The Week Ahead: FOMC and BoJ meetings to drive markets

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US: FOMC to keep rates on hold

We expect the FOMC to keep monetary policy steady at its September meeting (on 20-21), in line with consensus. We believe that the Fed will wait for the December meeting to raise rates by 25 bps. The FOMC will likely want to see some signs of a pickup in inflationary pressures before hiking. The focus will be on the accompanying statement and post-conference comments by Fed Chair Janet Yellen, in which we expect her to reiterate recent comments that the case for an increase in the fed funds rate has strengthened and that economic conditions will warrant a further normalisation in rates before year end. Regarding the labour market, we believe that the conditions already meet the Fed's requirement for a rate hike. However, FOMC members still seem divided over the need to hike next week. While governors Bullard, Rosengren and Dudley had suggested the possibility of a September raise in their August speeches, recent dovish comments by board member Brainard have dampened the probability of one next week. When the Fed does hike, we expect most GCC countries to follow by raising their deposit rates (as in December 2015), whilst keeping benchmark lending rates steady. Kuwait was the only country to increase lending rates in December 2015.

Japan: BoJ to stick to its 2% inflation target

The BoJ meeting (20-21 September) will also be in focus, where the central bank will present its assessment of the QQE policy, in operation since April 2013. We expect the BoJ to re-affirm its commitment to bringing inflation back to 2% y-o-y in the long term, though a specific timeline for this target may be dropped. We also expect some measures by the BoJ to stem the JPY's strength, which in our view has been the strongest external shock to inflation expectations and economic momentum. We expect the bank to provide guidance on when it will cut rates further into negative territory to further weaken the currency, notwithstanding the objections from the financial sector. We believe negative interest rate policy will take precedence over the expansion of asset purchases by the BoJ in the near term as the exchange rate shock of a stronger currency poses a greater risk to its inflation target than domestic price dynamics.

Turkey: CBRT to continue normalising policy rates

The CBRT is likely to cut its overnight lending rate by another 25 basis points at its monetary policy meeting (Thursday). We believe the bank is likely to continue simplifying its monetary toolbox by bringing its overnight lending rate (8.50%) closer to its benchmark policy rate (7.5%), as long as global risk sentiment towards EM assets remains supportive. However, once the two rates converge towards year end, we expect the CBRT to have little room to cut rates any further, as this might cause a sharp tightening in external funding conditions.

I. Recent Data and Events

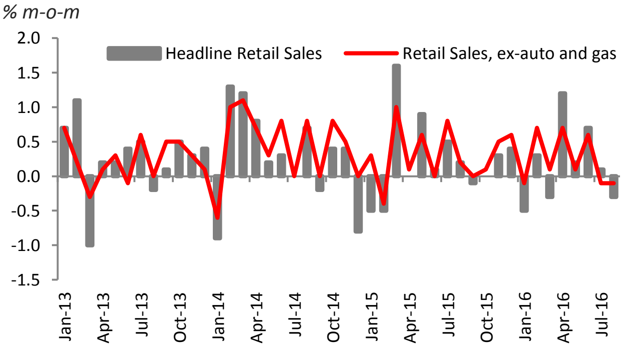
A. G4 Economies

US: Economic data supportive of our case for December hike

Retail sales in August come off after exceptionally strong 2Q2016

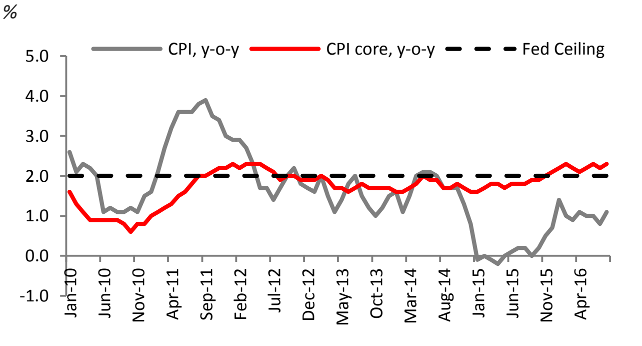
Retail sales in August moderated slightly, falling -0.3% m-o-m (consensus: -0.1%; July: 0.1%), though lower gasoline prices caused much of this decline. Excluding this volatile category, the decline in retail sales was more modest (unchanged at -0.1% m-o-m since July). Though the retail sales numbers for August might weaken the case for a Fed rate hike in September, we do not see them as signalling a renewed weakness in consumer spending. In our view, household consumption is pulling back from the extremely strong 4.4% q-o-q saar growth seen in 2Q2016. Interestingly, while retail sales ticked down in August, there was also a significant increase in retail inventories and orders over the month. To us, this suggests that firm-level expectations of consumer spending remain strong, and we could once again see a rebound in retail sales in 4Q2016 ahead of the festive season.

Fig. 1. US: Retail sales ticked down in 3Q, after having remained strong through 2Q



Source: US Census Bureau

Fig. 2. US: Core inflation now above Fed ceiling, reflecting firming wage momentum



Source: Bureau of Labour Statistics, US

Inflation picked up more than expected in August, supporting our case for December hike

Meanwhile, inflation came in stronger than expected in August, with prices rising by 1.1% y-o-y (consensus: 1%; July: 0.8%). Core prices, which we believe are a better measure of wage-related inflationary pressures, rose by 2.3% y-o-y. The distribution of price increases revealed more evidence of a push-up to inflation from a strong labour market, as rental and medical care costs were the two major drivers of inflation in August. We expect inflation to further increase in the next two to three months, as higher core prices are likely to be complemented by a rise in energy prices. Given these dynamics, we expect the Fed to provide strong hints of a December rate hike to prepare the markets, while it may still hold back from hiking rates next week.

