# The Week Ahead: US NFP data in focus as Fed sees stronger case for rate hike

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## Contents



## US: Jobs growth likely remained healthy in August

August NFP data (due 2 September) will be even more closely scrutinised after Fed Chair Janet Yellen indicated that the case for an interest rate hike had strengthened (see page 4). Yellen's comments keep the door open for a September rate hike if the August payroll numbers are strong, though we still see December as the most likely timing. We believe the Fed is preparing the market for a rate increase, albeit likely wanting to see further signs of a pickup in growth and inflation. Consensus expects that August jobs growth remained solid at 180K, albeit down from 255K in July. The unemployment rate is expected to have fallen to 4.8% in August (consensus), though we estimate the rate likely remained steady at 4.9%. Personal spending and PCE deflator data (due 29 August) will also be important releases this week. The PCE deflator, the Fed's preferred gauge of inflation, is expected to have stayed flat in July (0% m-o-m), with core PCE rising only moderately by 0.1% m-o-m.

## India: GDP likely eased marginally but remained robust in 2Q

We forecast that India's 2Q GDP (due 31 August) will slow to 7.7% y-o-y from 7.9% in 1Q. We expect consumer spending to take a breather, softening to around 8% y-o-y after having hit a six-year high of 8.3% y-o-y in 1Q. Meanwhile, private capex is set to remain weak as reflected in capital goods production data for the quarter. High leverage and excess capacity continue to adversely affect investment in the heavy industry and mining sectors. However, an increase in government spending and less drag from net exports (due to import contraction) are likely to support growth. Looking ahead, we expect a small acceleration in GDP in 2H2016 as the boost to consumer spending from public sector pay hikes kicks in. Private capex is likely to remain limited by balance sheet constraints, though a pickup in government spending on public infrastructure should prevent a contraction in overall investment spending as seen in 1H2016.

## Europe: August inflation dynamics to remain feeble

August consumer inflation in the Eurozone, due 31 August, is expected to have climbed marginally to 0.3% y-o-y (0.2% in July), mainly due to a spike in seasonal food prices. Core inflation likely remained unchanged at 0.9% y-o-y, with a limited build up in price pressure. The August numbers are likely to further support our case for more monetary easing by the ECB at its 8 September meeting. We expect the central bank will make changes to its sovereign asset purchase rules to favour peripheral economies and extend its QE program by another nine months (presently ending in March 2017). Meanwhile, market interest will also focus on August consumer confidence data from the UK (due 30 August). Consensus expects a more moderate contraction of -8 (index) in August, from -12 in July. A downside surprise to consensus could signal a sharper contraction in household spending in 3Q2016, than are currently being forecast.

# I. Recent Data and Events

## A. MENA Economies

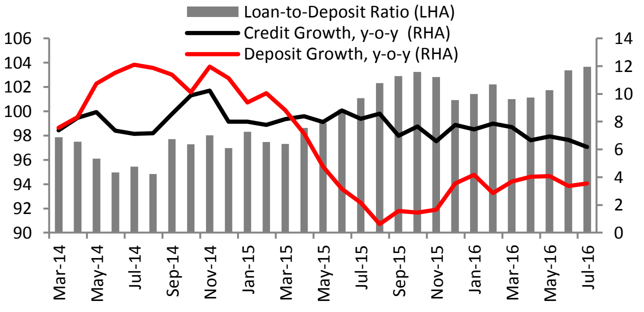
### UAE: Credit and deposit growth down m-o-m in July

*Retail credit growth continues to decelerate with greater job uncertainty*

Credit and deposit growth fell on a monthly basis in July, which we view as being partly due to the beginning of the quieter summer period. Loan growth also reflected the moderating economic activity leading to weaker credit demand. Total loan growth fell by -0.2% m-o-m in July, resulting in the annual rate moderating to 6.2% y-o-y (6.7% y-o-y in June). The yearly deceleration in loan growth was particularly notable in the GRE segments, as credit growth slowed to 5.1% y-o-y in July from above 12% in May and June. This could pick up after the summer period. Meanwhile, personal credit growth continued to trend downwards, reaching 6.4% y-o-y in July from 7.1% in June and 9.7% in January. We believe that job cuts and greater uncertainty over jobs and wages are behind this softening. Job losses became more evident over the summer months, as many people waited to see out the end of the school year before leaving the country.

