The Week Ahead: ECB meeting back in focus

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Eurozone: Significant monetary easing expected by ECB

The ECB's monetary policy meeting on 8 September will be the market-moving event of next week. We believe the ECB will be compelled to act to prevent a further deterioration in inflation expectations after prices remained at low levels through the summer and money supply growth slowed again despite the QE. We expect the ECB to extend its QE program by another nine months to December 2017; the programme is currently due to end in March 2017. We also expect the central bank to change the proportions in which it buys sovereign bonds from its member countries as a part of this program. Currently, bonds are bought in proportion to a member country's economic weight. This has severely depressed German bond yields, with the relative size of the German bond market being lower than the country's economic weight in the region. Changes to this rule of GDP-weighted sovereign purchases are, in our view, necessary for the ECB to extend its QE program, as buyable German bonds are likely to run out of supply by mid-2017. This move may also offer some support to countries like Italy, which are likely to run higher fiscal deficits in the medium term as a result of bailing out bad banks. That said, we do not expect the ECB to cut its policy rate further, since any such move is likely to further hurt the net interest margins of banks.

China: August economic data to show modest improvement

Chinese economic data for August will be released over the next weeks and may show some modest improvement in economic momentum relative to July levels in our view. We believe that increased fiscal support to the economy might have stemmed the decline in imports, though export growth is likely to remain tepid given subdued import demand in major developed markets. That said, fixed investment and industrial production are both likely to see the adverse impacts from measures taken to resolve over capacity and high debt in the industrial sector. We expect industrial output growth at a modest 6% y-o-y (6.2% y-o-y consensus) and fixed investment growth to further decelerate below 8%. However, overall we expect the data to continue to show a gradual softening in economic momentum in 2H2016.

Turkey: Sharp deceleration in GDP in 2Q

Consensus expects GDP growth (due 9 September) to have softened to 3.7% y-o-y in 2Q (4.8% in 1Q), with a sharp increase in imports and sluggish investment spending. Household consumption likely remained robust though is unlikely to have offset the headwinds from softening capex and a greater drag from net exports. Inflation numbers for August (due 6 September) are likely to moderate slightly from the July high of 8.8% y-o-y on account of easing food prices. However, we believe they are unlikely to fall meaningfully towards the CBRT's inflation target range of 3-7% y-o-y given the TRY depreciation so far in 2H2016. We do not see the economic case for further interest rate cuts by the central bank in 2016, though we still expect the CBRT to ease further, supported by short-term capital flows.

The next issue of Global Data Watch will be published on Monday 19 September 2016.

I. Recent Data and Events

A. MENA Economies

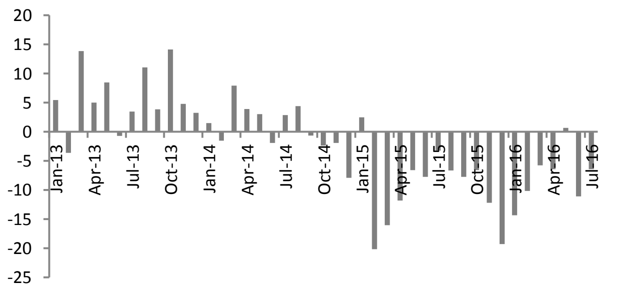
Egypt: VAT at 13% approved, to rise to 14% in next fiscal year

Vital step in raising government revenues and reducing fiscal deficit

Egypt's parliament has approved the introduction of VAT at 13%, effective from September. The rate is to be raised to 14% in FY2017-18 (July-June). This reform was an essential component of Egypt's USD12 billion agreement with the IMF and is a vital step in helping to reduce the country's fiscal deficit, which stood at around 12% of GDP in FY2015-16. Moreover, the introduction of the tax raises confidence that Egypt is making progress with its difficult but much-needed structural reform programme. The VAT will replace the current sales tax (10%) and will cover a broader spectrum of components. We estimate that the VAT should initially raise government revenues by around 1% of GDP per fiscal year. Egypt estimates that its fiscal deficit should fall to around 9.8% of GDP as a result of the pullback in spending, energy subsidy reforms, and the introduction of VAT. We believe that this could be on the optimistic side given the expected slowdown in economic activity. We estimate that real GDP growth will decelerate to around 3.2% in FY2016-17, from around 4% in the previous fiscal year, on the back of the fiscal tightening and expected weakening in the EGP. However, the deceleration should be cushioned somewhat by the fall in imports resulting from the weaker domestic demand. Meanwhile, consumer inflation is expected to rise sharply (from the already high 14% seen in July) when VAT is introduced.