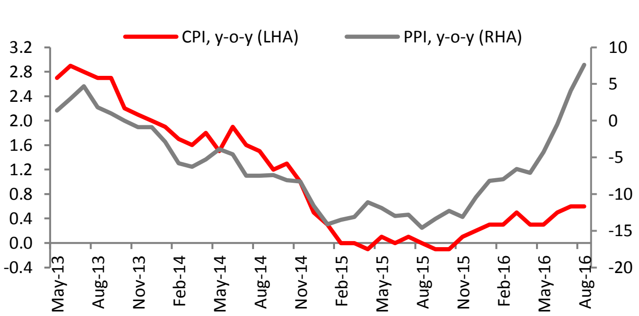
UK: Scant signs of Brexit-driven slowdown

Inflation remained stable in August, though input price pressures are rising

UK data released last week showed few signs of an economic slowdown post the Brexit vote. Inflation remained stuck at low levels, coming in at 0.6% y-o-y in August (consensus: 0.7%; July: 0.6%), as firms refrained from passing on higher import prices to consumers. Interestingly, prices of discretionary goods – clothing, furniture and hotel accommodation - have seen the sharpest declines since the Brexit vote, which to us suggests that retailers might be discounting prices to de-stock inventories as the economic outlook becomes more uncertain. We expect inflation to rise above 1% y-o-y before the year-end, as producers begin to transmit some of the higher input prices to customers. Indeed, the impact of GBP depreciation is already being seen on producer prices which jumped by 7.6% y-o-y (4.1% y-o y previously). However, if the UK government cuts VAT significantly in its spending review in November, we could see inflation undershooting our current estimates in 2017.

Fig. 3. UK: Headline inflation remains stable, but input prices already under pressure from GBP depreciation

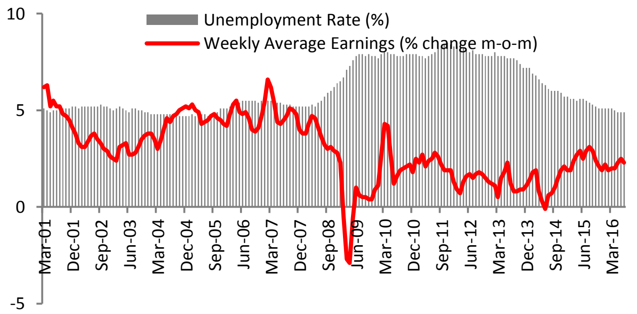
%



Source: Office for National Statistics, UK

Fig. 4. UK: Labour markets have remained stable post-Brexit vote, as near-term uncertainty has lessened

%



Source: Office for National Statistics, UK

Near-term stabilisation of economic sentiment has kept labour markets resilient

Meanwhile, the labour market remained resilient in July, with the unemployment rate remaining at a 10-year low of 4.9%. Employment and wage growth also came in above market expectations. In our initial assessment of the economy following the Brexit vote, we had expected a sharp decline in hiring sentiment and labour market conditions. However, we see two reasons why it has avoided an immediate downturn in momentum. First, pro-active monetary easing by the BoE has allayed the near-term funding concerns of corporates. Second, the selection of a relatively moderate Theresa May as the new PM has kept the hard-line anti-EU politicians at bay, ensuring for now the prospect of an orderly Brexit. That said, we still expect a gradual decline in the pace of job creation over the coming months. Hiring sentiment surveys, which tend to lead actual employment numbers by three to six months, are edging down, with employers hinting at hiring freezes in 2017.

UK: BoE keeps policy rates on hold, sounds less downbeat on economy

BoE significantly less dovish on near-term economic outlook; maintains policy stance

BoE kept the size of its asset purchases and the Bank Rate unchanged at its meeting last week, in line with our and the market's expectations. However, the policy statement following the meeting was significantly less dovish, reflecting the change in the BoE's assessment of the near-term prospects of the economy following a string of stronger than expected economic data so far in 3Q2016. In particular, the central bank noted that the dynamics of housing market and consumer spending have been less negative than it had expected in its August assessment of the economic outlook. The BoE also revealed that the initial response to its August monetary stimulus has been positive, with a number of banks cutting lending rates, which might have supported economic activity. That said, it cautioned over the long-term risks to the economy from Brexit, suggesting that it would keep the option of further monetary easing open if economic conditions deteriorated to levels consistent with those highlighted in its August report.

No further easing by central bank before 2017

We believe that the BoE's recent comments have set a high bar for further easing, and that any further policy action by the central bank will not come before 2017. The bank's projections for growth and inflation both argue against the possibility of further monetary easing in November. In its latest projections, the central bank revised up its growth forecasts for 3Q2016 to 0.2% q-o-q (0% in August forecasts) and expected inflation to rise more gradually than it had previously expected. Further, we see a strong possibility of a fiscal stimulus by the UK government in its November spending review, which may provide more support to the economy. This again supports our case that the BoE, which has so far been more reserved in its preference for aggressive QE compared to its peers in Japan and Eurozone, might refrain from easing monetary policy unless we see the economy heading towards outright stagnation.

B. Emerging Market Economies

India: Inflation drops sharply in August but not enough to merit October rate cut

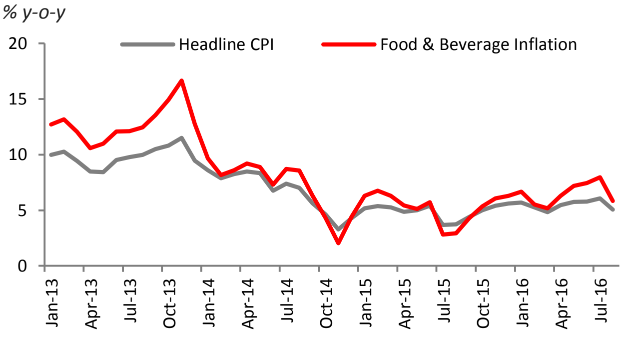
Inflation decelerates sharply as prices of vegetables and pulses decline

Inflation showed a remarkable deceleration in August, rising by only 5.1% y-o-y (consensus: 5.2%; July: 6.1%). Prices of pulses and vegetables, which had been the major drivers of inflation over the summer, saw significant declines over the month. We estimate that almost the entire fall in the inflation rate (91 bps) was simply due to inflationary pressures easing in these segments. We expect further moderation in pulse prices, as sowing is so far up 30% y-o-y, in response to plentiful rainfall in pulse-growing areas. Similarly, good rains and the recent resolution of strikes by agricultural wholesalers will help ease the rise in vegetable prices. We expect food inflation to range between 4.5-6.5% y-o-y until March 2017 (5.9% y-o-y currently).

