

Weekly Economic Commentary, 19 Jun 2016

Markets

In equity markets the week ended on a mixed note. In the run up to the Fed's policy meeting the S&P500 scored the worst losing streak since February. Afterwards, the inaction of key monetary policy authorities (the central banks of US, Japan, UK and Switzerland left policy unchanged) sapped investors' mood. The sharpest effect was felt in Japan where the main indices sank. The FTSE 100 experienced its longest run of declines of the year due to fear of the Brexit and the first politically motivated assassination on English soil in decades. The yield on Germany's 10-year sovereign debt crossed the zero line for the first time in history. This is part of a global trend that has seen record low yields and surging volatility in developed market sovereign debt: the yield on the Bloomberg Global Developed Sovereign Bond Index touched a record low of 0.58%. In currency markets the JPY broke through the 105 level vis-à-vis the dollar after the Bank of Japan refrained from taking action at its policy meeting. Furthermore, the Renminbi reference rate was set at its lowest level in nearly five-and-a-half years at RMB 6.6001 to the USD. Regional markets were mostly negative with the notable exception of Abu Dhabi. Oil prices suffered from the widespread downbeat atmosphere, which conversely lifted the gold price.

Global Developments

US/Americas:

- **US Fed's Open Market Committee left rates unchanged.** Yellen asserted that rates could stay depressed in the longer term due to slow productivity growth and aging global societies. However two further 25 bp hikes in 2016 cannot be ruled out.
- **US CPI inflation** was 0.2% mom (1.0% yoy) in May following a 0.4% increase in Apr with energy prices advancing 1.2% in May after 3.4% in Apr. Food prices fell -0.2%.
- **US industrial production fell** -0.4% mom in May, after increasing 0.6% in Apr. Capacity utilization lost 0.4% in May to 74.9%, which is 5% below its historical average.
- **US retail sales rose** 0.5% in May after surging 1.3% in Apr corroborating the view that higher wages will boost consumption.
- **US PPI rose** 0.4% mom in May double the rate in Apr, in the wake of a 6.6% increase in gasoline prices, confirming that deflationary pressure are quickly abating.
- **US housing starts fell** 0.3% mom but were up 9.5% yoy in Apr.
- **US unemployment claims increased** 13,000 to 277,000 during the week after Memorial Day (which distorts the figure). The 4-week moving average was little changed. Continuing claims rose 45,000 to 2.157 million while the insured unemployment rate rose from 1.5% to 1.6%.

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- **US current account deficit increased** from USD 113.4bn in Q4 to USD 124.7bn in Q1 a figure among the highest since 2009 due to the dollar appreciation and subdued global demand.
- **US business inventories increased** only 0.1% mom in Apr vs 0.4% in Mar. Manufacturers' inventories fell -0.1% which could weigh on the Q2 GDP numbers. The inventory-to-sales ratio fell to 1.4.

Europe:

- **Eurozone's inflation declined** by -0.1% yoy in May, following a -0.2% drop in Apr.
- **Eurozone's industrial production** regained ground increasing 1.1% mom in April after a -0.7% drop in Mar, lifted by capital goods.
- **The Eurozone's current account surplus expanded** to EUR 34bn in Apr, from EUR 24.9 bn a year earlier. Energy prices remained the main factor behind export and import developments.
- **Greece obtained a new loan** worth some EUR 7.5bn, after another thorny review of the bailout program.
- **UK retail sales rose** 6% yoy (0.9% mom) in May, up from 5.2% (2.0% mom) in Apr. The increase was broad based across all types of stores.
- **UK unemployment rate dropped** unexpectedly to 5%, a record low since October 2005.
- **UK inflation** rose 0.3% yoy in May, the same rate as in Apr.

Asia and Pacific:

- **The Bank of Japan maintained policy rates** and other policy tools, disappointing markets that had hoped for some measure to prop up the anemic economy.
- **China's stock markets** for the third year in a row were **declined inclusion in the MSCI**, frustrating authorities' wish to gain international recognition on the effect of their reforms.
- **China's fixed-asset investment growth** in Jan-May 2016 fell to 9.6% compared to the same period in 2015, its slowest rate in 16 years and down from 10.5% gain in the first 4 months. Private investment grew by a disappointing 3.9% while public investment grew 23.3%. **Real estate** investment decelerated to 6.6% yoy in May from 10.3% in Apr.
- **China's M2 growth decelerated** to 11.8% in May from 12.8% in Apr, as the government curbs credit growth after the upswing earlier this year.
- **China's industrial production grew** 6% yoy in May, unchanged from April.
- **China's retail sales growth** was almost **stable** at 10% yoy in May from 10.1% in April
- **China retail trade** ticked **up** 10% yoy in May after a 10.1% yoy rise in Apr, driven by stronger car sales, while low global energy prices led to lower petrol sales.
- **China's foreign direct investment** for May came in at USD 8.9 bn, **down** -4.8% yoy, which is a deceleration from a USD 9.9 bn inflow in Apr, which was 2.8% yoy.
- **India industrial production fell** -0.8% yoy in Apr, with declines across most sectors. Internal demand is hampered by rising bad loans on bank balance sheets.
- **India CPI was stable** at 5.8% yoy in May, after a similar rise in Apr.
- **India wholesale price inflation** was **up** 0.8% yoy in May, from 0.3% in Apr.

