The Week Ahead: Awaiting the Fed's rate decision

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US: Our core scenario is a 25 bps rate hike

The key event this week will be the FOMC's meeting on 16-17 September. We believe that the US labour market has rebounded sufficiently to meet the FOMC's requirements for a rate increase. We continue to expect the Fed to raise rates on 17 September by 25 bps, with the healthy state of the US economy enabling it to weather a rise. The main growth driver is consumer spending, which is benefitting from continued increases in employment, gradually rising wages, and low energy prices. The real estate market and construction are also experiencing a rising trend. Finally, there are signs that corporations' capital expenditure growth has finally begun to accelerate. However, inflation remains subdued, and is likely to rise slowly. Key data releases from the US this week are expected to show healthy consumption (retail sales excluding gasoline and other volatile components), though with no pickup in headline inflation.

US: Global developments make timing of hike a close call

With the Fed highlighting global growth and market volatility as risks, the timing of the expected rate hike will be a tough call. Data from China and Japan last week added to concerns about slackening global growth. Markets have also remained jittery, though less volatile than at the end of August. The Fed may postpone its interest rate liftoff to October or December in light of these concerns. However, we would see limited benefit in doing so, as a delay would likely add to global market uncertainty. We believe that a rate hike could reassure markets, implying that the Fed sees the impact of the China-led slowdown as contained. We believe that the expected rate hike would be accompanied by a message highlighting that subsequent hikes would be slow and gradual. Separately, we expect the central banks of Japan and Egypt to keep rates on hold this week (at their respective 15 and 17 September meetings).

GCC: Some space not to follow any US rate hike

Given the GCC currency pegs to the USD, the focus will be on how regional central banks respond to any rate hike. We believe that some GCC countries could initially respond to an increase in the US federal funds target rate (FFTR) by raising their benchmark deposit rates whilst keeping their lending rates unchanged. Maintaining an accommodative monetary environment will likely be a key objective given the signs of weakening non-oil activity, contained inflation, and tightening liquidity in the banking sector. The majority of GCC countries reduced their benchmark lending rates by a lesser degree than the US in 2008 and 2009, thus widening the differential (Figure 1). Non-interest rate monetary tools will also be important for the GCC countries going forward. We expect their central banks to ensure ample liquidity (in local currencies and USD) in the banking system should any tightness arise.

I. Recent Data and Events

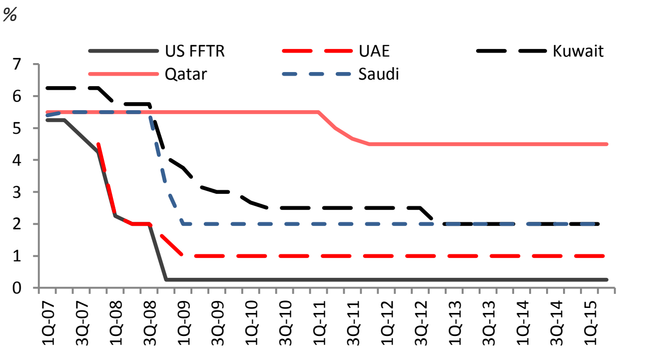
A. MENA Economies

GCC: Qatar development plans unchanged despite weaker hydrocarbon prices

Qatar well positioned to withstand falling hydrocarbon prices: BBE oil price and debt level low

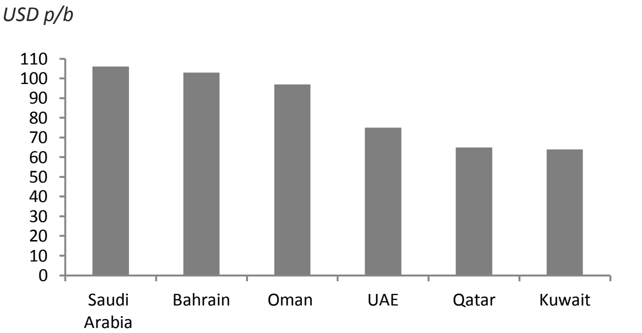
Qatar is not looking to scale back its development plans or reduce subsidies despite the sharply lower hydrocarbon prices, according to Minister of Finance Ali Sherif Al Emadi. He highlighted that international events, particularly the 2022 World Cup, require investments worth USD200 billion in 2014-2022. Moreover, Al Emadi reasserted the country's commitment to the education sector. A low budget breakeven (BBE) oil price of around USD65 p/b and a relatively contained fiscal deficit support the spending outlook. While we expect government spending to remain expansionary in 2015 and 2016, we highlight that Qatar had already implemented some rationalisation of government spending and its development plans before the fall in hydrocarbon prices. Nevertheless, with the government largely progressing with its investment plans, we continue to see robust real non-hydrocarbon GDP growth of 10.2% in 2015 and 9.7% in 2016. For more details on our Qatar economic outlook, please see our note – **Qatar: Growth outlook remains strong, investment returns critical (29 July 2015).**