RBI should stay on hold at 4 October meeting; we expect 25 bps rate cut in December

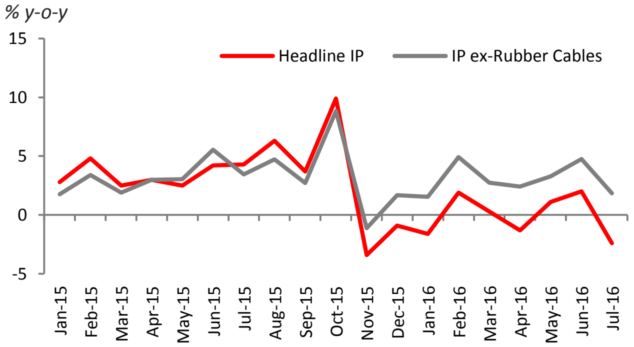
That said, we do not expect the RBI to cut the benchmark policy rate in its 4 October meeting. We do not see any broad disinflationary trends in the economy yet. While food inflation has remained volatile throughout the year, core prices have remained stable at between 5.2–5.5% y-o-y. In our view, the RBI will carefully monitor the inflation numbers until November to see if the easing in prices seen in August sustains itself. It will be particularly watchful of the impact that public sector pay hikes might have on core inflation, though we believe that this will not be as inflationary as it has been in previous such cycles. Furthermore, the RBI will also prefer to wait to see the impact of the Foreign Currency Deposit redemption close to USD20 billion due in November on the INR, and hold back a rate cut to stave off the volatility in capital flows. We believe that inflation will stabilise into a 5–5.5% y-o-y range by December, well below the RBI's upper inflation limit of 6% y-o-y, allowing the central bank to ease policy rates by another 25 basis points in its December meeting.

Fig. 5. India: Sharp drop in food inflation pushes down headline CPI



Source: Ministry of Statistics and Program Implementation, India

Fig. 6. India: Headline numbers stronger, excluding effects of Rubber and Cables – a small and volatile segment



Source: Ministry of Statistics and Program Implementation, India

Decline in industrial output was unrepresentative in our view, though overall dynamics still remain fragile, except for consumer durables.

Meanwhile, industrial output contracted by -2.4% y-o-y in July (consensus: 1.4%; June: 2%), highlighting the still-fragile investment cycle in India. However, we remain sceptical of the pessimism with which this data has been interpreted in the markets as a signal of a downturn in India's economic momentum. We agree that the industrial sector in India has been stricken with overcapacity, high leverage and a lack of export demand, and in the near term is likely to grow by the low single digits. However, the headline IP numbers are contaminated by sampling defects, in our view. Much of the decline (-4.2 pp) in the July numbers was due to a massive drop in the output of a small but volatile category – Rubber and Cables (0.12% of the index). We note that reports in Indian business newspapers recently revealed that the samples for industrial output taken for the segment come from just one company that supplies to a single public sector telecom services provider, and therefore the volatile dynamics perhaps reflect the delivery cycle for that company rather than that of the entire sector. Excluding this component, India's IP has been in the range of 2-5% y-o-y over the last 18 months, which we believe is more in line with other indicators of economic activity (infrastructure output, cement output, railway freight etc.). Also consumer durables output continues to benefit from falling inflation, robust growth in consumer credit and structural reforms to boost consumption. Output of television sets, air conditioners, furniture and mobile phones has continued to grow in double-digits this year.

China: Signs of strong fiscal support for economy

Macroeconomic data in August positively surprised consensus, reflecting impact of supportive fiscal policy

Macroeconomic data from China rebounded strongly in August, soothing concerns about a slowdown that had risen in the wake of weakening economic momentum in July. In particular, the impact of a supportive fiscal stance was visible across indicators, with infrastructure investment stabilising, credit growth rising in response to local government borrowing and industrial output staging a modest rebound. However, we still see downside risks to the economy from slowing private capex and make no change to our 2016 GDP growth forecast of 6.5%.

Local government bond issuances and strong household credit growth propped up credit aggregates

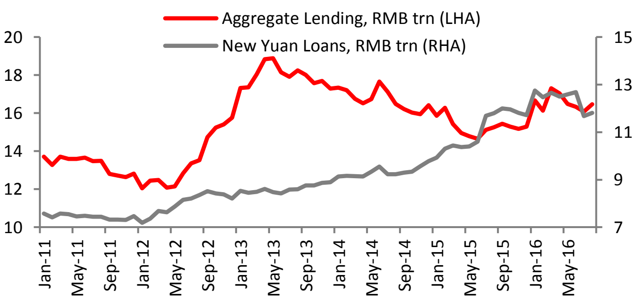
Aggregate financing rose by RMB1470 billion in August (consensus: 900; July: 488), underpinned by a strong increase in bond issuance by local governments to finance infrastructure investments. Much of this jump in local government borrowing was a result of central government's measures to alleviate their previous debt obligations through a swap. In August, the amount of debt swapped rose to RMB723 billion (up from RMB251 billion in July). Loans to households remained firm, particularly in the mortgage segment, rising by RMB646 billion (from RMB458 billion in July). Despite the positive turn in the credit numbers, we remain less sanguine about their impact on China's near-term growth potential. We note the divergence between M1 and M2 money supply growth as an indicator of the ongoing deleveraging cycle in China, particularly in the corporate sector. The rapid increase in M1 liquidity (currency and demand deposits) has not been mirrored by M2 metrics (which include time and longer-term deposits). This suggests that banks and firms are using cash injections by the PBoC to pay back loans or build contingency buffers. The potency of the monetary stimulus is therefore likely to remain weak, particularly in the corporate sector.

Fixed investment growth stabilises at low level, following strong infrastructure investment growth

A combination of fiscal and monetary support ensured that investment data remained stable in August. Fixed-asset investment growth bottomed out, remaining stable at 8.1% y-o-y, supported by double-digit infrastructure investment growth (19.7% y-o-y). We believe that an acceleration in fiscal spending to 10.5% y-o-y (from 0% in July) was responsible. Real estate investment also stabilised (6.2% y-o-y) after four consecutive months of decline. We expect real estate investment growth to accelerate mildly over the coming months, responding to the steady increase in household mortgage lending since May. Industrial production rose by 6.3% y-o-y (consensus: 6.2%; July: 6%), which was higher than our estimate. However, we remain sceptical about a rebound in industrial output, as the August numbers were boosted by two extra working days compared to 2015. Firm-level production data on industrial goods continue to suggest signs of deceleration.