- **India's central bank** governor Rajan announced that he **will not be seeking a second term** when the current term expires on Sep 4, a move that markets considers a blunder by Modi's government.
- **The Bank Indonesia unexpectedly cut interest rates** for the fourth time in 2016 by 25 bp to 6.5%, taking the total rate drop to 100 basis points this year in an attempt to fight disinflation and revive sluggish growth.
- **Singapore's non-oil domestic exports grew** 11.6% yoy in May after contracting a revised -7.9% in Apr.

Bottom line: *Another week where the flow of macro data did not change significantly in the medium term outlook. Financial markets' tensions Brexit, which in itself would not be such a disaster as it is often portrayed, signals that fundamentals remain shaky and investors fear that any relatively mild shock could derail the painfully slow recovery.*

Regional Developments

- **Bahrain introduced** a USD 100mn **liquidity fund** to enhance the depth of its illiquid stock market; supported by a number of market participants, the fund will act as market maker.
- **Egypt's central bank hiked interest rates** by 100bps to their highest level in years, in a bid to dampen inflation and ease downward pressure on the EGP. The overnight deposit rate was raised to 11.75% (highest level in over a decade) and the overnight lending rate was hiked to 12.75% (highest since 2008).
- **Egypt is likely to receive the second tranche of the African Development Bank (AfDB)'s loan** (USD 500mn) before end of the year, reported *Amwal Al Ghad*, citing an AfDB official.
- Due to natural gas shortages, **Egypt will cut gas supplies to industry** from Aug and divert them to meet increased demand from electric power plants, according to an official at the state gas board EGAS.
- **Inflation in Jordan dropped** by 0.11% mom and 1.6% yoy in May; overall, average inflation dropped by 1.2% during Jan-May 2016. The drop in May was due to a slowdown in transport (-8%), fuel and lighting prices (-7.5%), though rents (3.2%), culture and entertainment (4.3%) and health (2.9%) showed upticks.
- **Iraq has approved the reform package** as requested by the **IMF**, including settling of all oil arrears by end of the year. The IMF loan - USD 5.4bn over 3 years - is conditional on Iraq implementing measures to cut spending and increasing non-oil revenue. The Fund is expected to meet in end-Jun for approval of the loan.
- **Iraq plans to seek loans** to the tune of USD 20bn over the next three years (post-IMF loan agreement) to rebuild its infrastructure according to an economic adviser to the Baghdad government. The country has suffered war losses of about USD 7bn per year, which is roughly 3.0-5.0% of GDP.
- **Lebanon's central bank might increase its USD 1.5bn stimulus package** if needed, as the "objective is to stimulate internal demand", revealed the governor. He was quoted saying that only USD 600mn was left of the current USD 1.5bn package.

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- **Moody's** maintained a “**negative**” **outlook for Lebanon**, stating it “reflects the downside risks from the delay in implementing reforms that would help narrow the fiscal deficit”.
- **Qatar** is setting up **special economic zones**, with tax incentives, to attract foreign companies and capital. Under the draft law approved last week, the country plans three economic zones: a warehousing and logistics hub specialising in airfreight and technology; a light manufacturing site for petrochemical and food processing firms; and a zone focusing on construction materials and machinery.
- Total **ICT spending** by **Qatar's** “commercial sector” is **expected to rise** to around USD 2.8bn by 2019, compared to the USD 1.9bn spent in 2015, according to a report published by the Ministry of Transport and Communications.
- **Saudi Arabia's** cabinet has approved the introduction of a “**White Land tax**” (2.5% annual tax). ‘White Land’ has been defined as empty land designated for residential and commercial use within the urban growth boundaries of all cities. In stage one, the tax will apply to undeveloped land over 10,000 sq m within certified master planned developments will be taxed (no info provided on the master planned developments).
- **Saudi Arabia opens up retail and wholesale sector**: the cabinet approved rules “for foreign companies to invest in (the) wholesale and retail trade sector with 100% ownership” compared to the current 75%. Vision 2030 envisages the creation of an additional one million Saudi jobs by 2020 in a growing retail sector, while increasing the relatively low proportion of e-commerce.
- Dow Chemical Co disclosed that it had become the first foreign company to receive a **trading license** (which gives full ownership) from **Saudi Arabia**.
- **Bilateral trade** between **Saudi Arabia** and US touched USD 30bn. US is the second largest trading partner and accounts for the largest share of FDI.
- **Saudi Arabia** provided **total aid** of USD 99.75bn to developing countries during 1973-2009, according to the Saudi Ambassador to the UN. This is higher than the UN's targeted rate of development aid worth 0.7% of donor countries GDP.
- **Net profit** of the **GCC banks** expanded 6% qoq in Q1 this year, with Saudi Arabia leading the gain (13.9%), followed by Qatar (13.3%) and Kuwait (1.6%), according to research published by Global Investment House. **Total assets** expanded 5.6% yoy, with Qatar growing the strongest at 11.8%, followed by UAE (6.8%) and Saudi Arabia (2.2%).
- **Sovereign Wealth Funds** in the region clocked in an **average return on investment** of 4.1% versus the target of 5.9%, according to Invesco's Global Sovereign Asset Management Survey. The 15 regional funds interviewed either withdrew or cancelled planned investments equating to 7% of assets, while making new investments equating to just 3%. (Read the report: <http://igsams.invesco.com/pdf/IGSAMS-2016.pdf>)
- Around USD 3.5mn was **invested** in 126 **start-ups** by 12 MENAT-based accelerators, revealed the 2015 Global Accelerator Report, published by Gust. (Access the report for more details: <http://gust.com/middle-east-accelerator-report-2015/>)