Fig. 1. GCC: Differential between GCC benchmark lending rates and FFTR widened in 2008 and 2009



Source: Regional central banks, Bloomberg

Fig. 2. GCC: BBE oil price varies sharply among GCC countries, reflecting differing abilities to withstand lower price



Source: IMF, ADCB estimates

However, we believe that the reduction of subsides will benefit medium-term fiscal sustainability. Moreover, reducing subsidies in a low oil price environment (as seen in the UAE) will be less painful for consumers. We do not expect Saudi Arabia to implement subsidy reforms.

Saudi Arabia reiterates plans to cut non-essential expenditure

Saudi Arabia capital expenditure: Saudi Arabia has again reiterated that it is looking to cut non-essential expenditure. Minister of Finance Ibrahim Al Assaf has indicated that the government plans to cut spending and delay some state funded projects in response to the lower oil prices. However, investment spending on education, health, and infrastructure are to remain priorities. We believe that 2H2015 project awards will be weaker than those seen in 1H, when awards remained robust. There is already some uncertainly regarding a number of projects, such as the plan to build 11 football stadiums. Our growth forecasts for 2016 assume sharply lower capital and current expenditure, stemming from the need to reign in the fiscal deficit. We estimate a budget breakeven oil price of USD106 p/b for Saudi Arabia in 2015.

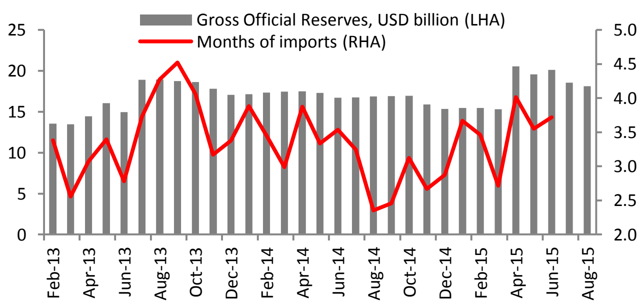
Egypt: Again looking to tap bond market as FX reserves fall in August

Egypt's second debt issuance in 2015 expected in November or December

Egypt is looking to raise up to USD1.5 billion via bonds by year end, according to Samy Khallaf, head of the Finance Ministry's debt management unit. This is to be part of the country's USD10 billion bond programme, under which Egypt sold USD1.5 billion of 10 year bonds in June 2015. The further debt issuance will be vital to moderating the decrease in international reserves, especially given the weak current account outlook and absence of additional international aid/grants expected for the remainder of the year. Data for August showed that Egypt's net international reserves fell to USD18.1 billion, the second consecutive monthly decline. The funding terms for any upcoming issuance may, however, be less favourable than in July (with a yield of 6%), due to the Fed's expected rate hike, poorer EM sentiment, and Egypt's weaker FX reserve position.

Fig. 3. Egypt: FX reserves down versus April 2015, when Kuwait, Saudi Arabia, and UAE deposited USD6 billion with CBE

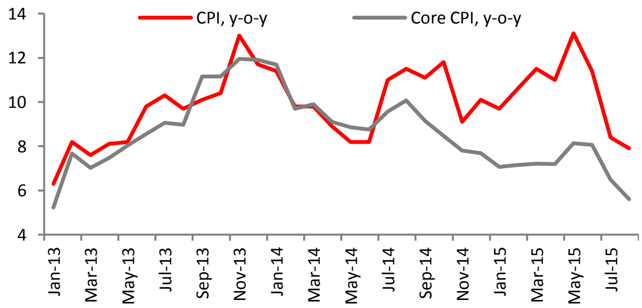
USD billion (LHA); months (RHA)