Fig. 7. China: Credit aggregates boosted by government bond issuance and strong household borrowing

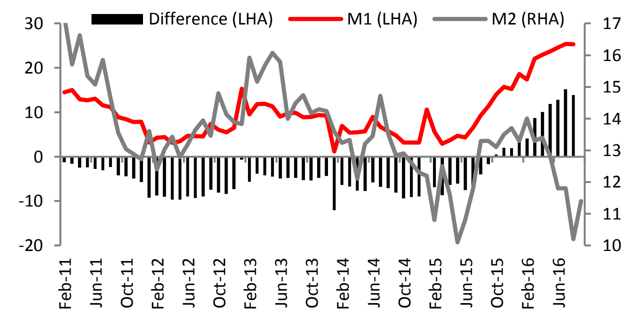
12m rolling sum



Source: People's Bank of China

Fig. 8. China: Rising gap between M1 and M2 growth suggests weakening monetary transmission

% y-o-y (LHA), % y-o-y (RHA)



Source: People's Bank of China

Government could draw down deposits available with PBoC to impart a greater fiscal impulse than implied in budget deficit target

We believe that these dynamics reflect the recent policy preferences of the Chinese Communist Party. The minutes from a State Council meeting chaired by Prime Minister Li Keqiang earlier this month suggested that the government would take steps to encourage state-owned companies to invest in electricity grids, telecoms and urban infrastructure. In our view, these measures are intended to stem the deceleration seen in fixed-asset investment in 2Q2016. We believe that the fiscal support to the economy in 2H2016 is likely to be more than what is implied by the fiscal deficit target of 3% of GDP in 2016 (2.4% in 2015). Additional support could come from a drawdown of central government deposits with the PBoC or through local government debt swaps.

II. Economic Calendar

Fig. 9. Upcoming Events and Releases*

Time*	Country	Data Point	Period	Prior	Consensus
Expected this week					
	Saudi Arabia	CPI, y-o-y	Aug	3.8%	--
	Saudi Arabia	GDP Constant Prices, y-o-y	2Q	1.5%	--
	Oman	Nominal GDP YTD, y-o-y	2Q	-12.2%	
	Oman	CPI, y-o-y	Aug	1.3%	--
	UAE	CPI, y-o-y	Aug	1.8%	
	UAE	M2 Money Supply, m-o-m	Jul	-2.3%	--
	Kuwait	CPI, y-o-y	Aug	3.1%	--
	India	Current Account Balance, USD bn	2Q	0.3	2.7
Monday, 19 Sep					
03:01	UK	Rightmove House Prices, m-o-m	Sep	-1.2%	--
04:30	China	Property Prices	Aug		
Tuesday, 20 Sep					
16:30	US	Housing Starts, ('000)	Aug	1211K	1190k
16:30	US	Building Permits, ('000)	Aug	1144K	1164k
Wednesday, 21 Sep					
	Japan	BoJ Asset Purchase Target		¥80T	¥80T
	Japan	BoJ Policy Rate		-0.1%	-0.1%
03:50	Japan	Exports, y-o-y	Aug	-14%	-4.5%
03:50	Japan	Imports, y-o-y	Aug	-24.7%	-16.5%
03:50	Japan	Adjusted Trade Balance	Aug	¥317.6B	¥500B
15:00	US	MBA Mortgage Applications	16-Sep		
22:00	US	FOMC Interest Rate Decision		0.50%	0.50%
22:00	US	Fed Summary of Economic Projections			
Thursday, 22 Sep					
	Egypt	Benchmark Deposit Rate		11.75%	--
15:00	Turkey	Benchmark Repurchase Rate		7.5%	7.5%
15:00	Turkey	Overnight Lending Rate		8.5%	8.25%
16:30	US	Initial Jobless Claims	17-Sep		
18:00	US	Existing Home Sales	Aug	5.39M	5.45M
18:00	Eurozone	Consumer Confidence	Sep	-8.5	-8.2
Friday, 23 Sep					
04:30	Japan	Nikkei Manufacturing PMI	Sep	49.5	
12:00	Eurozone	Markit Manufacturing PMI	Sep	51.7	51.5
12:00	Eurozone	Markit Services PMI	Sep	52.8	52.8
17:45	US	Markit Manufacturing PMI	Sep	52	52

**UAE time*

Source: Bloomberg

Fig. 10. Last Week's Data

Time*	Country	Data Point	Period	Prior	Consensus	Actual
Emerging Market Releases						
	China	M2 Money Supply, y-o-y	Aug	10.2%	10.5%	11.4%
	China	New Yuan Loans, CNY bn	Aug	464	750	949
	India	Exports, y-o-y	Aug	-6.8%		-0.3%
Monday, 12 Sep						
03:50	Japan	Machine Orders, y-o-y	Jul	-0.9%	0.3%	5.2%
16:00	India	CPI, y-o-y	Aug	6.1%	5.2%	5.1%
16:00	India	Industrial Production, y-o-y	Aug	2%	1.4%	-2.4%
Tuesday, 13 Sep						
06:00	China	Industrial Production, y-o-y	Aug	6%	6.2%	6.3%
06:00	China	Retail Sales, y-o-y	Aug	10.3%	10.3%	10.3%
06:00	China	Fixed Asset Investment YTD, y-o-y	Aug	8.1%	7.9%	8.1%
11:00	Eurozone	ZEW Survey Expectations	Sep	4.6	5.4	
12:30	UK	CPI, y-o-y	Aug	0.6%	0.7%	0.6%
12:30	UK	CPI Core, y-o-y	Aug	1.3%	1.4%	1.3%
Wednesday, 14 Sep						
08:30	Japan	Industrial Production, m-o-m	Jul	0%		-0.4%
11:00	Eurozone	Industrial Production, m-o-m	Jul	0.8%	-1%	-1.1%
11:00	Eurozone	Industrial Production, y-o-y	Jul	0.7%	-0.8%	-0.5%
12:30	UK	Jobless Claims Change, ('000)	Jul	`-3.6K	1.8K	2.4K
12:30	UK	Average Weekly Earnings, 3m/y-o-y	Jul	2.5%	2.1%	2.3%
12:30	UK	ILO Unemployment Rate	Jul	4.9%	4.9%	4.9%
12:30	UK	Employment Change, 3m/3m	Jul	172K	171K	174K
15:00	US	MBA Mortgage Applications	9-Sep	0.9%	--	4.2%
Thursday, 15 Sep						
11:00	Eurozone	CPI, y-o-y	Aug	0.2%	0.2%	0.2%
11:00	Eurozone	CPI Core, y-o-y	Aug	0.8%	0.8%	0.8%
12:30	UK	Retail Sales ex-Auto and Fuel, m-o-m	Aug	2.1%	-0.7%	-0.3%
15:00	UK	BoE Benchmark Bank Rate		0.25%	0.25%	0.25%
15:00	UK	BoE Asset Purchase Target, GBP		435B	435B	435B
16:30	US	Current Account Balance, USD bn	2Q	-124.7	-121	-119.9
16:30	US	Retail sales, m-o-m	Aug	0.1%	-0.1%	-0.3%
16:30	US	Retail sales Control Group, m-o-m	Aug	-0.1%	0.4%	0.1%
16:30	US	Initial Jobless Claims	10-Sep	259K	265K	260K
Friday, 16 Sep						
16:30	US	CPI, y-o-y	Aug	0.8%	1%	1.1%
16:30	US	CPI ex-Food and Energy, y-o-y	Aug	2.2%	2.2%	2.3%
18:00	US	Univ. of Mich. Cons. Sentiment	Aug	89.8	90.6	89.8