**Fig. 1. UAE: L-to-D ratio continues to rise with loan growth continuing to outstrip deposits**

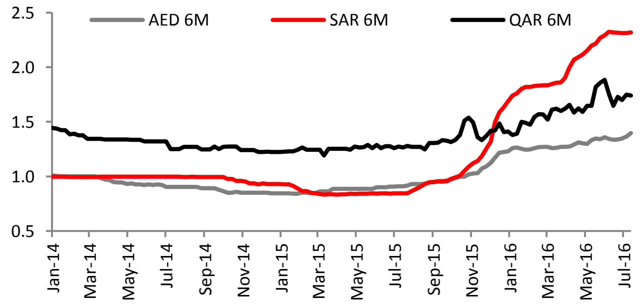
*Ratio (LHA); % change y-o-y (RHA)*




Source: Central Bank of UAE

**Fig. 2. GCC: Widening differential in interbank rates between UAE and Saudi Arabia a risk to non-resident deposits**

*%*




Source: Bloomberg

*Non-resident deposits have now fallen m-o-m for two consecutive months*

Meanwhile, system-wide deposits rose marginally on a y-o-y basis to 3.5% in July (June: 3.4%). This was despite deposits falling -0.5% m-o-m, with both the resident (-0.1%) and non-resident (-3.6%) categories seeing a monthly decline. We have previously highlighted the risk to non-resident deposits from higher market interest rates in other GCC countries, which are facing tighter liquidity conditions. Please see our note **UAE: Banking sector liquidity continues to tighten in 1H2016, albeit more gradually**, published on 8 August 2016. Expected sovereign bond issuance from Kuwait and Saudi could be a further risk to non-resident deposits in the UAE. July saw the second consecutive monthly fall in non-resident deposits, though they remained up 11.5% y-o-y. The loan-to-deposit ratio rose to 103.6% in July, up from 103.3% in June and 100.9% in December 2015. Banking sector liquidity remains tight and interbank rates have continued to rise, albeit at a more moderate pace than in 2H2015.

## Saudi Arabia: Inflation decelerates in July due to seasonal factors

*No fundamental shift – impact of seasonal factors*

Consumer inflation slowed to 3.8% y-o-y (0.1% m-o-m) in July, down from 4.1% y-o-y (0.3% m-o-m) in the previous month. This was the first time in 2016 that the yearly inflation reading was below 4%. The softening was largely due to food prices, which we consider to be linked to seasonal factors connected to Ramadan. Food prices tend to moderate m-o-m following Ramadan, alongside the yearly base effect distortion from the change in timing of the holy month. We believe that these seasonal factors were also behind the drop in clothing prices in July, which fell by 1% m-o-m in after rising 1.5% in June.

*Weak domestic demand limiting build-up of inflationary pressure*

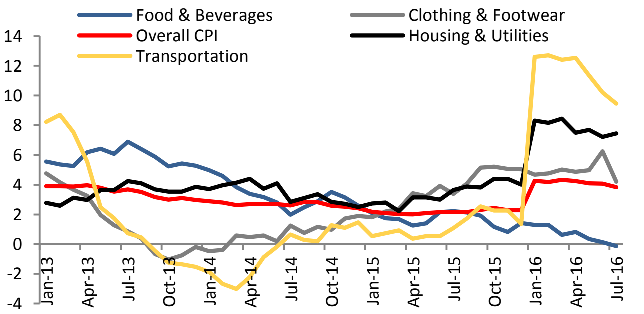
The data does not show a fundamental shift in consumer inflation drivers, in our view. Prices continue to be driven by the areas that have seen subsidy reforms (fuel and utilities). These two components continued to see the strongest price increases in July, with transportation rising 9.4% y-o-y and housing & utilities up 7.5%. Beyond the areas of subsidy reform, weakening growth momentum, low global inflation, and the strong USD contributed to a limited build-up in inflationary pressure. The higher utility prices and lower government spending have resulted in weaker private consumption growth in 2016.