- Qatar witnessed an 80% **expansion** in **millionaires** from 2007 to 2015, according to the **Middle East 2016 Wealth Report** published by New World Wealth, compared to 60% in the UAE and 25% in Saudi Arabia. Looking ahead, UAE is forecast to see a 50% jump in the number of millionaires living in the country by 2025 versus Qatar and Saudi Arabia's 45% and 40% respectively. (The report is available at <http://www.researchandmarkets.com/reports/3678151/the-middle-east-2016-wealth-report>)

UAE Focus

- **UAE** companies with annual revenues over AED 3.75mn will be obliged to **register under a Value Added Tax (VAT) system**, disclosed a senior Ministry of Finance official. Those whose revenues are between AED 1.87-3.75mn will have an option to either register or not during the first phase of rolling out the system; it will be obligatory from Phase 2 for which no date has been finalised.
- National Bank of Abu Dhabi (**NBAD**) and First Gulf Bank (**FGB**) have held preliminary talks on a **merger**, according to two banking sources. One said that an announcement could come as soon as this month - the merger would create the largest bank by assets in the Middle East and Africa.
- **Abu Dhabi** will introduce an **airport tax** of AED 35 on all passengers, including those in transit, from June 30; this follows similar moves in Dubai and Sharjah. The emirate also began imposing a 4% municipality **tax on hotel bills**, and a AED 15 charge per night per room, from the start of this month.
- **Inflation** in **Dubai** was by 0.2% mom and 1.5% yoy in May (Apr: 1.9% yoy). Housing prices were up 3.3% yoy while food and beverages prices fell by 0.5%.
- **Non-oil trade** in **Dubai** was **down** 3.6% yoy to USD 319bn in Q1 this year, according to Dubai Customs data. China retained the top trading partner spot (AED 39bn), followed by India (AED 24bn) and US (AED 22bn).
- According to the Chairman of DP World, **trade** between the Jebel Ali Free Zone (**JAFZA**) and **Japan** grew 36% in the past five years to AED 2.7bn in 2015.
- **Dubai's Meydaan** group disclosed raising AED 1bn of **Islamic financing** - AED 700mn through an issue of Islamic bonds and AED 300mn from a term financing facility - to strengthen "capital structure, diversify its investor base and support new projects".
- Emirates National Oil Company (**ENOC**) secured a USD 230mn **unsecured loan** from the Industrial and Commercial Bank of China (**ICBC**), to help fund new projects and support the company's expansion strategy and business operations.
- **Passenger traffic** through **Dubai airport** increased 7.2% yoy to 6.98mn in Apr, bringing the total to 27.93mn persons this year (+6.9% yoy).

Media Review

Diversification is a minefield

<http://www.advisorperspectives.com/commentaries/20160613-wells-fargo-asset-management-diversification-full-of-trade-offs-just-like-life>

China flunks the MSCI exam

<https://next.ft.com/content/68b885ac-3274-11e6-bda0-04585c31b153>

China turns to Islamic Finance to drive economic initiative

<https://www.zawya.com/mena/en/story/ZAWYA20160609081159/>

Renewable energy costs set to tumble; UAE plays major role - Irena

<http://www.thenational.ae/business/energy/irena-says-renewable-energy-costs-set-to-tumble-as-uae-plays-major-role>

An economist's defense of the world's tycoons and the businesses they build

<http://qz.com/703473/an-economists-defense-of-the-worlds-tycoons-and-the-businesses-theyve-built/>

IEX: 13th public stock exchange in the US

<http://qz.com/709271/iex-sec-approval-stock-exchange/>

Iran files complaint with ICJ to recover \$2bn frozen in US

<http://www.reuters.com/article/us-iran-politics-court-idUSKCN0Z12EU>