

The Week Ahead: Fed to keep policy steady, BoJ to ease

► Japan: BoJ expected to expand its QE programme and cut rates

In an action-packed week, central banks will take centre stage with particular focus on the BoJ's meeting (28-29 July). We and the market expect further easing, after the BoJ slashed its inflation forecasts. An expansion in the asset purchase programme of around JPY10 trillion (to JPY90 trillion) is most likely, largely centred on ETFs (to around JPY6 trillion a year, from JPY3.3 trillion). We also anticipate a cut in interest rates, despite the poor sentiment around negative rates. We believe that rate cuts would likely target funding for lending programmes, currently at 0% (negative interest rates have hitherto focused on excess financial institution reserves at the BoJ). However, a further cut in the marginal deposit rate into deeper negative territory (to -0.2%, from -0.1%) cannot be ruled out. Moreover, the easing could be accompanied by an announcement of a supplementary fiscal budget, supported by Prime Minister Shinzo Abe's renewed mandate.

► US: FOMC statement in focus as policy to remain steady

We expect the FOMC to keep monetary policy steady at its July meeting (on 26-27), in line with consensus. We believe that the Fed will wait for further data to gauge the trajectory of the US economy and the impact of Brexit. However, US data has improved over the last month and generally surprised to the upside, including a rebound in the June NFP numbers. Moreover, the global spillovers from the Brexit vote appears minor so far and financial conditions have actually eased since the UK vote. Markets will focus on the meeting statement to determine how much the Fed's economic outlook has changed in light of these developments. We believe that the FOMC will remain cautious, emphasising data dependence. However, the Fed will likely acknowledge a modest improvement in the data and keep the possibility of rate hikes on the table. We continue to see December as the most likely time for a 25 bps rate hike, though cannot rule out a September hike if there are signs of a further build up in domestic growth and inflation momentum. The Fed will likely wait until its annual Jackson Hole Policy Symposium (25-27 August) to provide a more detailed assessment of its monetary policy outlook.

► Global: 2Q GDP data for US, UK and Eurozone

The initial GDP numbers from the UK, US and Eurozone will be the key data releases this week. Consensus expects US 2Q GDP growth to rebound to 2.6% q-o-q SAAR, up from 1.1% in 1Q, supported by a marked acceleration in personal consumption (to 4.3% q-o-q SAAR in 2Q, from 1.5% in 1Q). However, business investment is likely to have remained weak. In the UK, although the 2Q reading will cover the Brexit referendum itself, it will not contain much impact from the vote. Consensus forecasts 2Q GDP growth at 2.1% y-o-y bolstered by strong activity at the beginning of the quarter, and up marginally from 2% in 1Q. Meanwhile, Eurozone growth is expected to have moderated in 2Q, as a number of one-off support measures in 1Q dissipated.

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I. Recent Data and Events

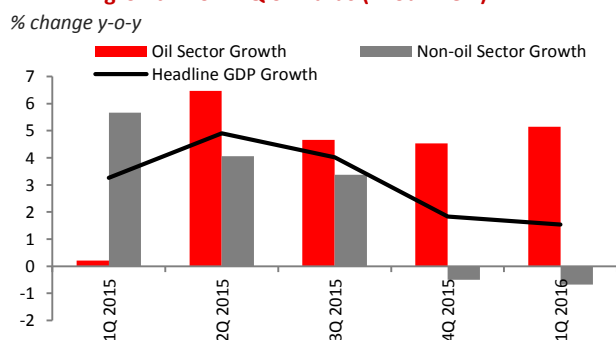
A. MENA Economies

MENA: IMF increases 2016 growth forecast, but lowers 2017

The IMF increased its real GDP growth outlook for the MENA region to 3.4% for 2016 in its July World Economic Outlook (WEO), up from 3.1% in the April WEO Projections. The 0.3 percentage point increase for 2016 can largely be attributed to a modest increase in the oil price. However, the Fund continued to highlight a need for fiscal consolidation by the region's oil exporters, in response to the structurally lower oil revenue. The IMF lowered its growth forecast for the MENA region for 2017 (to 3.3%, from 3.5% in April) given the geopolitical tensions and domestic armed strife.

