian roadshow last week** to promote its international bonds in South Korea, as part of a bid to bring down rising yields on its debt. The country's finance minister noted that the government was "advised to try to issue in Asia" and might consider issuing bonds in currencies other than the euro and the dollar.
- The **Central Bank of Egypt (CBE) signed and entered into a "new repurchase transaction"** of USD 3.8bn with a consortium of international banks. The transaction aims to enhance the CBE's "liability management by extending the duration of its debt structure".
- **Egypt** has the potential to meet up to 53% of its **electricity demand with renewable energy** by 2030, and this could reduce energy bill by up to USD 900mn annually in 2013, according to a report from IRENA.
- Jordan's PM announced a cabinet reshuffle and reduced his 29-member cabinet to 27 as the government looks to

push through economic reforms. The parliament will begin debating the tax bill this week.

- **Inflation in Oman** was 0.8% yoy in Sep down from 1.1% in Aug.
- **Moody's in its report on the Oman banking sector** maintained a negative outlook, reflecting the weaker capacity of the government to support the banks in case of crisis. The outlook also pointed at a lower asset quality and relatively tight funding. Moody's warned that "funding costs will continue to increase due to a combination of higher US interest rates and competition for deposits".
- **Qatar GDP growth expanded** by 2.5% yoy in Q2 (Q1: 2.0%), with the non-oil sector growing by 6.1% yoy and 0.3% qoq.
- **Qatar National Bank and Qatar Islamic Bank together raised USD 1.3bn in privately placed bonds**, reported *Reuters*.
- **Qatar's finance minister expects the 2019 budget to post a surplus**, thanks to moderate oil prices and lower expenditure; he also stated that the nation posted a budget surplus in the Jan-Sep period this year.
- **Bilateral trade between Saudi Arabia and its GCC peers jumped** 4% yoy to SAR 7.31bn in Jul. UAE was its largest trading partner, accounting for 72% of the trade with other GCC nations.
- **Saudi Arabia** allocated SAR 1.361bn to implement 11 **infrastructure projects**.
- **OPEC cut its forecast of global demand growth for oil next year for a third straight month**: world oil demand is expected to increase by 1.36mn barrels per day (bpd) next year, down 50k bpd from its previous estimate. OPEC production rose by 132k bpd to 32.76mn bpd in Sep, the highest since Aug 2017. Iran's oil output had fallen by just 51k bpd to 3.775mn bpd and the group pledged to increase output to compensate for any shortfall due to US sanctions on Iran from Nov onwards.

- **Total funding for MENA startups** touched USD 325mn in Jan-Sep this year, down 22.6% yoy, according to a MAGNiTT report; in Q3 alone, almost USD 82mn was invested across 62 deals in the region. UAE accounted for the largest of startup transactions (29%), with investments accounting for 61% in 2018 year-to-date.

UAE Focus

- The **UAE** issued a **law permitting the federal government to begin issuing sovereign debt**: this will support deepening of the country's capital markets. This will allow issuances of government bonds in AED or foreign currencies, help the central bank manage the inter-bank money market and eventually lead to the creation of a benchmark yield curve. A Public Debt Management Office will be established at the Ministry of Finance.
- **Money supply in the UAE (M2) decreased** by 1.8% mom to AED 1.279trn in Aug 2018. Gross bank assets grew by 0.9% mom to AED 2.8trn while gross credit was up 0.6% mom to AED 1.63trn.
- Non-oil private sector activity in Dubai, as tracked by the **Dubai Economy Tracker**, **fell to a five-month low** of 54.4 in Sep (Aug: 55.2). Travel & tourism was the weakest performing category at 51.3, followed by construction (53.8).
- **Inflation in the UAE edged up in Aug**, rising to 3.9% yoy (and 0.1% mom), in spite of a 3.9% yoy drop in housing and utility costs. Transport prices were up 17% and food costs grew by 2.9%.
- **Industrial sector is expected to create 27k jobs in the UAE**, with the sector growing by an additional AED 18bn by 2030, and accounting for 20% of GDP.
- **Four major companies are expected to list in UAE equity markets at the beginning of 2019**, according to the CEO of UAE's Securities and Commodities Authority.
- **UAE's** recently announced law **allowing 100% foreign**

ownership of companies will only apply to some sectors of the economy, according to senior government officials.

- **UAE plans to introduce initial coin offerings (ICOs) next year to boost capital markets:** the board of the Emirates Securities & Commodities Authority approved considering ICOs as securities and will announce and implement regulations in H1 next year.
- **UAE's DMCC topped the list of fDi's Global Free Zones of the Year 2018 for the fourth consecutive year.** The free zone is home to 14,805 companies and more than 61,700 employees.
- **According to HSBC's Expat Explorer 2018, UAE ranked as the 10th best location in the world for expats.** With an average annual expat salary of USD 155,039, 85% of the respondents say that they are able to build up their savings and pay off debt. While 17% own a property in the UAE, a typical expat keeps only a fifth of their wealth in the UAE.
- **Dubai recorded 39,802 real estate transactions worth AED 162bn in the Jan-Sep period this year,** according to the Dubai Land Department. UAE citizens invested AED 9.4bn from 4,112 investments while Indians reportedly invested AED 8.6bn from 4676 transactions.
- **UAE's brand value grew an impressive 19%, rising to 20th spot in the nation brand ranking.**

Media Review

IMF: Financial system is stronger, but new vulnerabilities have emerged

<https://blogs.imf.org/2018/10/09/the-financial-system-is-stronger-but-new-vulnerabilities-have-emerged-in-the-decade-since-the-crisis/>

Trumponomics casts a sinister shadow

<https://www.bloomberg.com/view/articles/2018-10-09/-trumponomics-takes-a-heavy-toll-on-world>

Will Trumponomics collapse?

<https://www.newyorker.com/news/swamp-chronicles/will-trumponomics-collapse>

Trump's new NAFTA

<https://www.project-syndicate.org/commentary/usmca-employment-north-american-competitiveness-by-anne-krueger-2018-10>

Iran braces for US sanctions

<https://www.ft.com/content/d5a39a98-cb1b-11e8-b276-b9069bde0956?segmentId=b348cbb8-e1d8-c16f-c0bc-d70f5303573e>

The Dollar and its Discontents

<https://www.project-syndicate.org/commentary/dollar-could-lose-global-hegemony-by-barry-eichengreen-2018-10>

OPEC says oil market well supplied, wary of 2019 surplus

<https://www.reuters.com/article/us-oil-opec/opec-says-oil-market-well-supplied-wary-of-2019-surplus-idUSKCN1ML0YI>

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<https://www.khaleejtimes.com/nation/dubai/Now,-travel-through-Dubai-Airports-without-passports->

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