Fig. 1. Saudi Arabia: Fall in SAMA's FX reserves slows to -USD6.4 billion in July, from -USD11.1 billion in June

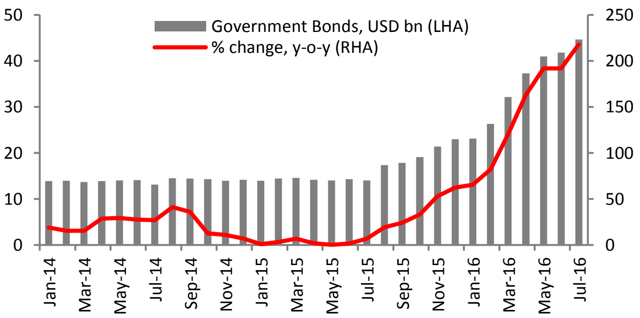
USD billion



Source: SAMA

Fig. 2. Saudi Arabia: Rise in government debt growth accelerates in July, having flattened in June

USD billion (LHA), % change y-o-y (RHA)



Source: SAMA

Saudi Arabia: FX reserves fall by USD6.4 billion in July

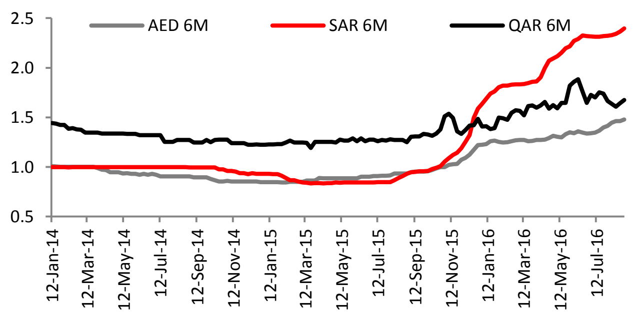
Growth of government borrowing from banking sector accelerates to 6.8% m-o-m

SAMA's net foreign assets (NFAs) fell by -USD6.4 billion in July (-1.2% m-o-m and -17.2% y-o-y) to USD555.4 billion. We see this as being around the trend level for monthly declines when oil prices are in the USD45-50 p/b range. The sharper fall in SAMA's NFAs in June (of -USD11.1 billion) was likely due to a limited rise in government borrowing from the banking sector, possibly due to the tightening liquidity. The pace of government borrowing again accelerated in July, rising by 6.8% m-o-m, likely supported by SAMA's measures to boost short-term liquidity. These measures included offering around USD4 billion in short-term loans to banks and deposits at the end of June. We believe that some short term easing in liquidity conditions is likely once Saudi Arabia issues an international bond (expected in October). We believe that a significant volume of the funds raised will be placed as deposits in the banking sector. However, these measures are only expected to have a temporary impact given the funding requirements of the fiscal deficit.

Quieter summer and post-Ramadan period reflected in private sector data

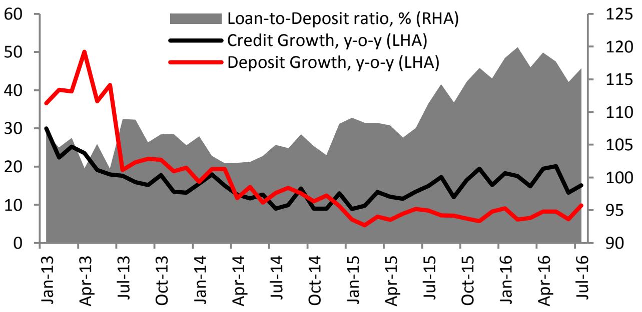
Meanwhile, system wide deposit growth continued to fall (-3% y-o-y), due partly to the ongoing drop in government deposits (-14%). Total credit growth remained robust at 15.4% as government borrowing accelerated. Private sector credit growth decelerated to 7.4% y-o-y in July from 8.1% in June. We see this slowdown as being due largely to the quieter post-Ramadan and summer period. We believe that the need for working capital could lead private sector credit growth to pick up moderately after the summer. Seasonal factors were also reflected in POS transaction data, which fell by a notable -15.7% y-o-y in value terms (June: 2.7%). We believe that the particularly sharp fall in spending in July reflected the yearly base effect distortion from the change in timing of the holy month. Nevertheless, the pullback in government expenditure and subsidy reforms in 2016 are likely to lead to weak household spending for the whole year.

