

Weekly Economic Commentary, 20 Sep 2015

Markets

China's bourse remains a major focus and a driver of global market volatility: shares jumped almost 5% on Wednesday on rumors of government intervention, but then the Fed decision took to maintain the status quo took center stage and propelled a brief rally immediately after the announcement. Nevertheless all indices in developed economies closed on a weekly loss. Emerging markets on the contrary had an elated reaction. The VIX volatility index, which had tumbled 25% in September leading up to Fed meeting, ended Friday above 20 for the 20th straight session, the longest stretch since Jun 2012. Regional markets were generally downbeat, on the wake of lower oil prices. The euro fell, post-Fed decision, from a 3-week high earlier in the week vis-a-vis the USD and the yen turned out to be the major beneficiary of the Fed decision, together with gold whose price closed at a 3-week high.

Global Developments

US/Americas:

- **The US Fed** left interest rates unchanged and gave little indication on its next course of action saying that it will depend on the analysis of future macro data. The Fed is concerned about the lackluster US growth and the effects of tightening on riskier asset classes from junk bonds to emerging markets debt.
- **Retail sales in the US** increased for the second straight month in Aug, by 0.2% mom after a 0.7% gain in Jul.
- The Obama administration is **bracing for a government shutdown** next month as Republicans opposed to abortion are bent on blocking public funding.
- **US industrial production** fell -0.4% in Aug following an upwardly revised 0.9% increase in Jul. Capacity utilization fell to 77.6% in Aug (Jul: 78%).
- **CPI in the US** dipped -0.1% mom in Aug, following a 0.1% gain in Jul and a 0.3% increase in June.
- **The NAHB Housing Market Index** rose to 62 in Sep gaining 1 point mom.
- **Initial claims for unemployment benefits** fell 11,000 to 264,000. The four-week moving average fell 3,250 to 272,500.
- **The Conference Board index of leading indicators** rose by 0.1% in Aug, signaling that economic conditions are expected to improve mildly in the near term. Jul estimate was revised up 0.2%.

Europe:

- **Euro zone industrial production** increased 0.6% mom (1.9% yoy) in Jul, a 5-month high, following a -0.3% mom decrease (1.5% yoy) in Jun. Output of capital goods and durable

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consumer goods rose strongly; France was the main exception to the acceleration in IP, with output falling -0.8% mom.

- **Germany ZEW indicator of economic sentiment** sank to 12.1 in Sep from 25 in Aug, while the ZEW indicator for the current situation rose to 67.5 from 65.7.
- **Moody's lowered France's government bond rating** by one notch to Aa2, with negative outlook, citing the mediocre medium term growth outlook which will exacerbate government's "high debt burden over the remainder of the decade".
- **Euro zone CPI** declined to 0.1% yoy in Aug (vs 0.2% in Jul) due to low energy prices. Among the individual countries, **France's CPI** was up 0.1% yoy in Aug from 0.2% in Jul; the **UK CPI** was flat in Aug, after rising 0.1% yoy in Jul and **Italy's CPI** was up 0.2% yoy in Aug, identical to Jul's gain.
- **The euro zone's trade surplus** widened to a record-high EUR 31.4bn in Jul from EUR 26.4bn in Jun and EUR 21.2bn in Jul 2014, due to the weaker euro and the drop in oil prices. The **euro zone's current account surplus** expanded to EUR 33.8bn in Jul, from a revised EUR 30.6bn in Jun.
- The **UK unemployment rate** for Q2 slid to 5.5%, unchanged from Q1 but down from 6.2% last year.
- The **UK retail sales index** rose 3.7% yoy (0.2% mom) in Aug, slightly down from a 4.1% yoy (1% mom) increase in Jun, due to weak sales of food items.
- **Spanish new industrial orders** grew strongly by 8.9% yoy in Jul vs a 6% gain in Jun.

