بنك أبوظبي التجاري ADCB

Economic Research

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The Week Ahead: Focus on Yellen's speech at Jackson Hole Symposium

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US: Market to look for guidance on rate hike timing

The key event this week will be Fed Chair Janet Yellen's speech (26 August) at the Jackson Hole Symposium, titled "Designing Resilient Monetary Policy Frameworks for the Future". The occasion has been used as a platform to announce policy directions and shape monetary policy expectations in the past. We believe that Yellen will use it to prepare the market for a rate hike at the September meeting (20-21), if the Fed is seriously considering one. The minutes of the FOMC's July meeting, released last week showed no urgency in raising rates. However, recent comments from FOMC members continue to suggest that a rate hike in September is possible. We believe that the Fed will want to see some sign of a pickup in economic momentum and inflation before raising rates. As such, we believe that Yellen will indicate that economic conditions will warrant a further normalisation in rates before year end, without giving a specific time frame. Our core scenario remains a 25 bps rate hike in December, though we cannot rule out a September surprise.

Turkey: Considerable uncertainty around monetary stance

The CBRT's monetary policy meeting (scheduled for 23 August) will again be in focus due to the persistent uncertainty around the bank's monetary stance. The policy rate cut announced at the previous meeting was smaller than expected, reflecting some caution by the CBRT regarding the risk to external flows from a rate cut. Moreover, inflation remains elevated, with headline CPI accelerating to 8.8% y-o-y in July. That said, there has been greater political influence on CBRT decisions recently, including the moves to ease bank funding costs despite rising inflation and to support domestic credit growth. We think that a steady monetary stance would be prudent given the expected deterioration in the current account deficit (on weaker tourism) and inflation dynamics. However, we see the possibility of a politically motivated rate cut of 25 bps, supported by favourable sentiment towards EMs and the strengthening of the TRY since the attempted coup in July.

Global: US 2Q GDP (second reading), Japan July CPI

US releases, include housing and durable goods orders for July, are set to dominate this week. Headline durable goods orders are expected to rise strongly (3.5% m-o-m), driven by aircraft sales following the Farnborough Air Show. Orders (excluding the volatile transport segment) are forecast to show some improvement, rising by 0.3% m-o-m. There have been signs of a pickup in manufacturing activity in July. Meanwhile, consensus is looking for a modest downward revision of 2Q GDP growth to 1.1% (from 1.2% in the first print) on likely weaker inventories. In Japan, CPI for July is expected to remain steady at -0.4% y-o-y, due to the low energy prices and lacklustre domestic and external demand. The weak data will continue to place pressure on the government and BoJ to implement new policies to boost economic activity and inflation.

I. Recent Data and Events

A. MENA Economies

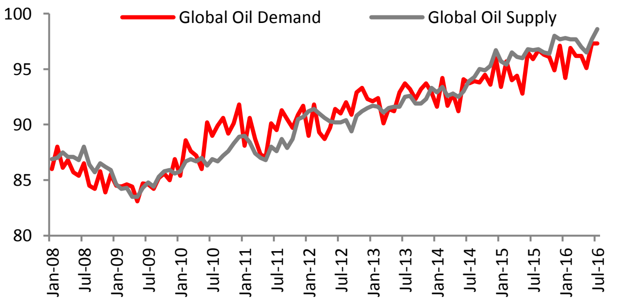
Oil: Rises on proposed production freeze discussions, fundamentals remain weak

Many OPEC countries producing at or close to capacity limits

Talks about an OPEC meeting with Russia to discuss an oil production freeze have supported an oil price recovery. Brent crude strengthened to around USD48-50 p/b at the end of last week, up from around USD40 p/b in early August. The OPEC countries are planning to meet in Algeria in September to discuss an output freeze. We believe there is a strong chance that no agreement will be reached, as happened at the group's meeting in Doha in April. Again, Iran's role will be critical in reaching an agreement. Tehran has not thus far indicated whether it is going to attend the talks. Iran's oil production and exports have increased since January, though Tehran will likely want to see further gains before capping output. Even if an agreement is reached, any freeze would likely be at a high overall production level, which will have a limited impact on rebalancing the oil market. Saudi Arabia has increased production over the summer, largely to meet the higher domestic energy demand. However, the rise has likely been partly in order to strengthen its negotiating position at the meeting. The latest data shows that Saudi's exports of crude and refined products rose in June, reaching the highest on record for that month. Saudi Arabia, Iraq, and non-OPEC member Russia are currently producing at, or close to, maximum capacity. However, Nigeria and Libya continue to struggle with production, which could also make an agreement difficult to achieve.