*Saudi Arabia expected to tap international debt market in early October*

Meanwhile, market indications suggest that Saudi is likely to issue its debut benchmark-sized international bond in early October. The issuance will be important in boosting short-term domestic liquidity and FX reserves. However, highlighting the challenges in covering the fiscal deficit, FX reserves fell by an average of -USD5.6 billion per month in 2Q2016. This was despite Saudi Arabia raising USD10 billion of syndicated loans in end-April 2016.

**Fig. 3. Saudi Arabia: Inflation continues to be driven by utility and transportation components**

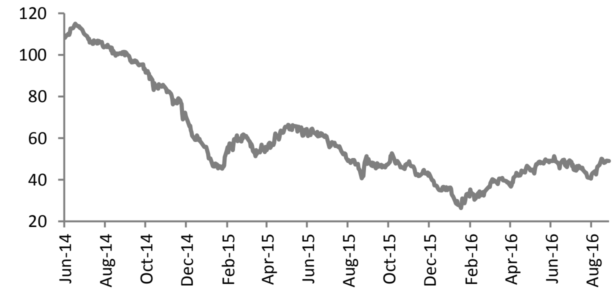
*% change y-o-y*




Source: General Authority of Statistics

**Fig. 4. Brent Crude: Prices remain supported, though talks on output freeze unlikely to change market fundamentals**

*USD p/b*




Source: Bloomberg

## OPEC: Iran looking to reach output of 4 million b/d before freezing

*Saudi sees no need for production cut*

Iran has indicated that it will join other OPEC and non-OPEC members for oil output talks in September. However, Tehran has said that it will only be open for joint action once it regains its pre-sanctions output of 4 million b/d. Iranian output stood at 3.6 million b/d in July. This stance could make an agreement difficult to reach at this point as Saudi seems to be looking for a freeze at current levels. The Saudi Oil Minister Khalid Al-Falih said last week that he does not see the need for a production cut. A freeze at current OPEC output levels should still lead to an oversupplied market, in our view.

# B. G4 Economies

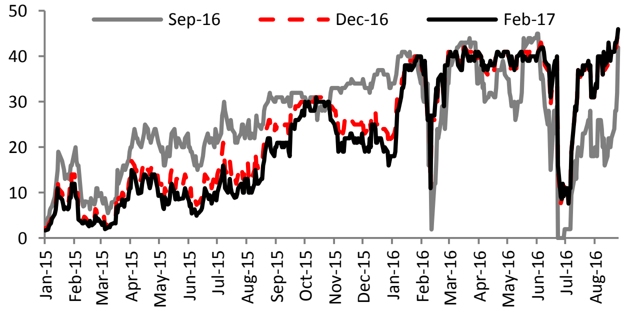
## US: Yellen sees case for interest rate hike growing

*Economy close to full employment*

Market expectations of a rate hike this year have increased following Fed Chair Janet Yellen's speech at Jackson Hole. She noted that "the case for an increase in the Fed Funds rate has strengthened in recent months", which was in line with recent comments by other FOMC members. Yellen highlighted that the economy was close to reaching the Fed's twin goals of employment and inflation, whilst consumer spending remained solid. On inflation, Yellen mentioned that the transitory effects of earlier declines in energy and import prices were reasons for inflation running below the FOMC's 2% target. However, she also outlined economic uncertainties, notably that exports were being hurt by a strong USD and that business investment was weak. Yellen did not provide a time frame for the rate hike, which we believe likely supports our outlook for a December rate hike. Nevertheless, she kept the door open to a September rate hike if the data is strong. Data dependence was once again reiterated, as in most Fed communication. In line with this, Fed Vice Chair Stanley Fischer suggested that the hike could come as soon as September, if the economy was doing well.