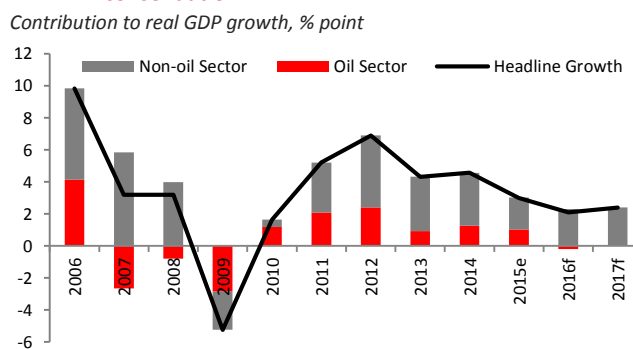
IMF's upgrade of 2016 MENA growth forecast to 3.4% largely due to higher oil price

Fig. 1. Saudi Arabia: Real non-oil GDP growth contracts in 4Q2015 and 1Q2016; oil sector to provide weaker growth from 2Q onwards (in our view)



Source: General Authority of Statistics

Fig. 2. UAE: Real non-oil GDP growth to strengthen from 2017 with pickup in investment and weaker fiscal consolidation



Source: National Bureau of Statistics, ADCB estimates

Within the GCC, the IMF maintained the headline growth forecast for Saudi Arabia's GDP at 1.2% for 2016, whilst marginally increasing the 2017 forecast to 2% (1.9% previously). We recently revised our GDP growth forecasts for Saudi Arabia following the release of 1Q data, and now see headline GDP growth contracting in 2016 by -0.1%. We forecast that real non-oil GDP growth will contract by -0.2% in 2016, given the pullback in government spending and the impact of subsidy reforms. For further details, please see our note – **Saudi Arabia: Non-oil GDP growth contracts in 1Q2016 with fiscal consolidation**, published on 3 July 2016. Meanwhile, our UAE growth forecasts are more in line with the IMF's. We see real non-oil GDP growth expanding by 2.3% in 2016, marginally below the IMF's estimate of 2.4%. Both the IMF and ourselves see non-oil activity accelerating in 2017. The IMF noted that medium-term growth will be supported by softer fiscal consolidation with a higher oil price increase, pickup in private investment in the run-up to Expo 2020, and stronger internal demand. Please see our note, **UAE: Non-oil sectors responding to softer demand backdrop**, published on 4 July 2016.

We have a more bearish outlook on Saudi Arabia's growth forecast than IMF; our UAE outlook more in line

B. G4 Economies

Europe: Strong hints of more monetary easing by ECB

The ECB's monetary stance at its policy meeting last week was similar to the one adopted by the BoE earlier this month, with the central bank saying it would refrain from any increase in monetary accommodation until it had more information on the impact of the Brexit vote on the outlook for growth and inflation. We believe that the ECB is likely to extend its QE programme by at least another six months (until September 2017), in its upcoming meeting in September, when it will also have some hard 3Q economic data and its staff's updated medium-term economic forecasts at its disposal. In his post-policy statement, President Draghi strongly emphasised imminent easing, saying that the bank had the "readiness, willingness and ability" to act to ease monetary conditions when it is in a "better position to assess the underlying monetary conditions".

ECB hints at extension to QE programme in September

Further, we believe that the ECB is likely to make some changes to its "capital-key" requirements – which require it to buy different countries' sovereign bonds in proportion to their share of European GDP – in the light of an impending scarcity in buyable German bonds. The ECB could also increase the share of corporate bond purchases in its next review of the QE programme, in order to further ease funding conditions for corporates.