Fig. 1. Global: Oil market remains oversupplied; freeze close to current production would have limited impact

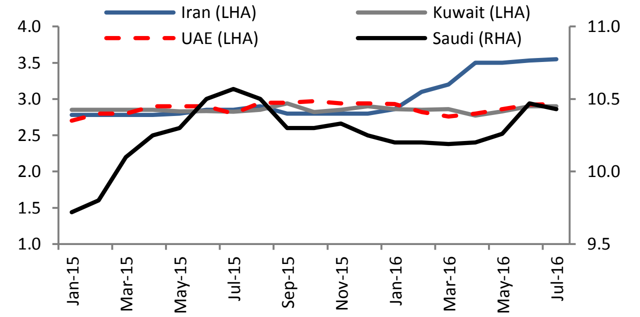
Million b/d



Source: Energy Intelligence Group

Fig. 2. OPEC: Saudi and Iranian oil production higher than in January; Saudi expected to increase output in August

Million b/d



Source: Bloomberg

Oil fundamentals remain weak, verbal support boosts sentiment

The fundamentals of the oil market (and thus this price rally) remain weak, with the market still oversupplied. Global oil inventories remain high, production in the US has stabilised, and other areas such as Brazil are seeing a rise. Nevertheless, the verbal intervention to support oil prices is positive for the GCC. This is especially as many regional governments, including Bahrain, Kuwait, and Saudi Arabia, are looking to tap the debt markets. We expect the oil price to remain in the USD44-49 p/b range for the next few months.

B. G4 Economies

US: Mixed signals from Fed, inflation weak in July

FOMC members say September rate hike possible, though Fed minutes show caution

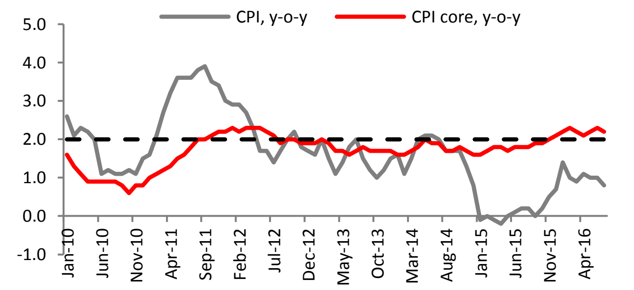
FOMC members again indicated last week that the Fed was looking to raise interest rates. Both New York Fed President William Dudley and Atlanta Fed President Dennis Lockhart said that the September FOMC meeting will be 'live'. Dudley highlighted that wage gains and the tighter labour market could boost inflation, and said that the economy is closer to the point at which it will be appropriate to raise rates further. However, the minutes of the July Fed meeting showed that the committee was divided, and that there was little urgency in implementing the next rate increase. Our core scenario is for a 25 bps rate hike in December. Most FOMC members felt that more economic data would be needed before raising rates, especially on the inflation front. However, some said that policy would need to be tightened soon, especially as the economy is heading towards full employment and low interest rates could hurt financial stability. Overall, FOMC members are still looking to normalise rates, though they are being careful to avoid doing so prematurely.

Lower neutral interest rate will result in very shallow rate hiking cycle

We believe Fed Chair Janet Yellen will use her speech at Jackson Hole to prepare the market for a rate hike if the Fed is seriously considering acting in September. The aim of the current rate hiking cycle is gradually to normalise rates to reflect the improvements in the economy since 2009, especially in the labour market, rather than to respond to a high growth and inflation environment. As such, we expect a very shallow rate hiking cycle only, due to the fall in neutral interest rates.