Source: Central Bank of Egypt, Bloomberg

Fig. 4. Egypt: Headline inflation falls to 7.9% y-o-y in August 2015, providing room for further EGP weakening against USD

% change y-o-y



Source: Bloomberg

Further EGP weakening expected

Recent official comments also suggest that the EGP needs to be weakened further to support export competitiveness. We believe that the recent easing in inflation and the benign global inflation environment support the outlook for further depreciation of the EGP against the USD. Inflation moderated to 7.9% y-o-y in August, from 8.4% in July, whilst core inflation softened to 5.6%. Egypt has already weakened the EGP against the USD twice in 2015 in a bid to boost exports and strengthen its FX reserve position. Notably, the parallel EGP market has returned in September, having been absent for the previous few months. The overvalued EGP is also hampering capital inflows into Egypt, and further devaluation of the currency is expected.

No change to economic policy expected

New cabinet to be formed: Egypt's cabinet resigned on 12 September in a surprise move. Oil Minister Sherif Ismail has been tasked with forming a new cabinet within one week of the resignation. There has been no official announcement regarding the reasons for the resignation; media are suggesting that President Abdel Fattah El Sisi was unhappy with some ministers' performances. Moreover, earlier last week, the cabinet was rocked by corruption allegations. Egypt's Agriculture Minister Salah Helal resigned, and was arrested in connection with a corruption investigation. We do not expect any substantial changes to economic policy following the formation of the new government. However, the focus will likely be on better implementation of the key economic objectives. We believe that policy will remain focused on boosting investment and fiscal reforms. The change to the cabinet could, however, delay the introduction of VAT. Meanwhile, parliamentary elections are to start in October.

B. G4 Economies

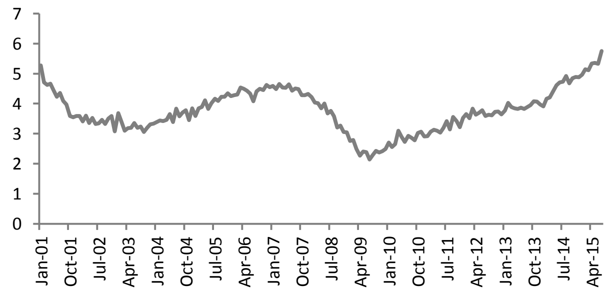
US: JOLTS data point to labour market tightening

Job openings hit record high in July

The US Job Openings and Labour Turnover Survey (JOLTS), an important indicator for labour market developments, pointed to solid activity in July. Job openings increased by 430K to 5.8 million, the highest level since the series started in December 2000. This pushed the job openings rate to 3.9% in July, after it had held steady at 3.6% for the preceding three months. Moreover, signs of labour market tightening were underscored by a sharp drop in the number of unemployed job seekers per open job to a record low of 1.44 in July, from 1.56 in June. The JOLTS data reinforced our view that the job market is strong enough to weather a rise in interest rates. We continue to expect the Fed to raise rates on 17 September, though prevailing concerns about global market volatility make the timing of the expected rate hike a tough call.

Fig. 5. US: Job openings rise to highest recorded level in July, pointing to healthy labour market

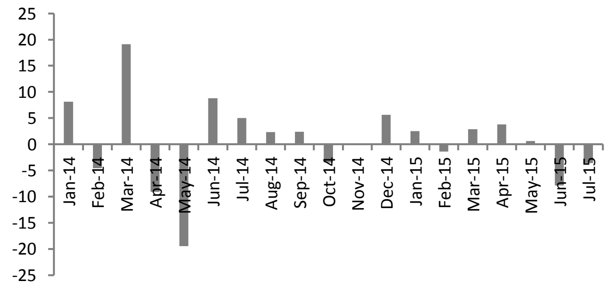
Job openings, million (SA)



Source: Bureau of Labor Statistics

Fig. 6. Japan: Machine orders contract for second consecutive month in July

% change m-o-m



Source: Bloomberg

Japan: 2Q GDP growth revised up, investment growth down

Deeper contraction in investment growth in 2Q

Revised data showed that Japan's economy contracted by a weaker amount in 2Q2015 (-1.2% q-o-q annualized) than originally estimated (-1.6% q-o-q annualized). However, the growth driver composition looked weaker, with a stronger buildup in inventories being the main factor behind the smaller contraction. Inventory gains added 0.3 pp to growth, more than the preliminary estimate of 0.1 pp. The contribution from consumption was also revised higher, to 0.2 pp. Meanwhile, private non-residential investment growth was reduced considerably, to -0.9% q-o-q from -0.1% initially.