ECB may soon change "capital key" requirements, possibly September

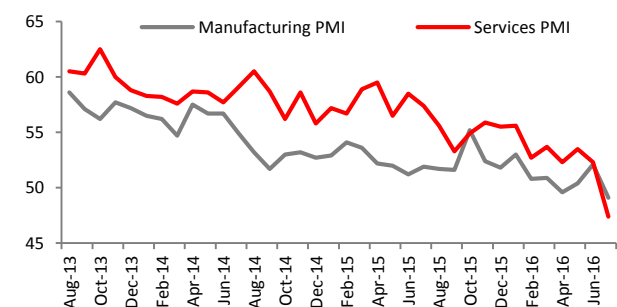
UK: PMI data show first signs of economic deceleration

The first set of economic data since the Brexit vote, the July PMI numbers, showed a sharp deterioration in economic sentiment, with both services (47.4 after 52.3) and manufacturing (49.1 after 52.1) falling into contractionary territory. Respondents specifically pointed out near-term risks to production and hiring from a sharp depreciation in the GBP seen over the last month. We believe this data foreshadows a significant slowdown in economic activity over the coming 18-24 months, though given the localised nature of this economic slowdown within Europe, global financial markets are unlikely to see a massive downturn. Further, the PMI numbers, alongside other evidence of rising business uncertainty reported by the BoE Agents' Survey, should provide additional support for a significant monetary stimulus by the BoE next month. We also expect the BoE to lean more towards easing funding conditions for businesses, through extension of the Funding for Lending scheme and corporate bond purchases, than towards aggressive policy rate cuts or a large sovereign QE programme.

PMI data contract in July, revealing concerns over weak GBP in aftermath of Brexit vote

Fig. 3. UK: Both manufacturing and service PMI move into contractionary territory in July (flash)

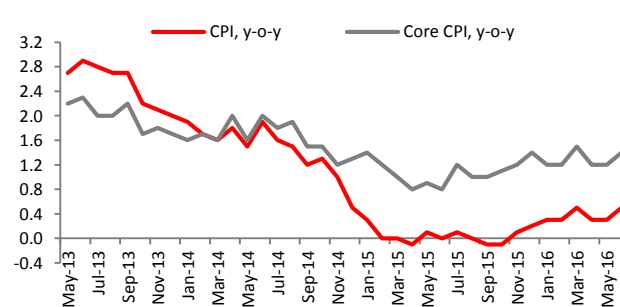
Index, a reading above 50 indicates an expansion



Source: Markit Economics

Fig. 4. UK: Inflation rises in June, expected to accelerate with weakening of GBP

% change y-o-y



Source: Bloomberg

In another release, inflation in June printed at 0.5% y-o-y (0.3% previously), likely showing some impact of the GBP depreciation in the run-up to the UK referendum. We believe inflation will easily print above 1% y-o-y before the year-end, on account of a sharp fall in the currency following the referendum. However, this is unlikely to deter the BoE from cutting rates, judging by its inclination to look through the one-off shock to inflation from the unexpected Brexit result. We believe that monetary and fiscal policy will focus on supporting economic activity.