Fig. 3. GCC: Saudi interbank rates continue to rise with tightening liquidity; Qatar down from June peak



Source: Bloomberg

Fig. 4. Qatar: Loan-to-deposit ratio 116.7% in July, down from 119.9% in February



Source: Central Bank of Qatar, ADCB estimates

Non-resident deposits rise to 20% of total

Qatar: The system-wide loan-to-deposit ratio rose to 116.7% in July from 114.6% in June, highlighting the ongoing liquidity shortages. Overall loan growth accelerated to 15.1% y-o-y, led by a 27.3% rise in government borrowing. Meanwhile, total deposit growth (9.8% y-o-y in July) continued to be driven by non-resident deposits (up 92.9% y-o-y). On a monthly basis, non-resident deposits increased by 2.5% m-o-m and accounted for 20.2% of total deposits at the end of July (versus 5.9% in January 2014). Government deposits in the banking sector were also higher (up 49% y-o-y in July), supported by the sovereign bond issuance in May. Consequently, the loan-to-deposit ratio was down from its recent peak of 119.1% (seen in April 2016).

B. G4 Economies

US: August labour data weaker than consensus but still respectable

151K jobs added in August, weak wage growth of just 0.1% m-o-m

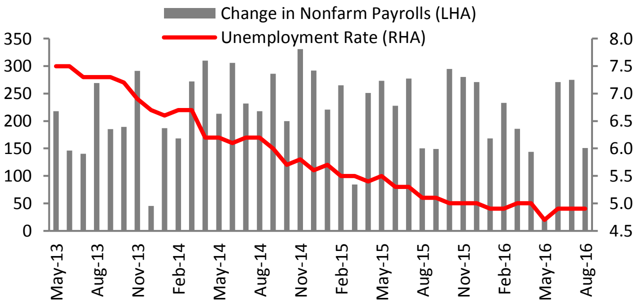
The US economy added 151K jobs in August, weaker than market expectations of 180K. The net revision to the June and July data was -1K, albeit from very strong levels. Other areas of the August NFP reports also fell short of market estimates. Wage growth was modest, rising by just 0.1% m-o-m against consensus of 0.2% and 0.3% in July. This resulted in the annual rate softening to 2.4% y-o-y, down from 2.7% in July. Meanwhile, the unemployment rate remained at 4.9%, in line with our expectation but below the consensus of a drop to 4.8%. The participation rate also remained steady at 62.8% in August.

Data partly reflects the maturity of the US economic recovery cycle

Despite the headline figures remaining weak, we believe that they are respectable enough for the Fed to raise rates once, by 25 bps, before the end of the year. Firstly, given that the US economic recovery cycle is in its latter stages, we assume that the pace of jobs growth will moderate. We have noted in earlier research that we did not expect to see jobs growth of 200K+ being sustained. Rather, we forecast monthly prints in the 150-180K range, still comfortably above the breakeven rate of employment growth (90-100K). Indeed, last week Cleveland Fed President Loretta Mester noted that the US economy needs to generate between 75K and 150K jobs per month to keep the jobless rate stable. Secondly, the recent trend looks solid despite August being weaker (three-month average at 232K and six-month at 175K). Thirdly, the unemployment rate is close to the level that the Fed sees as being full employment (4.8%). Historically, August tends to see the greatest upward revisions to the jobs growth data, though we are not counting on this for our Fed rate call.

Fig. 5. US: Jobs growth moderates in August though still points to a tightening in the labour market

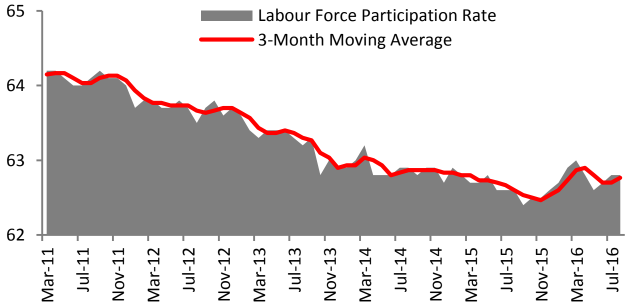
'000s (LHA), % (RHA)



Source: Bureau of Labor Statistics

Fig. 6. US: Participation rate remained steady in August at 62.8%, marginally above the 62.6% of August 2015