**UAE time*

Source:

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US: Rates to remain steady at FOMC meeting

We expect the FOMC to keep monetary policy steady at its September meeting (on 20-21), in line with consensus. We believe that the Fed will wait for the December meeting to raise rates by 25 bps. The FOMC will likely want to see some signs of a pickup in inflationary pressure (consumer and wages), before hiking. The focus will be on the accompanying statement and post-conference comments by Fed Chair Janet Yellen, where we expect her to reiterate recent comments that the case for an increase in the Fed Funds rate has increased and that economic conditions will warrant a further normalisation in rates before year end. Regarding the labour market, we believe that the conditions already meet the Fed's requirement for a rate hike. As such, FOMC members still seem divided over the need to hike Fed Fund rates next week. While Governors Bullard, Rosengren and Dudley had suggested the possibility of a September hike in their August speeches, recent dovish comments by Board Member Brainard have pushed back the

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probability of a rate hike next week. When the Fed does hike, we expect that most GCC countries will follow by raising their deposit rates (as in December 2015), whilst keeping benchmark lending rates steady. Kuwait was the only country increase lending rates in December 2015

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Turkey: CBRT to continue normalizing policy rates

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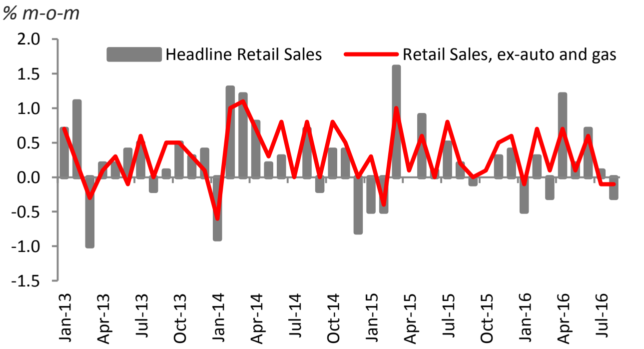
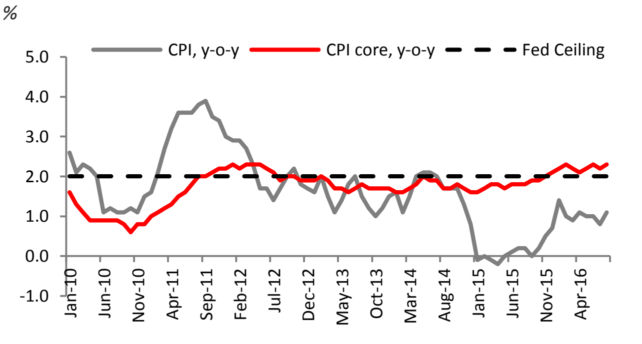
Fig. 11. US: Retail sales ticked down in 3Q, after having remained strong through 2Q



Source: US Census Bureau

Fig. 12. US: Core inflation now above the Fed ceiling, reflecting firming wage momentum



Source: Bureau of Labour Statistics, US

Inflation picked up more than expected in August, supporting our case for a December hike

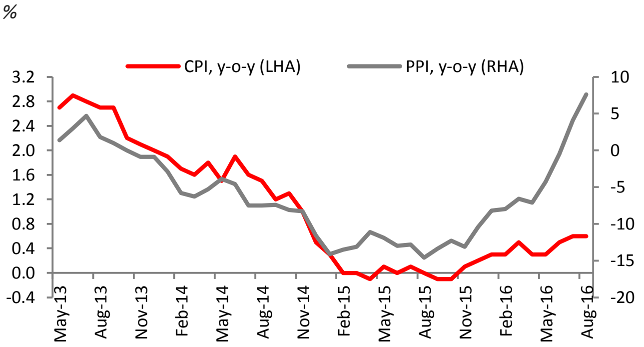
Meanwhile, the inflation data for August came in stronger than expected, rising by 1.1% y-o-y in August (Consensus: 1%; July: 0.8%). The core prices, which we believe are a better measure of wage related inflationary pressures, rose by 2.3% y-o-y. The distribution of price increases revealed more evidence of a push-up to inflation from a strong labour market, as rental and medical care costs were the two major drivers of inflation in August. We expect inflation to further increase in the next 2-3 months, as higher core prices are likely to be complemented by a rise in energy prices. Given these inflation dynamics, we expect the Fed to provide strong hints of a December rate hike to prepare the markets, while it may still hold back from hiking rates next week.

UK: Scant signs of a Brexit driven slowdown

Inflation remained stable in August, though input price pressures are rising

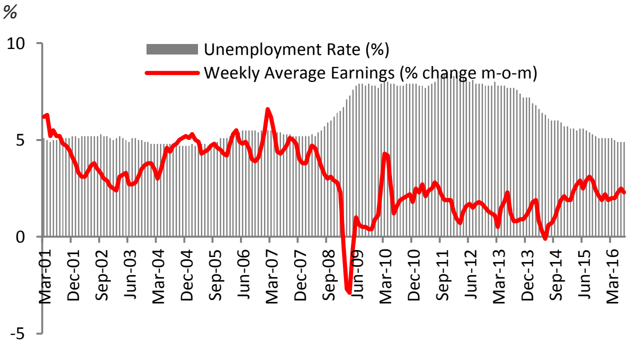
UK data released last week showed little signs of an economic slowdown post-Brexit vote. Inflation remained stuck at low levels, coming in at 0.6% y-o-y in August (Consensus: 0.7%, July: 0.6%), as firms refrained from passing on the higher import prices to consumers. Interestingly, prices of discretionary goods –clothing, furniture and hotel accommodation- have seen the sharpest declines since the Brexit vote, which to us suggests that retailers might be discounting prices to de-stock inventories as economic outlook becomes more uncertain. We expect inflation to rise above 1% y-o-y before the year-end, as producers begin to transmit some of the higher input prices to the customers. Indeed, the impact of GBP depreciation is already being seen on producer prices which jumped by 8.6% y-o-y (4.3% y-o y previously). However, in case the UK government cuts VAT taxes significantly in its spending review due in November, we could see inflation undershooting our current estimates in 2017.