Fig. 3. US: Inflation moderates in July on weaker energy prices, which also feed into core inflation

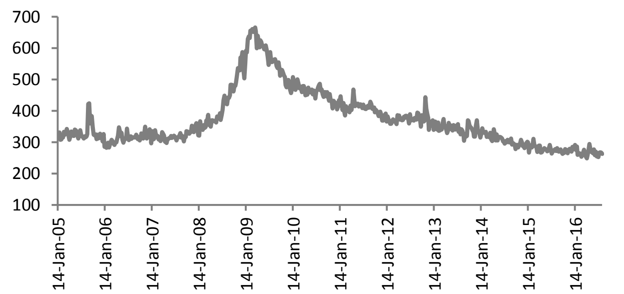
% change y-o-y



Source: Bloomberg

Fig. 4. US: Fall in jobless claims points to ongoing firming in labour market

'000 claims



Source: Department of Labor

Risks of low interest rate environment highlighted

Meanwhile, San Francisco Fed President John Williams highlighted in an essay (published on 15 August) that global central banks need to protect their economies against persistently low interest rates. A continued low interest rate environment would limit the ability to respond to future recessions, making them deeper and more difficult to avoid. Policy could include raising inflation targets, linking monetary policy directly to economic output, instituting government spending programmes that automatically kick in during economic downturns, and boosting investment in education and research. The comments also highlighted the need for wider economic support from government and corporate spending to boost economic activity, after years of low growth and inflation despite ultra-loose monetary policy. We do not expect his comments to impact near term monetary policy. Williams also indicated in a speech last week that the economy is strong enough to warrant an increase in interest rates soon, warning that waiting too long risks high inflation or asset bubbles that would cripple growth. Rather, the essay could serve as a discussion point for the Jackson Hole conference, especially as other major central banks continue to ease monetary policy despite significant spare capacity.

Lower energy prices also feeding into core inflation

Inflation: Headline consumer inflation for July was in line with the consensus at 0% m-o-m, though core inflation was weaker at 0.1% m-o-m (consensus: 0.2%). Service prices continued to rise, including owners' equivalent rent, up 0.3% m-o-m. Medical costs were also higher. However, the weaker energy prices fed into areas such as airfares, resulting in core commodity prices contracting by -0.1% m-o-m in July. In y-o-y terms, core inflation remained steady at 2.2%, indicating no change in inflation trends. We expect the yearly drag from energy prices to moderate from September, which we believe would support the case for a rate hike at the end of 2016.

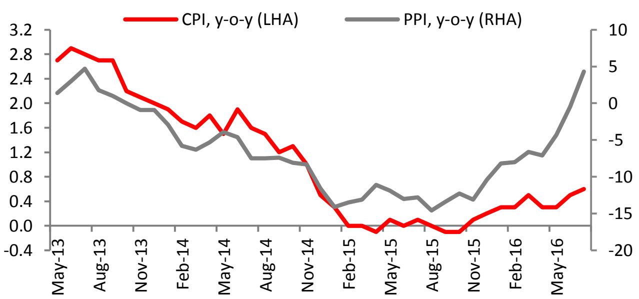
UK: Economic data yet to reflect Brexit vote effect fully

Headline inflation gains modestly, producer prices rise sharply

July CPI, the first reading since the Brexit vote, saw inflation accelerate 0.6% y-o-y (consensus: 0.5%; June: 0.5%). This was the highest level since November 2014. That said, the latest increase was still underwhelming, in our view. We foresee inflation rising even more sharply, likely towards 1.5% y-o-y by December, as the base effects from food and energy prices fall off and the impact of GBP depreciation is passed on by firms to consumers. Indeed, higher import costs are already visible in producer prices, whose growth jumped to 4.3% y-o-y in July (0% in June), indicating that CPI may increase sharply over the coming months.

Fig. 5. UK: Input prices rise sharply in July, suggesting upside for CPI

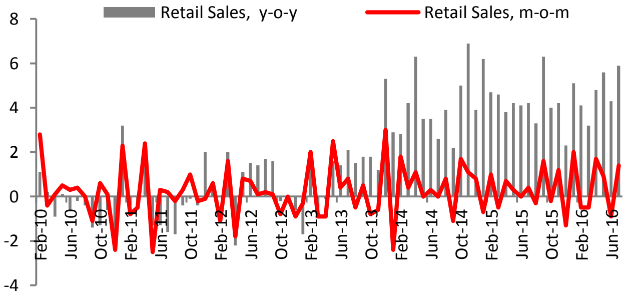
% change y-o-y



Source: Bloomberg

Fig. 6. UK: Heavy discounts on existing stock likely supported overall retail sales in July (post Brexit vote)

% change



Source: Bloomberg

Higher inflation unlikely to concern BoE until 2018

This pickup in inflation is unlikely to have as positive an impact on consumer spending or economic activity in the UK as it would in other developed markets (Japan or Germany). Rather, consumer spending will likely be squeezed as inflation is driven up by import costs. However, we do not expect the BoE to tighten monetary policy to any additional pickup in inflation, given the downside risks to the economy. The bank's current forecasts have inflation at 2.4% y-o-y by end-2018, well above its 2% target, suggesting that monetary policy will likely remain accommodative until close to this time, at which point there should be greater clarity on post-Brexit trade deals with the EU.