Inflation to rise in 2H, though BoE will look past headline numbers

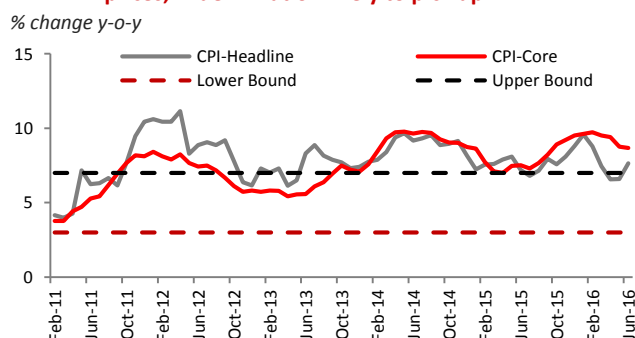
C. Emerging Market Economies

Turkey: CBRT eases but advocates caution

The CBRT lowered its overnight lending rate by another 25 basis points to 8.75% (we had expected a 50 bps cut), progressing with its medium-term objective of simplifying its monetary policy toolkit. However, the July monetary policy statement was more bearish than those released earlier this year, with the central bank admitting that the current steps towards improving “the effectiveness of monetary policy” were “cautious”, recognising the heightened risks to the political and economic order in the aftermath of the attempted military coup on 15 July. These statements are in line with our view that the CBRT has limited room to ease policy rates this year, with the central bank likely remaining on hold in 3Q2016. Rising food inflation, capital flight and TRY depreciation on the back of rising political uncertainty could stand in the way of further policy rate cuts, especially when the external financing requirements of banks and firms over the next 12 months stand close to 27% of GDP. Further, the CBRT may even have to reverse its stance and begin raising rates towards the end of the year, if political uncertainties accelerate capital outflows. Indeed, the recent easing of collateral requirements by the CBRT for FX settlement by banks is an acknowledgement of the rising risks of liquidity in the domestic FX markets. In the coming months, we expect a resumption of FX interventions by the CBRT, discontinued since April, to limit the volatility in currency markets.

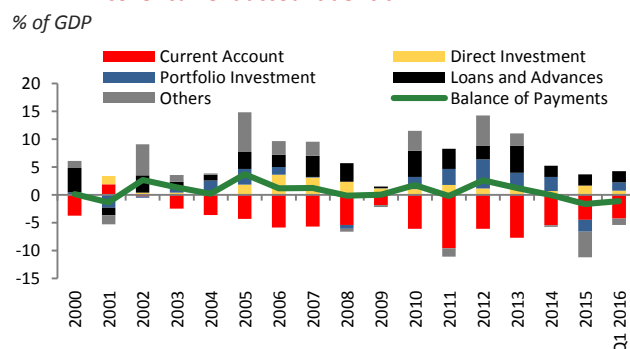
CBRT to remain on hold in 3Q due to rising inflation and weaker TRY

Fig. 5. Turkey: Headline CPI rises in June due to higher food prices, wider inflation likely to pick up



Source: Bloomberg

Fig. 6. Turkey: Reliant on short-term capital inflows to help cover current account deficit



Source: CBRT

Further, given the recent political developments in Turkey, we expect economic growth to print at 2.9% y-o-y in 2016 (consensus: 3.5%; 2015: 4%). We believe that consensus has underestimated the impact the political instability could have on domestic and foreign capital spending. Further, we believe that imposition of a state of emergency by the government is unlikely to quell underlying political tension and could obstruct day-

Political instability could take toll on investment sentiment and GDP growth

to-day business activity. These aspects, combined with the reality that the domestic economy remains extremely leveraged on foreign debt and dependent on short-term foreign capital flows to finance its current account deficit, imply that there could be more downside risks to our growth outlook if global financial conditions tighten abruptly.

China: Capital outflows accelerate in June; house prices stable

The general trend of a rise in global safe haven asset demand in the aftermath of Brexit was visible in China as well, as data released in June suggested a pick-up in capital outflows. While net FX sales to non-banks as reported by Chinese authorities remained stable at USD12.4 billion (USD12.5 billion previously), these numbers do not reflect truly the extent of capital outflows from China in our view. We believe this dynamic is more comprehensively captured by also looking at the cross-border flows of CNY from mainland Chinese to Hong Kong onshore markets (c.USD40 billion after c.USD20 billion in May). We feel such flows represent the sale of domestic assets by Chinese investors in the onshore CNY markets, anticipating further depreciation in the currency. Such capital outflows might also have been the reason, in our view, for the PBoC's increased liquidity operations in June, which led to a stronger than expected increase in money supply. We expect uncertainty related to both the domestic economy and the Brexit negotiations to weigh on CNY, prompting capital outflows at the same pace as in June, albeit at a slower pace than in 3Q2015. However, we believe that the PBoC will be reluctant to aggressively ease policy rates to prevent another spike in corporate leverage, considering the rebound in shadow bank lending once monetary conditions were eased in June.