Fig. 13. UK: Headline inflation remains stable, but input prices already under pressure from GBP depreciation



Source: Office for National Statistics, UK

Fig. 14. UK: Labour markets have remained stable post-Brexit vote, as near-term uncertainty has lessened



Source: Office for National Statistics, UK

Near-term stabilization of economic sentiment has kept labour markets resilient

Meanwhile, labour market remained resilient in July, with unemployment rate remaining at a 10-year low of 4.9%. Employment and wage growth also came in above market expectations. In our initial assessment of the economy post-Brexit vote, we had expected a sharp decline in hiring sentiment and labour market conditions. However, we see two reasons why it has avoided an immediate downturn in momentum post-Brexit vote. First, pro-active monetary easing by the BoE has allayed the near-term funding concerns of the corporates. Second, the selection of a relatively moderate Theresa May as the new PM has kept the hard-line anti-EU politicians at bay, ensuring for now the prospects of an orderly Brexit. That said, we still expect a gradual decline in the pace of job creation over the coming months. Hiring sentiment surveys, which tend to lead actual employment numbers by 3-6 months, are edging down, with employers hinting at some hiring freezes in 2017.

UK: BoE keeps policy rates on hold, sounds less downbeat on economy

BoE significantly less dovish on the near-term economic outlook; keeps policy stance steady

BoE kept the size of its asset purchases and the Bank Rate unchanged at its meeting last week, in line with our and market's expectations. However, the policy statement following the meeting was significantly less dovish, reflecting the change in BoE's assessment of the near-term prospects of the economy following a string of stronger than expected economic data so far in 3Q2016. In particular, the central bank noted that the dynamics of housing market and consumer spending have been less negative than it had expected in its August assessment of economic outlook post Brexit vote. The BoE also revealed that the initial response of its August monetary stimulus has been positive, with a number of banks cutting lending rates, which could have supported economic activity in the near-term. That said, it cautioned over the long-term term risks to the economy from Brexit, suggesting that it would keep the prospects of further monetary easing open if economic conditions deteriorate to levels consistent with those highlighted in its August report.

We expect any further easing by the central bank only in 2017

We believe that BoE's recent comments have set a high bar for further easing, and that we might see any further policy action by the central bank only in 2017. BoE's projections for growth and inflation both argue against the possibility of further monetary easing in November. In its latest projections, the central bank revised up its growth forecasts for 3Q2016 to 0.2% q-o-q (0% in August forecasts) and expected the inflation to rise more gradually than it had previously expected. Further, we see a strong possibility of a fiscal stimulus by the UK government in its November spending review, which may provide further support to the economy. This again supports our case that the BoE, which has so far been more reserved in its preference for an aggressive QE compared to its peers in Japan and Eurozone, might refrain from easing monetary policy further unless we see the economy heading towards an outright stagnation.

B. Emerging Market Economies

India: Inflation drops sharply in August but not enough to merit October rate cut

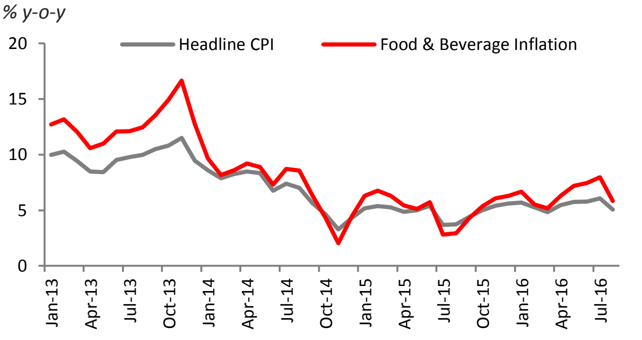
Inflation decelerated sharply as prices of vegetables and pulses cooled down

Inflation in August showed a remarkable deceleration, rising by only 5.1% y-o-y (consensus: 5.2%; July: 6.1%). Prices of pulses and vegetables, which had been the major drivers of inflation over the summer, saw significant declines over the month. We estimate that almost the entire pushback in the inflation rate (91 bps) was simply due to inflationary pressures easing in these segments. We expect further moderation in pulse prices, as sowing so far has been up 30% y-o-y, in response to plentiful rainfall in pulse-growing areas. Similarly, good rains and the recent resolution of strikes by agricultural wholesalers will help ease the rise in vegetable prices. We expect food inflation to range between 4.5-6.5% y-o-y until March 2017 (5.9% y-o-y currently).

RBI should stay on hold at 4 October meeting; we expect 25 bps rate cut in December

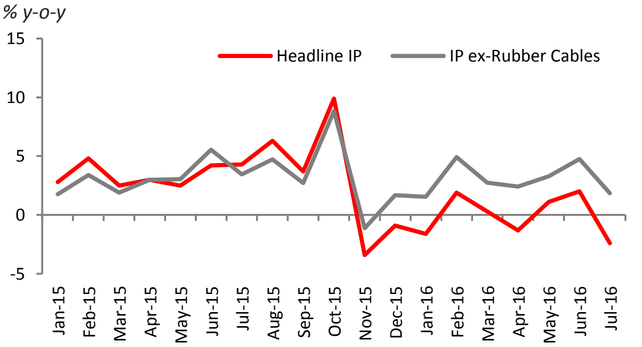
That said, we do not expect the RBI to cut the benchmark policy rate in its 4 October meeting. We do not see any broad disinflationary trends in the economy yet. While food inflation has remained volatile throughout the year, core prices have remained stable between 5.2–5.5% y-o-y in 2016. In our view, the RBI will carefully monitor the inflation numbers until November to see if the easing in prices seen in August sustains itself. It will be particularly watchful of the impact that public sector pay hikes might have on core inflation, though we believe that this will not be as inflationary as it has been in previous such cycles. Furthermore, the RBI will also prefer wait to see the impact of the Foreign Currency Deposit redemption close to USD20 billion due in November on the INR, and hold back a rate cut to stave off the volatility in capital flows. We believe that inflation will stabilize into the 5–5.5% y-o-y range by December, well below the RBI's upper inflation limit of 6% y-o-y, allowing the central bank to ease policy rates by another 25 basis points in its December meeting.