Government may have to introduce additional spending measures if demand remains weak

Japan's real GDP is expected to resume positive growth in 3Q2015 on the back of stronger private consumption. Corporate capital expenditure is also expected to strengthen on the back of improved earnings. Data thus far for 3Q point to weak recovery in corporate investment. Japanese machinery orders fell unexpectedly by -3.6% y-o-y for a second straight month in July, versus the consensus expectation of a 3% increase. Following the weak data, Prime Minister Shinzo Abe pledged a corporate tax cut, though this is unlikely to boost economic activity in the short term. The government plans to lower the corporate tax rate by a cumulative 3.3 pp over two years starting in FY2016-17 (April-March). If consumer spending fails to pick up, then the government may need to compile a supplementary budget to support growth. Greater fiscal stimulus may be more beneficial to the economy than monetary stimulus in the current environment considering the soft growth outlook in China. A weaker JPY, achieved through further monetary loosening, would be unlikely to bolster Chinese demand for Japanese exports. Nevertheless, we predict further monetary easing in 1Q2016, with inflation remaining low and substantially below the BoJ's target. This may be brought forward if domestic demand shows further signs of weakening.

UK: Monetary policy remains steady, balancing external and domestic developments

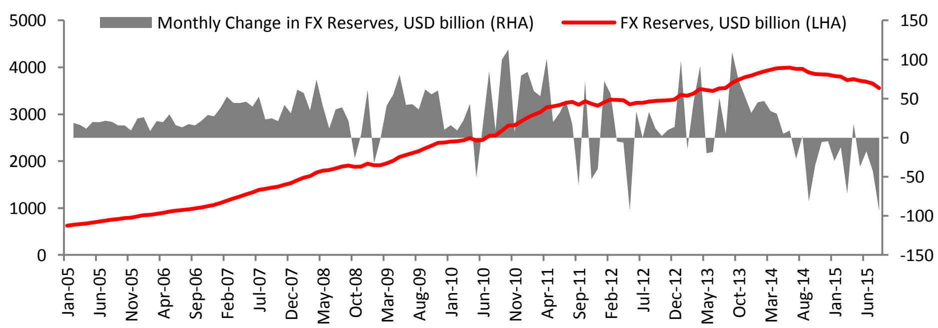
Minutes and post-meeting statement imply less concern over global developments

The BoE last week left the benchmark interest rate at 0.5% and the purchase target at GBP375bn, as expected. In line with the previous meeting, the Monetary Policy Committee voted 8-1 to keep rates steady; Ian McCafferty remained the only dissenter. The accompanying statement and overall minutes indicated less concern over slowing growth in China and other emerging markets than has been expressed by the Fed. Whilst the MPC did indicate that downside risks to the economic outlook have increased, global developments did "not as yet appear sufficient to alter materially the central outlook". The MPC highlighted that any external headwinds must be weighed against the prospects of continued healthy domestic expansion. The BoE retained its steady growth outlook, though it lowered its 3Q2015 real GDP growth forecast marginally, to 0.6% q-o-q (from 0.7%) on the back of weaker service activity. Inflation is still expected to pick up by the end of 2015. We continue to foresee an initial rate hike by the BoE in 1Q2016.

C. Emerging Market Economies

Fig. 7. China: FX reserves fall by USD93.9 billion in August

USD billion



Source: Bloomberg

China: FX reserves fall sharply in August; wider data reflect weak domestic environment

FX reserves fall in August on back of PBoC intervention in CNY market and capital outflows

China's FX reserves fell by USD93.9 billion in August to USD3.6 trillion, greater than the USD43 billion drop in July and the average decrease of USD26 billion per month in 1H. Taking valuation adjustments into account, the drop could have been even larger at about USD110 billion. The August fall was the largest monthly decline on record, reflecting the PBoC's FX intervention following the 11 August CNY devaluation and increased capital outflows. We expect FX reserves to fall less heavily in subsequent months, especially following the measures to stem currency speculation introduced earlier in September and the policy emphasis on a stable CNY. Nevertheless, capital outflows remain a risk in light of the expected US rate hike and weak confidence in China's economic prospects. As such, we continue to foresee further reductions in the reserve requirement ratio (RRR) – by 50-100 bps before year end – to ensure sufficient banking sector liquidity.