Real economy data strong again, though consumption indicators likely to lag

In other developments, retail sales and labour market data for July showed limited signs of a slowdown. Total unemployed claimant counts fell -8.6K (consensus: 9K; June: 0.9K), while retail sales defied expectations, rising 1.5% m-o-m (consensus: 0.3%; June: -0.9%). We believe that the solid rise in retail sales was due to merchandise already in stock being heavily discounted (which is unlikely to be sustained). Despite these positive surprises, we remain negative on the UK, expecting flat GDP growth in 3Q2016. We foresee more immediate shocks to the economy in the quarter from slower investment spending and a widening trade deficit rather than from consumer spending. Consumer spending is likely to pull back only in 4Q2016, when we expect inflation to begin rising and firms to freeze hiring as production costs rise.

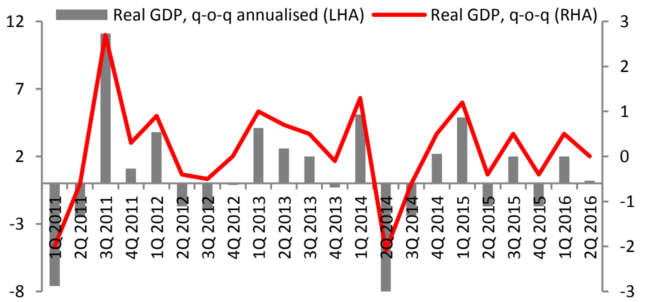
Japan: GDP growth stalls in 2Q; questions over further policy support

Net exports and business investment drag on growth

Japan's real GDP growth slowed to just 0.2% q-o-q SAAR (0% q-o-q) in 2Q, down markedly from the 2% in 1Q and below the consensus expectation of 0.7%. Private consumption growth remained positive (0.2% q-o-q), albeit soft and weakening from the 0.7% seen in 1Q. Low wage gains were likely a key contributor to the deceleration, though the leap-year effect also made an impact (boosting consumption activity in 1Q). Public spending and housing investment (the latter up 5% q-o-q, the fastest pace of growth since 2011) supported growth. Housing starts increased as the BoJ's accommodative monetary policy pushed down mortgage rates and increased demand for housing. However, business investment and net exports dragged on growth. Business investment contracted by -0.4% y-o-y (consensus: -0.2%, 1Q: -0.7%). Weak external and domestic demand as well as ongoing spare capacity continued to limit corporates' need to increase investment. The strong JPY likely contributed to the lacklustre external demand backdrop. Net exports subtracted -0.3 ppt from GDP growth, after a positive contribution of 0.1 ppt in Q1. The impact of the strong JPY continued to be reflected in the 3Q trade data. Exports fell -14% y-o-y in July, their sharpest drop since October 2009.

Fig. 7. Japan: Real GDP growth slows to 0.2% q-o-q SAAR, with net exports and business investment dragging

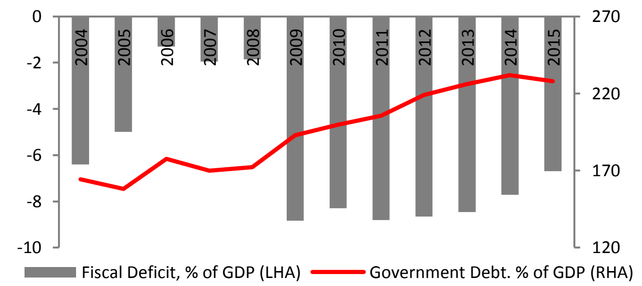
% change q-o-q



Source: Bloomberg

Fig. 8. Japan: High fiscal deficit and sovereign debt reduce government's ability to support growth