Fig. 15. India: Sharp drop in food inflation pushed down headline CPI



Source: Ministry of Statistics and Program Implementation, India

Fig. 16. India: Headline numbers stronger, excluding effects of Rubber and Cables – a small and volatile segment



Source: Ministry of Statistics and Program Implementation, India

The decline in industrial output was exacerbated in our view, though overall dynamics still remain fragile, except for consumer durables.

Meanwhile, industrial output contracted by -2.4% y-o-y in July (consensus: 1.4%; June: -2%), highlighting the still-fragile investment cycle in India. However, we remain sceptical of the pessimism with which this data has been interpreted in the markets as a signal of a downturn in India's economic momentum. We agree that the industrial sector in India has been stricken with overcapacity, high leverage and a lack of export demand, and in the near term may likely grow in the low single digits. However, the headline IP numbers are contaminated by sampling defects, in our view. Much of the decline (-4.2 pp) in the July numbers was due to a massive drop in the output of a small but volatile category – Rubber and Cables (0.12% of the index). We note that reports in Indian business newspapers recently revealed that the samples for industrial output taken for the "Rubber and Cables" segment come from just one company that supplies to a single public sector telecom services provider, and therefore the volatile dynamics perhaps reflect the delivery cycle for that company rather than that of the entire sector. Excluding this component, India's IP has been in the range of 2–5% y-o-y over the last 18 months, which we believe is more in line with other indicators of economic activity (infrastructure output, cement output, railway freight etc.). We also note that consumer durables output continues to benefit from falling inflation, robust growth in consumer credit and structural reforms to boost consumption. Output of television sets, air conditioners, furniture and mobile phones has continued to register a double-digit growth rate this year.

China: Signs of strong fiscal support to the economy

Macroeconomic data in August positively surprised consensus, reflecting impact of supportive fiscal policy

Macroeconomic data from China rebounded strongly in August, allaying concerns about a slowdown that had risen in the wake of weakening economic momentum in July. In particular, the impact of a supportive fiscal stance was visible across indicators, with infrastructure investment stabilising, credit growth rising in response to local government borrowing and industrial output staging a modest rebound. However, we still see downside risks to the economy from slowing private capex and make no changes to our 2016 GDP growth forecast of 6.5%.

Local government bond issuances and strong household credit growth propped up credit aggregates

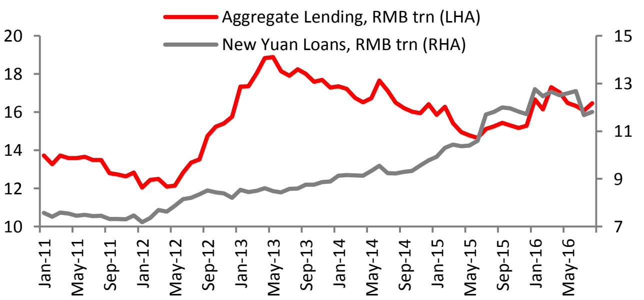
Aggregate financing rose by RMB1470 billion in August (consensus: 900; July: 488), underpinned by a strong increase in bond issuance by local governments to finance infrastructure investments. Much of this support consisted of measures to ease local governments' debt burden, which were further speeded up through local government debt swaps. In August, the amount of debt swapped rose to RMB723 billion (up from RMB251 billion in July). Loans to households continued to remain firm, particularly in the mortgage segment, rising by RMB646 billion (from RMB458 billion in July). Despite the positive turn in the credit numbers, we remain less sanguine about its impact on China's near-term growth potential. We note the divergence between M1 and M2 money supply growth as an indicator of the ongoing deleveraging cycle in China, particularly in the corporate sector. The rapid increase in M1 liquidity (currency and demand deposits) has not been mirrored by M2 metrics (which include time and longer-term deposits). This suggests that banks and firms are using cash injections by the PBoC to pay back loans or build contingency buffers. The potency of the monetary stimulus is therefore likely to remain weak, particularly in the corporate sector.

Fixed investment growth stabilised at low levels, following strong infrastructure investment growth

A combination of fiscal and monetary support ensured that investment data remained stable in August. Fixed-asset investment growth bottomed out, remaining stable at 8.1% y-o-y, supported by double-digit infrastructure investment growth (19.7% y-o-y). We believe that an acceleration in fiscal spending to 10.5% y-o-y (from 0% in July) was responsible for this. Real estate investment also stabilised (6.2% y-o-y) after having seen four consecutive months of decline. We expect real estate investment growth to mildly accelerate over the coming months, responding to the steady increase in household mortgage lending since May. Industrial production also came in at 6.3% y-o-y (consensus: 6.2%; July: 6%), which was higher than our estimates. However, we remain sceptical about a rebound in industrial output, as the August numbers were boosted by two extra working days compared to 2015. Firm-level production data on industrial goods continue to suggest signs of deceleration.

Fig. 17. China: Credit aggregates were boosted by government bond issuance and strong household borrowing

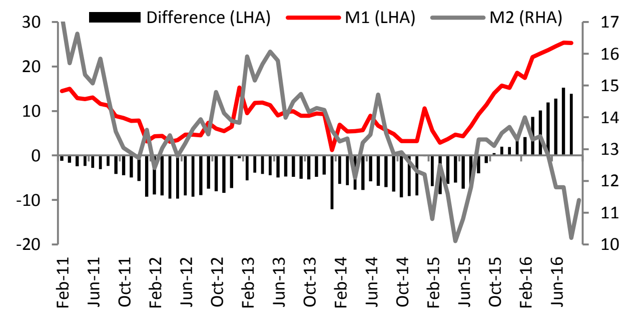
12m Rolling Sum



Source: People's Bank of China

Fig. 18. China: The rising gap between M1 and M2 growth suggests weakening monetary transmission

% y-o-y (LHA), % y-o-y (RHA)



Source: People's Bank of China

Government could draw down deposits available with PBoC to impart a greater fiscal impulse than implied in the budget deficit target

We believe that these dynamics reflect the recent policy preferences of the Chinese Communist Party authorities. The minutes from a State Council meeting chaired by Prime Minister Li Keqiang earlier this month suggested that the government would take steps to encourage state-owned companies to invest in electricity grids, telecoms and urban infrastructure. In our view, these measures are intended to stem the deceleration seen in fixed-asset investment in 2Q2016. We believe that the fiscal support to the economy in 2H2016 is likely to be more than what is implied by the fiscal deficit target of 3% of GDP in 2016 (2.4% in 2015). Additional support could come from a drawdown of central government deposits with the PBoC or through local government debt swaps.

