Weekly Economic Commentary – Oct 28, 2018

Markets

Global stock markets took another dive last week: the S&P 500 lost almost 4% amid lackluster Q3 corporate earnings reports, especially for industrials, and tumbling new home sales, which point to weaker growth. Contagion spread from Wall Street to European bourses that were already wobbly due to the Italian budget crisis and markedly declining economic activity. The notable exception was the UK's FTSE 100 which gained 1.0% thanks to the depreciation of the GBP. But the sharpest downturn was in Japan (the Nikkei 225 dropped 6.0%) and most of Asia, with the exception of China, where the Chinese government assured credit support to private enterprises. The MSCI EM continued its slide started in mid-Sep and regional markets were no exception to the global dark mood. The flight to safety lifted US Treasuries prices – thereby reversing their downward trend – and to a lesser extent the price of gold, which consolidated the gains of the past few weeks. In currency markets the USD and the JPY gained vis à vis most other major currencies, supported by "safe-haven" demand. The euro suffered from negative macro news and Italy-related concerns. The Chinese yuan edged lower, as the People's Bank of China lowered the daily reference rate. Oil prices recorded heavy losses especially on Tuesday when Saudi Arabia promised to make up for any supply shortfalls. The fact that U.S. crude oil inventories keep rising beyond expectations (in Mid-Oct they added 6.3mn barrels) is contributing to the negative sentiment.

Global Developments

US/Americas:

- **US GDP** in Q3 **grew** by 3.5% qoq ann, a shade above expectations, after 4.2% in Q2. Private consumption, inventory, government spending and nonresidential fixed investment gave positive contributions, while net exports and residential fixed investment were a drag.

- **US personal income rose** 0.3% mom in Aug, the same as in Jul. Wages and salaries rose 0.5% in Aug vs 0.3% in Jul and disposable income advanced 0.3% unchanged from the prior month.
- **The US Fed October Beige Book,** underlined that economic activity expanded at a modest to moderate pace. Manufacturing output rose moderately, although firms in some districts are hit by rising costs, tariffs and labor shortages. Consumer spending improved modestly, while wages pressure are mounting.
- **The IHS Markit US Composite PMI rose** to 54.8 in Oct from 53.9 in Sep, as both manufacturing (PMI 55.9 55.6 in Sep) and services activity (PMI at 54.7 from 53.5) perked up.
- **New orders for durable manufactured goods in the US gained** 0.8% mom in Sep vs a stellar 4.6% mom in Aug, mainly due the volatile defense aircraft segment, up 119.1% mom. Core capital goods orders fell -0.1% mom.
- **US wholesale inventory rose** 0.3% mom in Sep vs 1% in Aug, while retailers' inventories rose 0.1%.
- **The US goods trade deficit widened** for the fifth consecutive month in Sep, reaching USD 76bn from USD 75.5bn in Aug. Total exports increased 1.8% mom, and imports by 1.5%.
- **The US pending home sales index inched up** 0.5% mom to 104.6 in Sep slightly above its 4-year record low. **New-home sales** in Sep dropped -5.5% mom and 13.2% yoy after a -3.0% mom decline in Aug.
- **US claims for unemployment benefits increased** by 5,000, to 215,000. The 4-week moving average was unchanged at 211,750. Continuing claims fell by 5,000 to 1.636 mn and the 4-week moving average for declined by 6,750 to 1.646 mn.
- **The Bank of Canada raised its overnight rate target** by

25 bps to 1.75%, as solid growth and the new free trade agreement removed the uncertainty that held back the policy makers.

Europe:

- **The ECB left its policy rates unchanged and confirmed its QE program** which will end after Dec. The final statement was almost identical to the previous one. During the press conference (half of which was devoted to Italy) Draghi reiterated that the ECB cannot prop up the public debt of a Eurozone member.
- **The IHS Markit Eurozone Composite PMI** dropped to 52.7 in Oct 54.1 in Sep to mark the slowest expansion in 25 months. Both manufacturing (52.1 from 53.2) and services (53.3 from 54.7) hit the brakes. New orders touched a low since Aug 2016; new export orders were the weakest since Jun 2013; inflationary pressures intensified, with input prices recording the third-largest monthly rise since May 2011. Future growth expectations were the lowest since Nov 2014.
- **The Eurozone's Consumer confidence indicator** rose to -2.7 in Oct from -2.9 in Sep.
- The **Ifo Business climate index for Germany fell** to 102.8 in Oct from 103.7 in Sep. Current conditions went down to 105.9 from 106.6 and the business expectations to 99.8 from 100.9.
- The **IHS Markit Germany Manufacturing PMI fell** to 52.3 in Oct from 53.7 in Sep, the slowest expansion in 29 months. Order books contracted for the first time in nearly 4 years and new foreign export orders fell for a second consecutive month.