**Fig. 5. US: Market expectations of September rate hike have increased sharply following Yellen's speech**

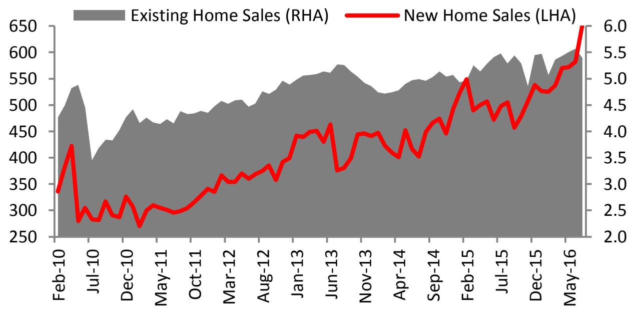
*Probability of a 25 bps rate hike by FOMC meetings*




Source: Bloomberg

**Fig. 6. US: Sharp rise in new home sales points to pickup in 2H residential investments**

*'000 units saar (LHA), million units saar (RHA)*




Source: National Association of Realtors; US census Bureau

*Further interest rate normalisation needed to deal with future recessions*

The key theme of Yellen's speech was the toolkit available to the Fed to deal with future recessions. She indicated that forward guidance, asset purchases and interest cuts will remain the main policy tools for tackling a moderate contraction in GDP growth. Yellen even hinted at the possibility of broadening the scope of Fed asset purchases if needed in the future. On interest rate policy, it was assumed that the FFTR would settle at around the 3% level to provide space for easing. This implies to us that the Fed is still looking to gradually normalise interest rates to ensure monetary policy space remains. Fiscal policy was also highlighted as a key tool to deal with any future recession.

*Inventories behind moderate downward revision*

***US GDP Growth:*** The 2Q GDP growth reading was revised down to 1.1% in the second print, in line with consensus expectations, from 1.2% in the first reading. The moderate downward revision is not too concerning as it was largely due to a steeper decline in inventories. Consumer spending growth was revised to a robust 4.4%, up from the initial 4.2%.

*Residential investment expected to rebound in 2H2016, with strong housing demand*

Moreover, recent data suggest a pickup in economic activity in 3Q. The strong performance of the US housing market points to a rebound in residential investment in 2H2016 after it subtracted marginally from growth in 2Q. New home sales jumped by

12.4% m-o-m to a seasonally annualised rate of 654K in July. This was the fastest pace of new home sales since October 2007 and the fifth consecutive month of gains. The July rise came mostly from homes not yet started or still under construction. Existing home sales fell in July, though this was after four months of solid gains. The -3.2% m-o-m fall to an annual rate of 5.4 million units was partly due to a shortage of properties on the market. However, a dearth of existing supply will boost demand for new construction. Meanwhile, durable goods orders for July were also encouraging after a weak performance in 1H2016. Orders excluding transportation were up 1.5% m-o-m, whilst durable inventories saw a first monthly increase in 2016, rising by 0.3%.

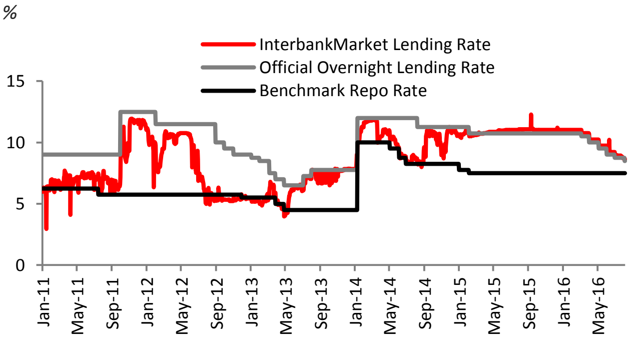
# C. Emerging Market Economies

## Turkey: Central bank continues to ease rates

*Monetary stance expected to remain accommodative this year due to political preference for lower lending rates*