% of GDP



Source: Bloomberg

Limited room to support growth with traditional fiscal and monetary policies

The weak data place additional pressure on the government and the BoJ to implement new policy to boost economic activity. The BoJ is conducting a comprehensive review of the impact of its monetary policy on economic activity. BoJ Governor Haruhiko Kuroda has indicated that the bank's future policy action will depend on this review. We believe that the BoJ will need to look at new measures to reinflate the economy and weaken the JPY, as the current monetary policy framework has largely reached its limits. Meanwhile, we expect moderate support from 4Q2016 as a result of the government's additional spending package announced earlier in August. We believe that a further fiscal stimulus package may be announced. However, high government debt and the fiscal deficit reduce the scope for government spending to revive the economy.

C. Emerging Markets

India: New RBI governor announced, steady monetary policy expected

New MPC to be announced shortly

Deputy Governor of the RBI, Dr Urjit Patel, has been selected as the RBI's next governor (effective 4 September). The decision did not come as a surprise to markets, as Patel's name had been discussed widely in the media. His appointment points to a continuation in policy, including on interest rates and liquidity. The expectation of steady monetary policy was already supported by the fact that the medium-term inflation target of 4% ±2% is now written into law. Adding to this, Patel authored a 2013 report that recommended that India move towards a flexible monetary policy committee (MPC) led inflation-targeting regime. The government is soon expected to announce the six-member MPC to decide on interest rates. The committee will feature three members from the RBI — the governor, a deputy governor and another official — and three independent members to be selected by the government. In June the government amended the RBI Act to hand over monetary policy-making to a newly constituted MPC.

II. Economic Calendar

Fig. 9. Upcoming events and data releases

Date Time	Country	Event	Period	Prior	Consensus
Expected this week					
	Bahrain	CPI, y-o-y	Jul	3.3%	--
	Bahrain	M2 Money Supply, y-o-y	Jun	2.2%	--
	Kuwait	M2 Money Supply, y-o-y	May	2%	--
	Kuwait	July Budget Balance YTD, y-o-y			
	Kuwait	CPI, y-o-y	Jul	3.1%	--
	UAE	CPI, y-o-y	Jul	1.8%	--
	UAE	M2 Money Supply, y-o-y	Jul	-0.5%	--
Tuesday, 23 Aug					
06:00	Japan	Nikkei Japan PMI Mfg	Aug P	49.3	--
08:00	Japan	Kuroda Speaks at BOJ's Fintech Conference			
12:00	Eurozone	Markit Eurozone Manufacturing PMI	Aug P	52	52
12:00	Eurozone	Markit Eurozone Services PMI	Aug P	52.9	52.8
15:00	Turkey	Overnight Lending Rate	23-Aug	8.75%	8.5%
15:00	Turkey	Overnight Borrowing Rate	23-Aug	7.25%	7.25%
17:45	US	Markit US Manufacturing PMI	Aug P	52.9	52.7
18:00	US	Richmond Fed Manufact. Index	Aug	10	6
18:00	Eurozone	Consumer Confidence	Aug A	-7.9	-7.7
18:00	US	New Home Sales	Jul	592K	580K
Wednesday, 24 Aug					
10:00	Germany	GDP SA, q-o-q	2Q F	0.4%	0.4%
15:00	US	MBA Mortgage Applications	19-Aug	-4%	--
18:00	US	Existing Home Sales	Jul	5.57M	5.51M
Thursday, 25 Aug					
12:00	Germany	IFO Business Climate	Aug	108.3	108.5
12:00	Germany	IFO Current Assessment	Aug	114.7	114.9
12:00	Germany	IFO Expectations	Aug	102.2	102.4
16:30	US	Durable Goods Orders	Jul P	-3.9%	3.5%
16:30	US	Initial Jobless Claims	20-Aug	262K	265K
16:30	US	Durables Ex Transportation	Jul P	-0.4%	0.4%
Friday, 26 Aug					
03:30	Japan	Natl CPI, y-o-y	Jul	-0.4%	-0.4%
03:30	Japan	Natl CPI Ex Fresh Food, y-o-y	Jul	-0.4%	-0.4%
03:30	Japan	Tokyo CPI Ex-Fresh Food, y-o-y	Aug	-0.4%	-0.4%
12:00	Eurozone	M3 Money Supply, y-o-y	Jul	5%	5%
12:30	UK	GDP, q-o-q	2Q P	0.6%	0.6%
12:30	UK	GDP, y-o-y	2Q P	2.2%	2.2%
16:30	US	GDP Annualized, q-o-q	2Q S	1.2%	1.1%
16:30	US	GDP Price Index	2Q S	2.2%	2.2%
16:30	US	Core PCE, q-o-q	2Q S	1.7%	1.7%
18:00	US	U. of Mich. Sentiment	Aug F	90.4	90.7
	US	Fed Chair Yellen to Speak at Jackson Hole Policy Symposium			