Asia Pacific:

- **The Nikkei Japan Manufacturing PMI** rose to 53.1 in Oct from 52.5 in Sep (a 6-month high). All subcomponents displayed positive performances: output, new orders,

work backlog and employment growth accelerated while new export orders advanced for the first time since May. Both output and input inflation rose.
- **South Korea's GDP expanded** 0.6% qoq (2.0% yoy) in Q3, the same pace as in Q2 (2.8% yoy). Private consumption expanded 0.6% qoq, while government consumption was up 1.6%. The external sector was quite perky with exports up 3.9% and imports down -0.1%. Investment contracted -4.5% qoq in Q3 vs -2.9% fall in Q2.
- **The Bank of Korea's consumer sentiment index slipped** 0.7 points to 99.5, after rising to 100.2 in the prior month. Sentiment about future living standards deteriorated, as did sentiment about prospective income. Meanwhile, sentiment about prospective and household spending held steady.

Bottom line:The typical signs of a late cycle in stock prices are mounting: higher volatility, bout of risk aversion, knee jerk reactions to earning reports and macro news. Attention is obviously focused on the US: in mid-Dec 2017, the S&P 500 was trading at a forward P/E of 18.9. Since then stock prices diverged from earnings growth, (which is approaching 25% in 2018) and hence appear increasingly bubbly. Based on valuations and past experience, a further 5% slide in the S&P 500 would trigger a bear market. In the Eurozone the confrontation between the populist Italian government and the EU institutions is reaching a new climax at a time in which the European economy is suffering the repercussions of the growing global trade war.

Regional Developments

- Bahrain's foreign minister disclosed that **the planned security alliance**(Middle East Strategic Alliance or **MESA**, which also includes Egypt and Jordan) **will be active by next year**.
- **Bahrain and Saudi Arabia will issue a tender for the King Hamad causeway**, seeking consultancy services to

manage the transition phase of the project. The parallel bridge to the King Fahd Causeway is estimated to cost between USD 3-4bn and will start mid-2021 and take about 3 years to complete.

- **Egypt's government postponed a planned IPO** of 4.5% of tobacco producer Eastern Company, citing global market volatility. This brings into question the 4 other IPOs scheduled for this year, estimated to raise around EGP 2bn (USD 110mn).
- **Egypt's foreign debt increased** by 17.2% yoy to USD 92.6bn at end-Jun, as a result of higher loans and financing; debt to GDP ratio touched a "safe limit" of 37%.
- **Egypt has set its external borrowing ceiling at USD 16.73bn for the 2018-2019 financial year,** reported *Reuters*. It will borrow USD 10.51bn for repayment of external debt in 2018-2019 and total external government debt is expected to be USD 98.863bn.
- **Egypt's PM is finalizing a government restructuring that includes a smaller cabinet and fewer civil servants**(around 38% of employees will be retired within the next 10 years), with an aim to cut red tape and attract foreign investors.
- The **Central Bank of Egypt issued Treasury bonds worth EGP 1.25bn**(USD 69.6mn) on behalf of the finance ministry, to "finance the budget deficit". Egypt aims to issue EGP 409.6bn T-bills and EGP 101.6bn bonds in fiscal year 2018/2019.
- **Egypt plans to present amendments to the mining law** – including a cap on royalties paid by investors –**to the parliament within the next three months**, in a bid to make the industry more attractive to investors.
- **Egypt spends more than USD 1.5bn per month in providing petroleum products to the market** – covering both imports and share of foreign oil companies. The nation spends USD 700-800mn buying foreign companies' share in local joint venture oil production, according to the petroleum

minister.

- **Iraq central bank announced foreign reserves in excess of USD 60bn**, thanks to an improvement in oil prices amidst supportive monetary and financial policy.
- **Inflation in Kuwait edged up** to 0.27% yoy in Sep, thanks to a 13.5% rise in tobacco prices.
- **Kuwait is nationalizing public sector jobs**: plan is to replace all expats with citizens in administrative, media, PR, IT, development, follow-up and statistics jobs within five years, 95% in scientific, financial, economic and commercial jobs and 80% in craft jobs
- **Kuwait signed a MoU with** the Chinese oil major **Sinopec** to build a refinery in the south of China.
- The **Omani government sold USD 1.5bn seven-year in Islamic bonds**, offering investors 280 bps over mid-swaps.
- **Qatar's bank deposits grew** 2.5% yoy and 1.3% mom to QAR 817.85bn (USD 226.78bn) in Sep, with private sector deposits up by 1.97% mom and public sector deposits rising 0.8%.
- **The Future Investment Initiative conference held in Saudi Arabia** last week saw deals worth USD 56bn being signed. Majority of the deals were oil and gas sector-based with Aramco, and US companies accounted for most of the deals signed in the conference.
- **Saudi Arabia's non-oil revenues increased** by 48% yoy to SAR 211bn (USD 56.25bn) in Q3, according to the finance minister. The budget deficit, projected at SAR 148bn (USD 39.5bn) this year, is officially expected to be eliminated by 2023 through reforms including cuts in taxes, fees and subsidies, and efficiency measures. Even beyond 2023, the government would not necessarily aim for a balanced budget every year – it would try to be flexible on deficits while focusing on growth.
- **Saudi Arabia's imports fell** -22.8% yoy to SAR 33.6bn in Aug, while oil exports surged by 49.8% to SAR 75.35bn and non-oil exports dipped -6.5% to SAR 16.7bn.