%



Source: Bureau of Labor Statistics

December remains our core scenario for a rate hike

Following the August NFP, we remain comfortable with our call of a rate hike in December, barring any economic or political surprises. Overall, the data showed that the labour market remains relatively healthy and continues to improve gradually, though there are no signs of a pick-up in inflation. We think that the Fed will want to see some build up in inflationary pressure (in wages and consumer prices), which we expect to see in 4Q as the drag from oil prices moderates. Nevertheless, market expectations of a September rate hike have moderated following the August report. We still do not rule out a September surprise; speeches by Fed members in the coming weeks will be critical if the Fed is considering a hike this month. Meanwhile, we do not see the weak ISM print for August (49.4) as a deal breaker for a rate hike given the small size of the manufacturing sector. Moreover, we see the stabilisation of oil prices after the recovery seen in 2Q, which boosted manufacturing activity, as also contributing to a degree.

Pace of income growth in July marginally above YTD trend level

Personal spending and income: Data for July were solid, supporting the case for a rate hike in 2016. However, the still weak inflation backdrop suggests that the Fed could wait until December, which is our base case. The data were largely in line with market expectations, with nominal income expanding by 0.4% m-o-m, slightly above the 0.3% trend seen YTD. Personal spending data remained respectable at 0.3% m-o-m growth, albeit decelerating from the robust 0.5% growth seen in June. The data pointed to solid household spending into 3Q; this would continue to be the main driver of GDP growth and be supported by the ongoing improvements in the labour market. Meanwhile, there were limited signs of a build-up in price pressure. The core PCE deflator, the Fed's preferred indicator of inflation, remained steady at 0.1% m-o-m. The tightening labour market should lead to a gradual rise in wage pressure and support a rise in core inflation.

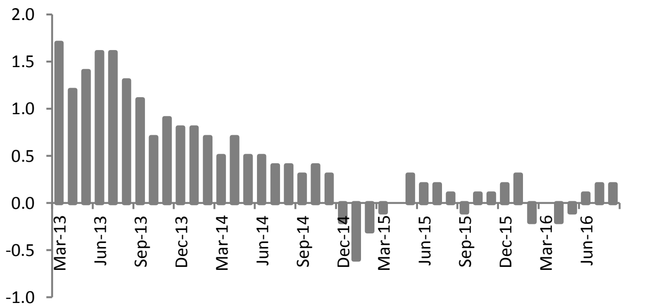
Eurozone: Low inflation supports case for more ECB easing

Headline inflation remained stagnant at low levels in August

Inflation in the Eurozone remained stuck at low levels, disappointing market expectations with a 0.2% y-o-y increase in August (consensus: 0.3%, July: 0.2%). A more worrying feature was core inflation declining to 0.8% y-o-y (July: 0.9%); it had hitherto remained stable throughout the year. We do not believe that the transient mechanics of food, energy, and seasonal travel prices explain the persistently low inflation in the Eurozone despite the ECB's QE. Last week's data may make it urgent for the ECB to ease monetary policy further at its September 8 meeting to prevent further deterioration in inflation expectations. We believe the ECB's action will involve changing the proportions in which it buys sovereign bonds to favour the peripheral economies and extending its QE purchases by another nine months to the end of 2017.

Fig. 7. Eurozone: Consumer inflation remains stuck at low levels, with lending growth tepid

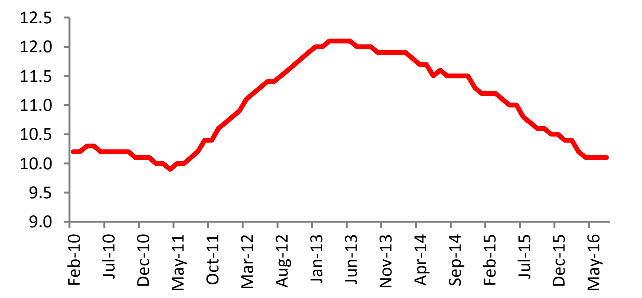
% change y-o-y



Source: Eurostat

Fig. 8. Eurozone: Unemployment stagnates at high rate of 10.1% since April, limiting upward price pressure

%



Source: Eurostat

Fiscal policy will need to complement monetary easing to push up inflation

We believe key underlying issues impeding Eurozone inflation to be the sticky unemployment and disappointing credit growth (despite the substantial monetary stimulus). Having fallen rapidly in 2013-14, unemployment has remained stuck at high levels throughout the Eurozone, particularly in Italy and France. Furthermore, concerns regarding bank NPAs across the region, combined with the limitations faced by Eurozone governments when it comes to bailing out weak banks, have weighed on banks' appetite to lend. Finally, we believe that the steady decline in German inflation over the past few months suggests that households have responded to negative bond market yields by saving a greater proportion as cash. All of these factors will make the ECB's inflation forecast of 1.6% y-o-y by the end of 2018 challenging to meet. Like Japan, the Eurozone may too have to lean towards greater fiscal spending to complement the monetary stimulus in order to push up inflation in the Eurozone.