* UAE time
Source: Bloomberg

Fig. 10. Last week's data

Date Time	Country	Event	Period	Prior	Consensus	Actual
MENA data						
	UAE	Central Bank Foreign Assets	Jul	314.1B	--	315.3B
	Qatar	CPI, y-o-y	Jul	2.5%	--	2.8%
Monday, 15 Aug						
3:50	Japan	GDP SA, q-o-q	2Q P	0.5%	0.2%	0.0%
3:50	Japan	GDP Annualized SA, q-o-q	2Q P	2%	0.7%	0.2%
03:50	Japan	GDP Deflator, y-o-y	2Q P	0.9%	0.7%	0.8%
08:30	Japan	Industrial Production, m-o-m	Jun F	1.9%	--	2.3%
08:30	Japan	Industrial Production, y-o-y	Jun F	-1.9%	--	-1.5%
16:30	US	Empire Manufacturing	Aug	0.6	2	-4.21
Tuesday, 16 Aug						
00:00	US	Net Long-term TIC Flows	Jun	$40.8B	$42B	-$3.6B
10:30	India	Wholesale Prices, y-o-y	Jul	1.6%	2.8%	3.6%
12:30	UK	CPI, m-o-m	Jul	0.2%	-0.1%	-0.1%
12:30	UK	CPI, y-o-y	Jul	0.5%	0.5%	0.6%
12:30	UK	CPI Core, y-o-y	Jul	1.4%	1.4%	1.3%
13:00	Germany	ZEW Survey Current Situation	Aug	49.8	50.2	57.6
13:00	Germany	ZEW Survey Expectations	Aug	-6.8	2	0.5
16:30	US	Housing Starts ('000)	Jul	1186K	1180K	1211K
16:30	US	CPI, m-o-m	Jul	0.2%	0%	0%
16:30	US	CPI, ex-Food and Energy, m-o-m	Jul	0.2%	0.2%	0.1%
17:15	US	Industrial Production, m-o-m	Jul	0.4%	0.3%	0.7%
Wednesday, 17 Aug						
12:30	UK	Claimant Count Rate	Jul	2.2%	2.2%	2.2%
12:30	UK	Jobless Claims Change	Jul	0.9K	9K	-8.6K
12:30	UK	Average Weekly Earnings, 3M/y-o-y	Jun	2.3%	2.4%	2.4%
12:30	UK	ILO Unemployment Rate, 3M	Jun	4.9%	4.9%	4.9%
15:00	US	MBA Mortgage Applications	12-Aug	7.1%	--	-4%
22:00	US	U.S. Fed Releases Minutes from July 26-27 FOMC Meeting				
Thursday, 18 Aug						
03:50	Japan	Trade Balance	Jul	¥693.1B	¥273.2B	¥513.5B
03:50	Japan	Exports, y-o-y	Jul	-7.4	-13.7	-14
03:50	Japan	Imports, y-o-y	Jul	-18.8	-20	-24.7
12:30	UK	Retail Sales, ex-Auto Fuel, m-o-m	Jul	-0.9%	0.3%	1.5%
12:30	UK	Retail Sales, inc. Auto Fuel, m-o-m	Jul	-0.9%	0.1%	1.4%
13:00	Eurozone	CPI, y-o-y	Jul F	0.1%	0.2%	0.2
16:30	US	Initial Jobless Claims	13-Aug	266K	265K	262K
16:30	US	Philadelphia Fed Business Outlook	Aug	-2.9	2	2
18:00	US	Leading Index	Jul	0.3%	0.3%	0.4%
Friday, 19 Aug						
08:30	Japan	All Industry Activity Index, m-o-m	Jun	-1%	0.9%	1.0%

* UAE time

Source: Bloomberg

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