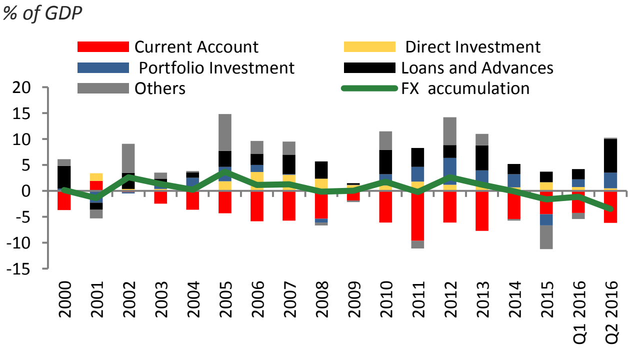
The Turkish Central Bank (CBRT) continued its policy of simplifying and easing its monetary policy, cutting its overnight lending rate by another 25 bps to 8.5%. The CBRT's post-meeting statement that monetary stance remains tight is at odds with our assessment, as real interest rates are now negative. Last week's move narrowed the interest rate corridor between the benchmark repo rate (which remained steady at 7.5%) and the overnight lending rate to 100 bps. We feel that the central bank's monetary stance has fallen in line with the political preference for lower lending rates. Thus, we expect that the CBRT will continue to loosen monetary conditions through rate cuts and repo operations, as long as financial markets' risk appetite for EM assets remains strong and Fed rates remain low.

**Fig. 7. Turkey: Interest rate corridor continues to narrow with cuts in overnight lending rate**




Source: Bloomberg

**Fig. 8. Turkey: 2Q16 current account deficit widened and was mainly funded through external loans**




Source: CBRT

*Current account deterioration and FX reserve erosion over 1H2016 have increased economic vulnerability*

However, external account vulnerabilities have increased recently. The current account deficit widened to -USD11.2 billion in 2Q2016 (from -USD7.9 billion in 1Q). Based on our calculations, the deficit rose to 6.2% of GDP in 2Q – its highest level since 2013. Furthermore, much of the new capital flows required to cover the current account deficit came from external borrowings by banks, as both FDI and portfolio flows dried up in the period. These developments increase the vulnerability of the economy, as external debt now stands close to 60% of GDP. Another notable aspect of 1H2016 was a massive erosion in FX reserves by around USD8.6 billion (8.5% of total reserves). Furthermore, the reserve drain seems to have accelerated – the 1H flows represent almost 80% of the total flows seen in 2015. We remain concerned by these dynamics and see a high risk of capital flows stopping suddenly if EM risk appetite sours or oil prices continue to rise. Should the current account deficit continue to deteriorate in 2H2016, which we think is likely, the CBRT might have to abruptly reverse its current monetary stance, much like it did in early 2014. This could be accompanied by a sharp deceleration in growth in 2H2017.