Chinese capital outflows were likely larger than that suggested by official numbers

Meanwhile, property prices rose by 1.2% m-o-m (1.3% previously) in June, at a broadly unchanged pace in May. However, the data showed that a lesser number of cities recorded an increase in June (55 as against 59), pointing towards waning momentum in the housing markets. We believe that the residential sector (25% of total capex) is unlikely to be as supportive of growth in 2H as in 1H2016, given the sharp decline seen in leading indicators of housing activity such as floor space sold and fixed investment in the property sector. This, we feel, is the main reason why GDP growth will likely print at a slower pace of 6.5% y-o-y in 2H (6.7% y-o-y previously).

Property markets to remain drag on Chinese growth in 2H2016

II. Economic Calendar

Fig. 7. Upcoming events and data releases

Date Time	Country	Event	Period	Prior	Survey
Expected this week					
	Saudi Arabia	CPI, y-o-y	Jun	4.1%	--
	UAE	CPI, y-o-y	Jun	1.6%	--
	UAE	Central Bank Foreign Assets	Jun	296.5B	--
	UAE	Dubai Airport Cargo Volume, y-o-y	Jun	4.7%	--
	Oman	CPI, y-o-y	Jun	1.1%	--
	Oman	Nominal GDP YTD, y-o-y	1Q	-14.1%	--
	Qatar	GDP Constant Prices, y-o-y	1Q	4%	--
	Qatar	GDP Constant Prices, q-o-q	1Q	-0.5%	--
	Kuwait	CPI, y-o-y	Jun	2.8%	--
Monday 25 July					
03:50	Japan	Trade Balance	Jun	-¥40.6B	¥474.4B
12:00	Germany	IFO Business Climate	Jul	108.7	107.5
12:00	Germany	IFO Expectations	Jul	103.1	101.6
Tuesday 26 July					
17:00	US	S&P/CaseShiller 20-City Index NSA	May	186.6	189.5
18:00	US	Consumer Confidence Index	Jul	98	95.5
18:00	US	New Home Sales	Jun	551K	560K
12:00	Eurozone	M3 Money Supply, y-o-y	Jun	4.9%	5%
12:30	UK	GDP, q-o-q	2Q A	0.4%	0.5%
Wednesday 27 July					
12:30	UK	GDP, y-o-y	2Q A	2%	2.1%
15:00	US	MBA Mortgage Applications	22-Jul	-1.3%	--
16:30	US	Durable Goods Orders	Jun P	-2.3%	-1.1%
16:30	US	Durables, ex-Transportation, m-o-m	Jun P	-0.3%	0.3%
16:30	US	Cap Goods Orders, Non-def Ex Air, m-o-m	Jun P	-0.4%	0.2%
16:30	US	Cap Goods Ship, Non-def Ex Air, m-o-m	Jun P	-0.5%	0.5%
18:00	US	Pending Home Sales, m-o-m	Jun	-3.7%	1.2%
22:00	US	FOMC Rate Decision (Upper Bound)	27-Jul	0.5%	0.5%
22:00	US	FOMC Rate Decision (Lower Bound)	27-Jul	0.25%	0.25%
Thursday 28 July					
10:00	UK	Nationwide House, PX m-o-m	Jul	0.2%	0%
10:00	UK	Nationwide House Px NSA, y-o-y	Jul	5.1%	4.5%
13:00	Eurozone	Consumer Confidence	Jul F	-7.9	-7.9
16:30	US	Initial Jobless Claims	23-Jul	253K	263K
Friday 29 July					
03:30	Japan	Natl CPI, y-o-y	Jun	-0.4%	-0.4%
03:30	Japan	Natl CPI Ex Fresh Food, y-o-y	Jun	-0.4%	-0.4%
03:50	Japan	Industrial Production, m-o-m	Jun P	-2.6%	0.5%
03:50	Japan	Industrial Production, y-o-y	Jun P	-0.4%	-3%
03:50	Japan	Retail Trade, y-o-y	Jun	-2.1%	-1.3%
10:30	Japan	BOJ Monetary Policy Statement After Rate Decision			
12:30	UK	Mortgage Approvals	Jun	67.0K	65.8K
13:00	Eurozone	CPI Estimate, y-o-y	Jul	--	0.1%
13:00	Eurozone	GDP SA, q-o-q	2Q A	0.6%	0.3%
13:00	Eurozone	GDP SA, y-o-y	2Q A	1.7%	1.5%
16:30	US	Employment Cost Index	2Q	0.6%	0.6%
16:30	US	GDP Annualized, q-o-q	2Q A	1.1%	2.6%
16:30	US	GDP Price Index	2Q A	0.4%	1.9%
17:30	US	Fed's Williams Discusses Policy Toolkit in Boston			
18:00	US	U. of Mich. Sentiment	Jul F	89.5	90