IV. Economic Calendar

Fig. 19. Upcoming Events and Releases*

Time*	Country	Data Point	Period	Prior	Consensus
Expected this week					
	Saudi Arabia	CPI, y-o-y	Aug	3.8%	--
	Saudi Arabia	GDP Constant Prices, y-o-y	2Q	1.5%	--
	Oman	Nominal GDP YTD, y-o-y	2Q	-12.2%	
	Oman	CPI, y-o-y	Aug	1.3%	--
	UAE	CPI, y-o-y	Aug	1.8%	
	UAE	M2 Money Supply, m-o-m	Jul	-2.3%	--
	Kuwait	CPI, y-o-y	Aug	3.1%	--
	India	Current Account Balance, USD bn	2Q	0.3	2.7
Monday, 19 Sep					
03:01	UK	Rightmove House Prices, m-o-m	Sep	-1.2%	--
04:30	China	Property Prices	Aug		
Tuesday, 20 Sep					
16:30	US	Housing Starts, ('000)	Aug	1211K	1190k
16:30	US	Building Permits, ('000)	Aug	1144K	1164k
Wednesday, 21 Sep					
	Japan	BoJ Asset Purchase Target		¥80T	¥80T
	Japan	BoJ Policy Rate		-0.1%	-0.1%
03:50	Japan	Exports, y-o-y	Aug	-14%	-4.5%
03:50	Japan	Imports, y-o-y	Aug	-24.7%	-16.5%
03:50	Japan	Adjusted Trade Balance	Aug	¥317.6B	¥500B
15:00	US	MBA Mortgage Applications	16-Sep		
22:00	US	FOMC Interest Rate Decision		0.50%	0.50%
22:00	US	Fed Summary of Economic Projections			
Thursday, 22 Sep					
	Egypt	Benchmark Deposit Rate		11.75%	--
15:00	Turkey	Benchmark Repurchase Rate		7.5%	7.5%
15:00	Turkey	Overnight Lending Rate		8.5%	8.25%
16:30	US	Initial Jobless Claims	17-Sep		
18:00	US	Existing Home Sales	Aug	5.39M	5.45M
18:00	Eurozone	Consumer Confidence	Sep	-8.5	-8.2
Friday, 23 Sep					
04:30	Japan	Nikkei Manufacturing PMI	Sep	49.5	
12:00	Eurozone	Markit Manufacturing PMI	Sep	51.7	51.5
12:00	Eurozone	Markit Services PMI	Sep	52.8	52.8
17:45	US	Markit Manufacturing PMI	Sep	52	52

**UAE time*
Source: Bloomberg

Fig. 20. Last week's Data

Time*	Country	Data Point	Period	Prior	Consensus	Actual
Emerging Market Releases						
	China	M2 Money Supply, y-o-y	Aug	10.2%	10.5%	11.4%
	China	New Yuan Lonas, CNY bn	Aug	464	750	949
	India	Exports, y-o-y	Aug	-6.8%		-0.3%
Monday, 12 Sep						
03:50	Japan	Machine Orders, y-o-y	Jul	-0.9%	0.3%	5.2%
16:00	India	CPI, y-o-y	Aug	6.1%	5.2%	5.1%
16:00	India	Industrial Production, y-o-y	Aug	2%	1.4%	-2.4%
Tuesday, 13 Sep						
06:00	China	Industrial Production, y-o-y	Aug	6%	6.2%	6.3%
06:00	China	Retail Sales, y-o-y	Aug	10.3%	10.3%	10.3%
06:00	China	Fixed Asset Investment YTD, y-o-y	Aug	8.1%	7.9%	8.1%
11:00	Eurozone	ZEW Survey Expectations	Sep	4.6	5.4	
12:30	UK	CPI, y-o-y	Aug	0.6%	0.7%	0.6%
12:30	UK	CPI Core, y-o-y	Aug	1.3%	1.4%	1.3%
Wednesday, 14 Sep						
08:30	Japan	Industrial Production, m-o-m	Jul	0%		-0.4%
11:00	Eurozone	Industrial Production, m-o-m	Jul	0.8%	-1%	-1.1%
11:00	Eurozone	Industrial Production, y-o-y	Jul	0.7%	-0.8%	-0.5%
12:30	UK	Jobless Claims Change, ('000)	Jul	`-3.6K	1.8K	2.4K
12:30	UK	Average Weekly Earnings, 3m/y-o-y	Jul	2.5%	2.1%	2.3%
12:30	UK	ILO Unemployment Rate	Jul	4.9%	4.9%	4.9%
12:30	UK	Employment Change, 3m/3m	Jul	172K	171K	174K
15:00	US	MBA Mortgage Applications	9-Sep	0.9%	--	4.2%
Thursday, 15 Sep						
11:00	Eurozone	CPI, y-o-y	Aug	0.2%	0.2%	0.2%
11:00	Eurozone	CPI Core, y-o-y	Aug	0.8%	0.8%	0.8%
12:30	UK	Retail Sales ex-Auto and Fuel, m-o-m	Aug	2.1%	-0.7%	-0.3%
15:00	UK	BoE Benchmark Bank Rate		0.25%	0.25%	0.25%
15:00	UK	BoE Asset Purchase Target, GBP		435B	435B	435B
16:30	US	Current Account Balance, USD bn	2Q	-124.7	-121	-119.9
16:30	US	Retail sales, m-o-m	Aug	0.1%	-0.1%	-0.3%
16:30	US	Retail sales Control Group, m-o-m	Aug	-0.1%	0.4%	0.1%
16:30	US	Initial Jobless Claims	10-Sep	259K	265K	260K
Friday, 16 Sep						
16:30	US	CPI, y-o-y	Aug	0.8%	1%	1.1%
16:30	US	CPI ex-Food and Energy, y-o-y	Aug	2.2%	2.2%	2.3%
18:00	US	Univ. of Mich. Cons. Sentiment	Aug	89.8	90.6	89.8

**UAE time*

Source:

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