Asia and Pacific:

- The **Bank of Japan** confirmed its expansionary monetary stance, increasing asset purchases at an annual rate of JPY 80 trillion. The BoJ expects inflation to rise and the economy to recover into 2016.
- **S&P's cut Japan's long-term credit** rating one level to A+, giving little credence to the Abe government's strategy changing the dismal outlook for growth and inflation.
- **Foreign direct investments into China** increased 22% yoy to USD 8.7bn in Aug, up from USD 8.2bn in Jul, and bringing the total inflow at USD 85bn for the period Jan-Aug. Financial market volatility and the depreciation in the yuan kept foreign investors cautious.
- **China's industrial production** grew 6.1% yoy in Aug, below market expectations, from 6% in Jul. Growth in **fixed-asset investment** slowed to 10.9% year-to-date, a 15-year low. **China's retail spending** increased 10.8% yoy in Aug, following an increase of 10.5% in Jul.
- **Japan's Services Activity Index** increased 0.2% yoy in Jul, after Jun's 0.3% gain.
- **India's wholesale price inflation** fell to a historic low of -4.95% yoy in Aug, mainly due to lower global commodity prices and local food prices. It has been in the negative zone since Nov 2014.
- **Singapore's non-oil domestic exports** fell -8.4% yoy in Aug, as exports to Europe and Asia declined dramatically. Non-oil domestic exports to China, Singapore's largest export market, fell 8.2% yoy in Aug, and this compares with a -1.6% contraction in Jul.

Bottom line: The Fed's cautious decision to hold rates unchanged and its dovish statement, fueled a spate of concern on the state of the global economy. If the US central bank after months spent preparing the market for a modest 25bp backed off, investors have strong reasons to worry that the massive liquidity injections have become a steroid that the world economy is hopelessly addicted to. It is unlikely that the outgoing US administration will be able to enact reforms that could reignite economic growth so minds are starting to focus on the 2016 Presidential elections. Meanwhile in China numbers provide fresh signs of a slowdown: the government's plans to reform state-owned enterprises and other deadweight sectors of the economy will not bring immediate effects. Europe's situation is improving at snail pace while the focus is on the refugees and migrants crisis. Today's elections in Greece will reopen another wound that has been left untreated for two months.

Regional Developments

- **Bahrain's GDP** grew 3.3% qoq and 3.7% yoy in Q2 this year (Q1: 2.8% yoy); oil accounts for only a fifth of Bahrain's GDP.
- **Bahrain and Saudi Arabia** signed contracts for a new **pipeline** link, aiming to pump 350k barrel per day (bpd), and worth USD 300mn; the link is due to be operational in 2018.
- **Egypt's exports** to the **UK** fell 25.6% yoy to GBP 447mn in H1 this year - Egypt was the seventh highest MENA exporter to UK - while imports from UK increased by 6.3%.
- **Unemployment rate** in **Egypt** declined to 12.7% by end-Jun from about 13.3% a year earlier, thanks to jobs in building and construction, according to the central bank governor.
- **Iraq's 2016 budget** projects a USD 25.8bn deficit ("to be plugged through loans and bonds and the use of Special Drawing Rights", as per the ministry of finance), with estimated oil price at USD 45 and average production of 3.6mn barrels per day (bpd), up from the current rate of about 3mn bpd.
- **Kuwait** plans to sell **local currency bonds** by end of this year, revealed the finance minister on the sidelines of a conference, while not specifying the value of the issuance.
- **Kuwait's petrol prices** are the fourth and third lowest globally and regionally, according to the Global Petrol Price Index of Sep 2015. Al-Nahar daily reported further that petrol price in Kuwait is equivalent to USD 0.21 per liter, whereas average price of petrol globally is about USD 1.06 per liter.
- The **IIF** lowered **Lebanon's GDP** growth to 1.1% this year, from 2.2% earlier this Apr, stating that prolonged political crisis and rising regional insecurity left its mark on subdued domestic demand and weakened economic activity.
- **Inflation in Oman** declined by -0.12% qoq in Q2, mainly driven by a fall in the prices of food items as well as clothing and footwear. However, the education (4.49%) and healthcare (2.24%) sectors recorded substantial price hikes.