C. Emerging Markets

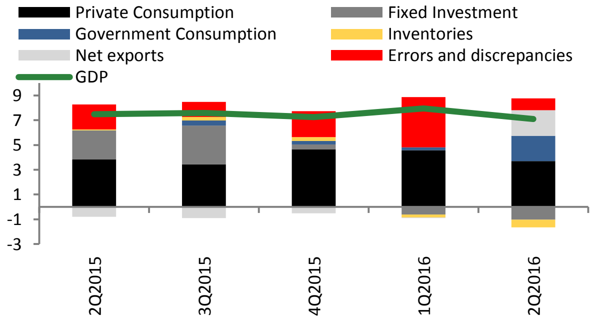
India: 2Q GDP growth not as disappointing as headline print

Downside surprise in 2Q GDP likely a payback for stronger-than-expected 1Q GDP print

India's GDP growth moderated to 7.1% y-o-y in 2Q, (consensus: 7.6%, 1Q: 8%), well below our estimate of 7.7% y-o-y. However, India's GDP data are seasonally unadjusted and subject to high volatility and subsequent revisions. As it is, the average growth of 7.6% y-o-y in 1H2016 was close to our year-end GDP growth estimate of 7.7%. Therefore, we interpret the downside surprise as payback from the sharper-than-expected increase in GDP in 1Q (8% y-o-y, versus our expectation of 7.4%), when measurement errors and discrepancies contributed close to 4.1 pp of GDP growth, likely reflecting disguised inventory accumulation and rural consumption growth.

Fig. 9. India: 2Q GDP pulled back after strong increase in 1Q, which had been driven by error components

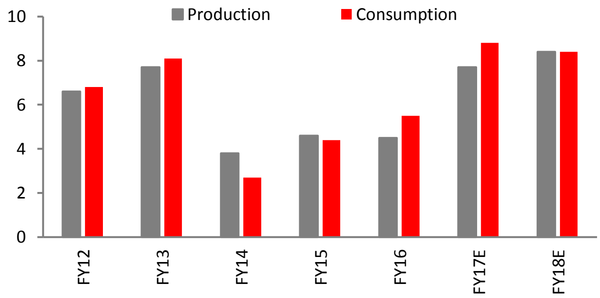
Contribution to GDP, pp y-o-y



Source: Ministry of Statistics and Programme Implementation

Fig. 10. India: Cement production likely to be ramped up in anticipation of greater housing demand

% y-o-y



Source: CMIE estimates based on company surveys

Consumption takes expected breather, investment spending contracts for second straight quarter

Barring this growth moderation, the economic momentum contained in the GDP print presented a familiar story. Private consumption growth took a breather (6.7% y-o-y, after 8.3% in 1Q) following two successive quarters of strong growth driven by urban purchases of household appliances. Government spending growth surged to 18.8% y-o-y (2.9% in 1Q) as the central and state governments added the arrears from the last fiscal year (ending March 2016) to their budgets for 2Q, which drove the growth in public services spending to double digits. However, capex growth contracted for a second straight quarter, (-3.1% y-o-y, after -1.9% in 1Q), as mining, manufacturing, and construction firms continued to cut capacity to service their debts. As per our estimates, almost all of the improvement in profit margins of firms in these sectors came from deleveraging and cost cutting, including in hiring. The rise in public investment spending, which comprises less than 20% of total capex by value, was unable to offset the decline in private capex.