Meanwhile, data for August continued to highlight the weak domestic demand environment, supporting our expectations of further measures to bolster growth. We also expect a further 25-50 bps of interest rate cuts in 2015, alongside increased government investment.

Fall in imports reflects weak domestic demand environment and low commodity prices

Trade developments: China's imports fell -13.8% y-o-y in August, far more than the -7.9% that analysts had forecast. The contraction in import growth continued to reflect both lower global commodity prices and sluggish domestic demand. The unexpected CNY devaluation in August, combined with slowing consumer demand, is likely to dent the prospects of imports picking up significantly in the near future. Exports also continued to contract in August, adding to China's weakening growth outlook. However, exports fell by -5.5% y-o-y, less than the consensus expectation of -6.6% and the July print of -8.3%. The export growth outlook remains weak, with policy makers reiterating a stable CNY outlook following the August devaluation.

Inflation: Consumer inflation accelerated to 2% y-o-y in August, above the market expectation of 1.8% and up from 1.6% in July. The rise was due largely to food (pork, vegetable, and egg) price increases, as well as the lower comparison base. While inflation could rise further in the coming months, driven by temporary supply-side factors (led by food price growth), it is expected to remain low overall and supportive of further monetary loosening. Demand side price pressure remains weak. Moreover, the PPI for August highlighted weak outlook for core inflation; the measure fell slightly more than expected to -5.9% y-o-y in August, versus -5.4% in June and against the market expectation of -5.6%. Overcapacity and the latest fall in oil prices are keeping PPI in deflationary territory.

II. Economic Calendar

Fig. 8. Upcoming Events and Data Releases

Time*	Country	Data point	Period	Prior	Consensus
Expected this week					
	Oman	CPI, y-o-y	Aug	0.5%	
	Qatar	CPI, y-o-y	Aug	1.6%	--
Monday, 14 Sept					
13:00	Eurozone	Industrial Production SA, m-o-m	Jul	-0.4%	0.3%
13:00	Eurozone	Industrial Production, y-o-y	Jul	1.2%	0.7%
16:00	India	CPI, y-o-y	Aug	3.8%	3.6%
Tuesday, 15 Sept					
07:00	Japan	Bank of Japan Policy Statement/Kuroda Press Conference			
	Japan	BOJ Annual Rise in Monetary Base	15-Sep	¥80T	¥80T
12:30	UK	CPI, m-o-m	Aug	-0.2%	0.2%
12:30	UK	CPI, y-o-y	Aug	0.1%	0%
12:30	UK	CPI Core, y-o-y	Aug	1.2%	1%
13:00	Germany	ZEW Survey Current Situation	Sep	65.7	64
13:00	Germany	ZEW Survey Expectations	Sep	25	18.3
16:30	US	Retail Sales Advance, m-o-m	Aug	0.6%	0.3%
16:30	US	Retail Sales, ex-Auto and Gas, m-o-m	Aug	0.4%	0.4%
16:30	US	Retail Sales Control Group, m-o-m	Aug	0.3%	0.4%
16:30	US	Empire Manufacturing	Sep	-14.9	-0.2
17:15	US	Industrial Production, m-o-m	Aug	0.6%	-0.2%
Wednesday, 16 Sept					
12:30	UK	Jobless Claims Change	Aug	-4.9K	-5K
13:00	Eurozone	CPI, m-o-m	Aug	-0.6%	0%
13:00	Eurozone	CPI, y-o-y	Aug F	0.2%	0.2%
13:00	Eurozone	CPI Core, y-o-y	Aug F	1%	1%
15:00	US	MBA Mortgage Applications	11-Sep	-6.2%	--
16:30	US	CPI, m-o-m	Aug	0.1%	-0.1%
16:30	US	CPI, ex-Food and Energy, m-o-m	Aug	0.1%	0.1%
16:30	US	CPI, y-o-y	Aug	0.2%	0.2%
16:30	US	CPI, ex-Food and Energy, y-o-y	Aug	1.8%	1.9%
16:30	US	Real Avg Weekly Earnings, y-o-y YoY	Aug	2.0%	--
Thursday, 17 Sept					
	Egypt	Deposit Rate, %	17-Sep	8.75%	--
	Egypt	Lending Rate, %	17-Sep	9.75%	--
3:50	Japan	Trade Balance	Aug	-¥268.4B	-¥542.5B
3:50	Japan	Exports, y-o-y	Aug	7.6	4.4
3:50	Japan	Imports, y-o-y	Aug	-3.2	-2.5
16:30	US	Housing Starts	Aug	1206K	1170K
16:30	US	Initial Jobless Claims	12-Sep	--	--
22:00	US	FOMC Rate Decision (Upper Bound)	17-Sep	0.25%	0.5%
22:00	US	FOMC Rate Decision (Lower Bound)	17-Sep	0%	0.25%
Friday, 18 Sept					
3:50	Japan	BOJ Minutes for Aug. 6-7 Meeting			