- **Saudi Arabia**'s economy minister disclosed that **privatization deals** ranging from grains to healthcare and water desalination **would be offered to international investors over the next six months**.
- **Saudi Arabia's PIF plans to raise its share of assets held internationally** to 50% by 2030 from around 10% currently, according to its MD. With assets at USD360bn, the PIF is ranked the 10th among the world's largest sovereign wealth funds.
- **Investment licenses issued in Saudi Arabia accelerated** by more than 90% to 499 in Q3 2018, according to SAGIA. Britain and US top the list of around 50 nations invested in the country since the beginning of this year.
- **SAGIA announced three major investments in the real estate and construction sector worth USD 3.7bn:** two real estate contracts are to build 15k houses and create more than 4000 jobs while the investment in the construction sector plans to introduce modern and rapid construction methods while creating 15k jobs.
- **Saudi Arabia hopes to attract investments of more than SAR 1.6trn** (USD 427bn) by **2030 to develop "national industries and logistics services"**, stated the energy minister.
- **The Saudi OPEC governor stated that oil market could be shifting towards oversupply** in Q4 this year as oil inventories rise and demand slows. Separately, the Saudi energy minister had stated that Saudi would soon raise output to 11mn barrels per day (bpd) from the current 10.7mn.
- **The "white land" tax** – taxes imposed on undeveloped urban land –**in Saudi Arabia helped to fund a** SAR 100mn (USD26.6mn)**housing project in Riyadh.**
- **Saudi Arabia will support Pakistan** by providing USD 3bn in **foreign currency support** for a year and a further loan of up to USD 3bn in **deferred payments for oil imports** to help avert a current account crisis.

- **UAE and Omani CEOs are more optimistic about the future prospects of their businesses** than their global counterparts, according to the annual global KPMG CEO Outlook. As many as four in ten UAE and Omani CEOs say their biggest challenge in meeting the needs of millennials is to understand how the needs of this generation differ from those of older consumers.
- **Middle East hotel occupancy levels dropped** 7% to 59.8% in Sep and the average daily rate slipped 18% to USD 124.49, resulting in a 23.7% dip in revenue per available room (USD 74.47), according to STR data.

UAE Focus

- **UAE government revenues increased** by 4.2% yoy to AED 39bn (USD 10.6bn) in H1 this year, already meeting 75.9% of the AED 51.388bn budget. Spending during this period was up 8.2% to AED 33.2bn, resulting in a budget surplus of AED 5.8bn. The Ministry of Finance accounted for 71% of total federal ministries' revenues (AED 27.67bn).
- **Foreign currency assets in the UAE grew** to AED 329.3bn (USD 89.6bn) in Sep from AED 326bn earlier this year. M3 increased and touched AED 1.58trn in Sep from AED 1.481trn in end-Jan.
- **Abu Dhabi's nominal GDP accelerated** to AED 456bn in H1 this year, posting growth rates of 9% and 13% yoy in Q1 and Q2 respectively. Oil GDP, at AED 180bn in H1, accounted for 39.4% of the emirate's economic output in current prices.
- **Non-oil trade in Abu Dhabi increased** by 24.2% yoy to AED 14.08bn in Aug, with non-oil exports at AED 2bn and non-oil imports at AED 1.8bn. US topped the list of Abu Dhabi's non-oil exporters (AED 1.61bn), followed by Saudi Arabia.
- **Abu Dhabi's trade of pearls and other gemstones rose** 7.1% yoy to AED 4.5bn in Jan-Aug this year; this accounts for 57.6% of total trade in the emirate.

- **UAE’s Federal Tax Authority will introduce a new biannual tax period next month for certain sectors**: this will include some small businesses, commercial real estate owners, and board members.
- The Dubai Financial Services Authority (**DFSA**) is opening the next round of applications for an “**Innovation Resting Licence**”; applications can be submitted during Nov 1-30.
- **DP World reported gross container volumes growing** at 2.6% yoy on a reported basis and 3.7% on a like-for-like basis in the first nine months of this year to 53.6mn TEU across its global portfolio.
- **About 26 new initiatives have been announced to ensure the happiness and welfare of senior Emiratis**: this includes keeping a database of seniors, training healthcare providers, home care mobile units, housing benefits, and financial protection among others.

Media Review

Janet Yellen on Trump, Fed politics and nurturing recovery

https://www.ft.com/content/c326faf8-d779-11e8-ab8e-6be0dcf18713

The Chinese century is well underway

https://www.economist.com/graphic-detail/2018/10/27/the-chinese-century-is-well-under-way

The Long Sino-American Trade War

https://www.project-syndicate.org/commentary/long-china-america-trade-war-by-michael-spence-2018-10

Norway fund plans to more than double investments in Saudi Arabia

http://www.arabnews.com/node/1394366/business-economy

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