- **S&P** reported that **Qatar** plans to award about USD 220bn worth of large-scale investment projects over the next 10 years, ahead of the 2022 World Cup, while affirming the nation's stable outlook 'AA/A-1+' ratings.
- A **risk perception** survey of **Qatar's** banks, undertaken by the central bank, revealed that the risk of default by real estate developers and contractors has been ranked the highest. The risk of a deteriorating fiscal balance is seen as a key risk factor by foreign banks.
- Shortly after the announcement by Qatar of its regulator's acceptance to issue licenses to GCC banks' branches, the **Saudi** Council of Ministers granted a license for **Qatar National Bank** to open a branch in the country.
- **Saudi Arabia** sold a new tranche of **bonds** to banks, worth SAR 20bn, in a bid to cover its budget deficit, reported Reuters, citing the Maaal financial website.
- Strain on funding sources amidst weaker growth will slow down **loan growth** in **Saudi Arabia**; the IMF forecasts that reduced supply of credit and weaker bank and corporate balance sheets will have feedback effects on growth.
- **Demand** has increased for **oil trade finance** in the region, particularly in Egypt and Iraq, according to several bankers.
- **Gulf investor sentiment** towards long-term prospects in Saudi Arabia remains strong, as per the results of Invesco Middle East Asset Management: 46% respondents said they were thinking of strongly increasing inflows into Saudi Arabia, with 23% planning a slight increase.
- **MENA** represents more than 4% of **SWIFT's** total traffic volumes. In the region growth was around 12% by end-Aug, and payments represent 57% of information sent through SWIFT, with securities forming 30% of the total data.

UAE Focus

- **Inflation** in **Abu Dhabi** was up 1.3% mom and 6.1% yoy in Aug; transport prices rose 12.0% mom, while prices of food and beverages grew 2.1%.
- **Dubai inflation** was up 0.8% mom and 4.4% yoy; housing and utility costs were up 6.6% yoy and 0.2% mom and food prices were down 0.1% yoy and 2.4% mom.
- **UAE credit growth** accelerated 8.6% yoy in Aug (Jul: 8.2%) while money supply (M3) reported the first dip since Jul 2012, shrinking 1.2% yoy (Jul: +0.7%).
- **UAE total humanitarian aid to Syrian refugees** amounted to around USD 581.5mn, revealed the State Minister for Foreign Affairs. Furthermore, the country hosts 243,324 Syrian residents, including 101,364 who have arrived since the conflict began in 2011.

Media Review

Investors shift to cash like in 2008

<http://www.fundssociety.com/en/news/business/bofa-merrill-lynch-fund-manager-survey-reveals-cash-balances-at-2008-crisis-levels?>

Fed's policy: hike or no hike?

<http://www.ft.com/intl/cms/s/0/a0e69d9e-5e29-11e5-9846-de406ccb37f2.html>

<http://www.project-syndicate.org/commentary/when-the-fed-raises-interest-rates-external-shocks-by-shang-jin-wei-2015-09>

Fed's dot-plots explained

<http://www.economist.com/blogs/graphicdetail/2015/09/daily-chart-13>

How Carly Fiorina did it

<http://www.bloomberg.com/politics/articles/2015-09-17/how-carly-fiorina-did-it-pugilism-with-a-precise-touch>

A slowdown in global trade growth is bad news for many emerging markets

<http://www.economist.com/news/finance-and-economics/21665040-slowdown-global-trade-growth-bad-news-many-emerging-markets-becalmed>

A growth strategy for Europe

<http://www.project-syndicate.org/commentary/reform-strategy-for-european-economic-growth-by-hans-helmut-kotz-et-al-2015-09>

Frackers' financial strain

http://www.eia.gov/petroleum/weekly/archive/2015/150910/includes/analysis_print.cfm#.Vfw9mN5sW9g.twitter

<http://www.eia.gov/todayinenergy/detail.cfm?id=22992>

India's inflation-deflation puzzle

<http://www.ft.com/intl/cms/s/0/6f1b3578-5b8f-11e5-a28b-50226830d644.html#axzz3mG5FKDSZ>