# II. Economic Calendar

**Fig. 9. Upcoming events and data releases**

| Time* | Country | Event | Period | Prior | Consensus |
|---|---|---|---|---|---|
| **Expected this week** | | | | | |
| | Saudi Arabia | M2 Money Supply, y-o-y | Jul | -2.5% | -- |
| | UAE | CPI, y-o-y | Jul | 1.8% | -- |
| | UAE | Dubai Airport Cargo Volume, y-o-y | Jul | 3.8% | -- |
| | UAE | Dubai's August Real Estate Sales, YTD y-o-y | | | |
| | Qatar | M2 Money Supply, y-o-y | Jun | -4.4% | -- |
| | Kuwait | June Budget Balance, YTD y-o-y | | | |
| | Kuwait | M2 Money Supply, y-o-y | Jun | 2.0% | -- |
| | Bahrain | M2 Money Supply, y-o-y | Jun | 2.2% | -- |
| | UK | Nationwide House Prices, m-o-m | Aug | 0.5% | -0.2% |
| **Monday, 29 Aug** | | | | | |
| 16:30 | US | Personal Income, m-o-m | Jul | 0.2% | 0.4% |
| 16:30 | US | Personal Spending, m-o-m | Jul | 0.4% | 0.3% |
| 16:30 | US | PCE, y-o-y | Jul | 0.9% | 0.8% |
| 16:30 | US | PCE Core, y-o-y | Jul | 1.6% | 1.5% |
| 16:30 | US | PCE, m-o-m | Jul | 0.1% | 0% |
| 16:30 | US | PCE Core, m-o-m | Jul | 0.1% | 0.1% |
| **Tuesday, 30 Aug** | | | | | |
| 12:30 | UK | Mortgage Approvals | Jul | 64.8K | 61.9K |
| 18:00 | US | Consumer Confidence Index | Aug | 97.3 | 97 |
| **Wednesday, 31 Aug** | | | | | |
| 03:50 | Japan | Industrial Production, m-o-m | Jul P | 2.3% | 0.7% |
| 11:15 | US | Fed's Rosengren to Address Financial Conference in Beijing | | | |
| 11:55 | Germany | Unemployment Change, '000 | Aug | -7K | -4K |
| 13:00 | Eurozone | CPI Estimate, y-o-y | Aug | 0.2% | 0.3% |
| 15:00 | US | MBA Mortgage Applications | 26-Aug | -2.1% | -- |
| 16:00 | India | GDP, y-o-y | 2Q | 7.9% | 7.6% |
| 16:00 | India | GVA, y-o-y | 2Q | 7.4% | 7.3% |
| 16:00 | US | Fed's Kashkari Speaks on Fed Structure in St. Paul | | | |
| 16:15 | US | ADP Employment Change, '000 | Aug | 179K | 175K |
| 17:45 | US | Chicago Purchasing Manager | Aug | 55.8 | 54 |
| 18:00 | US | Pending Home Sales, m-o-m | Jul | 0.2% | 0.6% |
| **Thursday, 1 Sep** | | | | | |
| 03:50 | Japan | Capital Spending, y-o-y | 2Q | 4.2% | 5.5% |
| 05:00 | China | Manufacturing PMI | Aug | 49.9 | 49.9 |
| 09:00 | Japan | Vehicle Sales, y-o-y | Aug | -0.2% | -- |
| 10:00 | India | Nikkei India PMI Manufacturing | Aug | 51.8 | -- |
| 12:30 | UK | Markit UK PMI Manufacturing SA | Aug | 48.2 | 49 |
| 16:30 | US | Initial Jobless Claims | 27-Aug | 261K | 265K |
| 18:00 | US | Construction Spending, m-o-m | Jul | -0.6% | 0.5% |
| 18:00 | US | ISM Manufacturing PMI | Aug | 52.6 | 52 |
| **Friday, 2 Sep** | | | | | |
| 03:50 | Japan | Monetary Base, y-o-y | Aug | 24.7% | -- |
| 16:30 | US | Trade Balance | Jul | -$44.5B | -$42.5B |
| 16:30 | US | Change in Nonfarm Payrolls, '000 | Aug | 255K | 180K |
| 16:30 | US | Unemployment Rate | Aug | 4.9% | 4.8% |
| 16:30 | US | Average Hourly Earnings, m-o-m | Aug | 0.3% | 0.2% |
| 18:00 | US | Factory Orders, m-o-m | Jul | -1.5% | 2% |
| 18:00 | US | Factory Orders, ex-Trans, m-o-m | Jul | 0.4% | -- |
| 21:00 | US | Fed's Lacker Speaks on Interest Rate Benchmarks in Richmond | | | |