We expect growth to accelerate mildly in 2H2016, led primarily by household consumption and public infrastructure spending

We expect GDP growth to accelerate mildly 2H2016 to around 8% y-o-y. We expect private consumption spending to be a major driver of this growth, rising by 8-8.5% y-o-y and adding around 0.6 pp to growth. Household spending, both urban and rural, is likely to receive a boost from public sector pay hikes and healthy monsoons, which should support farm incomes and reduce inflation. That said, this boost looks likely to be smaller than previous public sector pay hikes (in 1997-98 and 2009-10), as private sector hiring conditions today are not as buoyant. We expect capex growth to recover to a modest 3% y-o-y by the end of 2016. Though large manufacturing firms look likely to continue cutting capacity, we expect residential investment to recover as wages and consumption demand pick up. Indeed, preliminary output estimates from cement companies show an intention to ramp up production over the coming two years to meet the rising housing demand; this demand is being assisted by strong wage growth and credit subsidies by the government for low cost housing. Public spending on roads and ports is likely to remain robust, growing by double digits in 2H2016. Although net exports showed a surprise improvement in 2Q (adding 2.1 pp to GDP after -0.1 pp in 1Q), we remain cautious on their prospects due to rising oil prices and our bearish outlook on import demand from India's major trading partners.

FDI data show UAE became sixth largest FDI investor in India in FY16, jumping five places

Meanwhile, the UAE became the sixth-largest FDI investor in India in FY2016, jumping five places versus FY2015, as per data released by the RBI last week. The volume of investment by the UAE almost tripled to USD961 billion (from USD327 billion in FY2015). Though not all details of the investments are available, the bulk of the new FDI announcements were in the non-manufacturing sector, particularly healthcare facilities, universities, and road networks. We believe that the UAE's investments in such projects are likely to yield stable returns: The Indian government is prioritising approvals for public infrastructure projects, and demand is increasing for health and education services amongst the country's young and rapidly urbanising population.

II. Economic Calendar

Fig. 11. Upcoming events and data releases

Time*	Country	Event	Period	Prior	Consensus
Expected this week					
	UAE	CPI, y-o-y	Jul	1.8%	--
	UAE	Dubai Airport Cargo Volume, y-o-y	Jul	3.8%	--
	Kuwait	M2 Money Supply, y-o-y	Jun	2%	--
	Qatar	CPI, y-o-y	Aug	2.8%	--
5-9 Sep	China	G-20 Leaders Meet in Hangzhou, China			
Monday, 5 Sep					
08:15	Saudi Arabia	Saudi Arabia PMI	Aug	56	--
08:15	Egypt	Egypt PMI	Aug	48.9	--
08:15	UAE	UAE PMI	Aug	55.3	--
09:00	India	Nikkei India PMI Services	Aug	51.9	--
12:00	Eurozone	Markit Eurozone Services PMI	Aug F	53.1	53.1
12:30	UK	Markit/CIPS UK Services PMI	Aug	47.4	50
13:00	Eurozone	Retail Sales, m-o-m	Jul	0%	0.5%
Tuesday, 6 Sep					
13:00	Eurozone	GDP SA, q-o-q	2Q F	0.3%	0.3%
13:00	Eurozone	GDP SA, y-o-y	2Q F	1.6%	1.6%
18:00	US	Labor Market Conditions Index Change	Aug	1	--
18:00	US	ISM Non-Manf. Composite	Aug	55.5	55
21:00	Eurozone	Eurogroup's Dijsselbloem Speaks at Bruegel in Brussels			
Wednesday, 7 Sep					
	China	Foreign Reserves	Aug	$3201.1B	$3191B
	Egypt	Gross Official Reserves	Aug	$15.6B	--
5:15	US	Fed's Williams Speaks on Economic Outlook in Reno, Nevada			
11:30	UK	Halifax House Prices, m-o-m	Aug	-1.0%	-0.1%
12:30	UK	Industrial Production, m-o-m	Jul	0.1%	-0.2%
12:30	UK	Industrial Production, y-o-y	Jul	1.6%	1.9%
17:15	UK	BOE's Carney, Cunliffe, Forbes, McCafferty Speak in London			
18:00	US	JOLTS Job Openings	Jul	5624	5635
18:00	US	Fed's Lacker and George Appear before the House Financial Panel			
22:00	US	U.S. Federal Reserve Releases Beige Book			
Thursday, 8 Sep					
	Egypt	Urban CPI, y-o-y	Aug	14%	--
	China	Trade Balance	Aug	$52.31B	$52.31B
	China	Exports, y-o-y	Aug	-4.4%	-3.9%
03:50	Japan	BoP Current Account Balance	Jul	¥974.4B	¥2073.3B
03:50	Japan	GDP SA, q-o-q	2Q F	0%	0%
03:50	Japan	GDP Annualized SA, q-o-q	2Q F	0.2%	0.2%
08:15	UAE	Dubai Economy Tracker SA	Aug	55.9	--
15:45	Eurozone	ECB Main Refinancing Rate	8-Sep	0%	0%
15:45	Eurozone	ECB Deposit Facility Rate	8-Sep	-0.4%	-0.4%
15:45	Eurozone	ECB Marginal Lending Facility	8-Sep	0.25%	0.25%
15:45	Eurozone	ECB Asset Purchase Target	Sep	EUR80B	EUR80B
16:30	US	Initial Jobless Claims	3-Sep	263K	265K
Friday, 9 Sep					
05:30	China	CPI, y-o-y	Aug	1.8%	1.7%
08:30	Japan	Tertiary Index, m-o-m	Jul	0.8%	0.2%
11:00	Turkey	GDP, y-o-y	1Q	4.8%	3.7%
15:45	US	Fed's Rosengren to Deliver Economic Forecast in Boston			