* UAE time
Source: Bloomberg

Fig. 9. Last Week's Data

Time*	Country	Data point	Period	Prior	Consensus	Actual
Announced last week						
	Saudi Arabia	Non-Oil Exports, y-o-y	Jul	-21.1%	--	-20.1%
	China	New Yuan Loans	Aug	CNY1480B	CNY850B	CNY809.6B
	China	Aggregate Financing	Aug	CNY718.8B	CNY1000B	CNY1080B
Monday, 7 Sept						
	Egypt	Net International Reserves	Aug	$18.5B	--	$18.1B
10:00	Germany	Industrial Production SA, m-o-m	Jul	-0.9%	1.1%	0.7%
10:00	Germany	Industrial Production, y-o-y	Jul	0.9%	0.3%	0.5%
Tuesday, 8 Sept						
	China	Trade Balance	Aug	$43B	$48B	$60.2B
	China	Exports, y-o-y	Aug	-8.3%	-6.6%	-5.5%
	China	Imports, y-o-y	Aug	-8.1%	-7.9%	-13.8%
3:50	Japan	Trade Balance, BoP basis	Jul	¥102.6B	¥80B	¥108B
3:50	Japan	GDP SA, q-o-q	2Q F	-0.4%	-0.4%	-0.3%
3:50	Japan	GDP Annualized SA, q-o-q	2Q F	-1.6%	-1.8%	-1.2%
3:50	Japan	GDP Private Consumption, q-o-q	2Q F	-0.8%	-0.8%	-0.7%
13:00	Eurozone	GDP SA, q-o-q	2Q P	0.3%	0.3%	0.4%
13:00	Eurozone	GDP SA, y-o-y	2Q P	1.2%	1.2%	1.5%
14:00	US	NFIB Small Business Optimism	Aug	95.4	96	95.9
Wednesday, 9 Sept						
9:15	UAE	Dubai Economy Tracker SA	Aug	53.1	--	57.6
12:30	UK	Industrial Production, m-o-m	Jul	-0.4%	0.1%	-0.4%
15:00	US	MBA Mortgage Applications	4-Sep	11.3%	--	-6.2%
Thursday, 10 Sept						
	Egypt	Urban CPI, y-o-y	Aug	8.4%	--	7.9%
	Egypt	Urban CPI, m-o-m	Aug	0.7%	--	0.6%
3:50	Japan	Machine Orders, m-o-m	Jul	-7.9%	3%	-3.6%
5:30	China	CPI, y-o-y	Aug	1.6%	1.8%	2%
15:00	UK	BOE Asset Purchase Target	Sep	375B	375B	375B
15:00	UK	Bank of England Bank Rate	10-Sep	0.5%	0.5%	0.5%
16:30	US	Initial Jobless Claims	5-Sep	281K	275K	275K
Friday, 11 Sept						
16:00	India	Industrial Production, y-o-y	Jul	4.4%	3.6%	4.2%
18:00	US	U. of Mich. Sentiment	Sep P	91.9	91.1	85.7
18:00	US	U. of Mich. Current Conditions	Sep P	105.1	--	100.3

* UAE Time
Source: Bloomberg

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