*UAE time
Source: Bloomberg

**Fig. 10. Last week's data**

| Time* | Country | Event | Period | Prior | Consensus | Actual |
|---|---|---|---|---|---|---|
| **GCC and MENA Data** | | | | | | |
| | Bahrain | CPI, y-o-y | Jul | 3.3% | -- | 3.5% |
| | Kuwait | M2 Money Supply, y-o-y | May | 2% | -- | 2% |
| | Kuwait | CPI, y-o-y | Jul | 3.1% | -- | 3.1% |
| | Saudi Arabia | CPI, y-o-y | Jul | 4.1% | | 3.8% |
| | UAE | M2 Money Supply, y-o-y | Jul | -0.5% | -- | 0.9% |
| **Tuesday, 23 Aug** | | | | | | |
| 06:00 | Japan | Nikkei Japan PMI Mfg | Aug P | 49.3 | -- | 49.6 |
| 12:00 | Eurozone | Markit Eurozone Manufacturing PMI | Aug P | 52 | 52 | 51.8 |
| 12:00 | Eurozone | Markit Eurozone Services PMI | Aug P | 52.9 | 52.8 | 53.1 |
| 15:00 | Turkey | Overnight Lending Rate | 23-Aug | 8.75% | 8.5% | 8.5% |
| 15:00 | Turkey | Benchmark Repo Rate | 23-Aug | 7.5% | 7.5% | 7.5% |
| 17:45 | US | Markit US Manufacturing PMI | Aug P | 52.9 | 52.6 | 52.1 |
| 18:00 | US | Richmond Fed Manufact. Index | Aug | 10 | 6 | -11 |
| 18:00 | Eurozone | Consumer Confidence | Aug A | -7.9 | -7.7 | -8.5 |
| 18:00 | US | New Home Sales | Jul | 582K | 580K | 654K |
| **Wednesday, 24 Aug** | | | | | | |
| 10:00 | Germany | GDP SA, q-o-q | 2Q F | 0.4% | 0.4% | 0.4% |
| 15:00 | US | MBA Mortgage Applications | 19-Aug | -4% | -- | -2.1% |
| 18:00 | US | Existing Home Sales | Jul | 5.57M | 5.51M | 5.39M |
| **Thursday, 25 Aug** | | | | | | |
| 12:00 | Germany | IFO Business Climate | Aug | 108.3 | 108.5 | 106.2 |
| 16:30 | US | Durable Goods Orders | Jul P | -4.2% | 3.4% | 4.4% |
| 16:30 | US | Initial Jobless Claims | 20-Aug | 262K | 265K | 261K |
| 16:30 | US | Durables Ex Transportation | Jul P | -0.3% | 0.4% | 1.5% |
| **Friday, 26 Aug** | | | | | | |
| 03:30 | Japan | Natl CPI, y-o-y | Jul | -0.4% | -0.4% | -0.4% |
| 03:30 | Japan | Natl CPI Ex Fresh Food, y-o-y | Jul | -0.4% | -0.4% | -0.5% |
| 03:30 | Japan | Tokyo CPI Ex-Fresh Food, y-o-y | Aug | -0.4% | -0.4% | -0.4% |
| 12:00 | Eurozone | M3 Money Supply, y-o-y | Jul | 5% | 5% | 4.8% |
| 12:30 | UK | GDP, q-o-q | 2Q P | 0.6% | 0.6% | 0.6% |
| 12:30 | UK | GDP, y-o-y | 2Q P | 2.2% | 2.2% | 2.2% |
| 16:30 | US | GDP saar, q-o-q | 2Q S | 1.2% | 1.1% | 1.1% |
| 16:30 | US | GDP Price Index | 2Q S | 2.2% | 2.2% | 2.3% |
| 16.30 | US | Personal Consumption | 2Q S | 4.2% | 4.2% | 4.4% |
| 16:30 | US | Core PCE, q-o-q | 2Q S | 1.7% | 1.7% | 1.8% |
| 18:00 | US | U. of Mich. Sentiment | Aug F | 90.4 | 90.8 | 89.8 |

* UAE time
Source: Bloomberg

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