* UAE time

Source: Bloomberg

Fig. 8. Last week's data

Time*	Country	Data point	Period	Prior	Survey	Actual
MENA data						
	Bahrain	CPI, y-o-y	Jun	3.7%	--	3.3%
	UAE	M2 Money Supply, y-o-y	Jun	-1.4%	--	-0.5%
Monday 18 July						
5:00	UK	Rightmove House Prices, m-o-m	July	0.8%	--	-0.9%
Tuesday 19 July						
0:00	US	Net Treasury (TIC) flows, USD billion	May	93.1	--	-11
12:30	UK	CPI, y-o-y	Jun	0.3%	0.4%	0.5%
15:00	Turkey	CBRT Monetary Policy Meeting		9%	8.75%	8.75%
16:30	US	Housing Starts, ('000)	Jun	1135K	1165K	1189K
16:30	US	Building Permits, ('000)	Jun	1136K	1150K	1153K
Wednesday 20 July						
12:30	UK	Change in Employment, 3M/3M	May	55K	73K	176K
12:30	UK	Unemployment Rate	May	5%	5%	4.9%
12:30	UK	Average Weekly Earnings, 3m/y	May	2%	2.3%	2.3%
15:00	US	MBA Mortgage Applications	15-Jul	7.2%	--	-1.3%
18:00	Eurozone	Consumer Confidence	May	-7.2	-8	-7.9
Thursday 21 July						
8:30	Japan	All Industry Activity Index, m-o-m	May	0.8%	-1.1%	-1%
12:30	UK	Retail Sales ex-Auto, m-o-m	Jun	0.9%	-0.6%	-0.9%
12:30	UK	Retail Sales ex-Auto, y-o-y	Jun	5.2%	4.8%	3.9%
15:45	Eurozone	ECB Monetary Policy Meeting		-0.4%	-0.4%	-0.4%
16:30	US	Initial Jobless Claims, ('000)	16-Jul	254K	265K	253K
17:00	US	FHFA House Price Index, m-o-m	May	0.3%	0.4%	0.2%
18:00	US	Existing Home Sales	Jun	5.51M	5.48M	5.57M
18:00	US	Leading Index	Jun	-0.2%	0.2%	0.3%
Friday 22 July						
6:00	Japan	Manufacturing PMI	July	48.1	--	49
12:00	Eurozone	Manufacturing PMI	July	52.8	52	51.9
12:30	UK	Manufacturing PMI	July	52.1	48.7	49.1
12:30	UK	Services PMI	July	52.3	48.8	47.4
17:45	US	Manufacturing PMI	July	51.3	51.5	52.9

* UAE time

Source: Bloomberg

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