* UAE time
Source: Bloomberg

Fig. 12. Last week's data

Time*	Country	Event	Period	Prior	Consensus	Actual
MENA data						
	Saudi Arabia	M2 Money Supply, y-o-y	Jul	-2.5%	--	-3.3%
	Qatar	M2 Money Supply, y-o-y	Jun	-7.2%	--	-5.2%
	UAE	Dubai's August Real Estate Sales, YTD y-o-y	Aug	-29.5%	--	-26.2%
	UK	Nationwide House Prices, m-o-m	Aug	0.5%	-0.2%	0.6%
Monday, 29 Aug						
16:30	US	Personal Income, m-o-m	Jul	0.3%	0.4%	0.4%
16:30	US	Personal Spending, m-o-m	Jul	0.5%	0.3%	0.3%
16:30	US	PCE, y-o-y	Jul	0.9%	0.8%	0.8%
16:30	US	PCE Core, y-o-y	Jul	1.6%	1.5%	1.6%
Tuesday, 30 Aug						
12:30	UK	Mortgage Approvals	Jul	64.2K	61.9K	60.9K
18:00	US	Consumer Confidence Index	Aug	96.7	97	101.1
Wednesday, 31 Aug						
03:01	UK	Consumer Confidence Index	Aug	-12	-8	-7
03:50	Japan	Industrial Production, m-o-m	Jul P	2.3%	0.8%	0%
11:55	Germany	Unemployment Change, '000	Aug	-7K	-4K	-7K
13:00	Eurozone	CPI Estimate, y-o-y	Aug	0.2%	0.3%	0.2%
15:00	US	MBA Mortgage Applications	26-Aug	-2.1%	--	2.8%
16:00	India	GDP, y-o-y	2Q	7.9%	7.6%	7.1%
16:00	India	GVA, y-o-y	2Q	7.4%	7.3%	7.3%
16:15	US	ADP Employment Change, '000	Aug	194K	175K	177K
17:45	US	Chicago Purchasing Manager	Aug	55.8	54	51.5
18:00	US	Pending Home Sales, m-o-m	Jul	-0.8%	0.7%	1.3%
Thursday, 1 Sep						
03:50	Japan	Capital Spending, y-o-y	2Q	4.2%	5.5%	3.1%
05:00	China	Manufacturing PMI	Aug	49.9	49.8	50.4
10:00	India	Nikkei India PMI Manufacturing	Aug	51.8	--	52.6
12:30	UK	Markit UK PMI Manufacturing SA	Aug	48.3	49	53.3
16:30	US	Initial Jobless Claims	27-Aug	261K	265K	263K
18:00	US	Construction Spending m-o-m	Jul	0.9%	0.5%	0%
18:00	US	ISM Manufacturing PMI	Aug	52.6	52	49.4
Friday, 2 Sep						
03:50	Japan	Monetary Base, y-o-y	Aug	24.7%	--	24.2%
16:30	US	Trade Balance	Jul	-$44.7B	-$42.5B	-$39.5B
16:30	US	Change in Nonfarm Payrolls, '000	Aug	275K	180K	151K
16:30	US	Unemployment Rate	Aug	4.9%	4.8%	4.9%
16:30	US	Average Hourly Earnings, m-o-m	Aug	0.3%	0.2%	0.1%
18:00	US	Factory Orders	Jul	-1.8%	2%	1.9%
18:00	US	Factory Orders ex-Trans	Jul	0.4%	--	0.2%

* UAE time
Source: Bloomberg

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