The Week Ahead: US and UK GDP data and Fed minutes in focus

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US: FOMC minutes and 1Q GDP (2nd estimate) key releases

The upcoming week will be busy with a number of data releases (1Q GDP, April durable goods orders and May consumer confidence) and minutes of the FOMC's 3 May meeting. Markets will look to gauge the tone of the minutes, after the post-meeting statement was seen as hawkish, dismissing the softness in 1Q GDP growth and the March CPI report. Discussions on reducing the Fed's balance sheet will also be an area of focus. A number of Fed members have speaking engagements this week that will be closely watched for forward-looking comments after the disappointing April inflation numbers and if there are downside risks to the FOMC's CPI forecasts. Meanwhile, consensus expects 1Q real GDP growth to be revised up to 0.9% q-o-q SAAR in the second print, from 0.7% in the first estimate, driven by stronger personal consumption and investment in structures.

Other G4: UK 1Q GDP (2nd estimate) to re-confirm slowdown

No change is expected in the second estimate of UK 1Q GDP growth of 0.3% q-o-q (4Q: 0.7%). The focus will be on the detailed expenditure breakdown and we expect consumption to markedly decelerate, considering the steady downtrend in retail sales through 1Q. Industrial production and monthly trade numbers also suggest a softening in investment activity and net exports. Elsewhere, EU ministers are likely to approve a bailout tranche of EUR6 billion to Greece at a Eurogroup meeting (22-23 May), allowing it to meet its debt repayment obligations in July. In Japan, headline inflation (26 May) is likely to have risen further to 0.4% y-o-y in April (March: 0.2%), largely reflecting the lagged impact of JPY depreciation and higher food prices. However, core inflation should remain subdued (consensus: 0% y-o-y; March: -0.1%), as reflected in the sharp deterioration in the GDP deflator in 1Q (see page 3).

OPEC: Oil production cut deal expected to be extended

OPEC and non-OPEC producers will meet on 25 May to discuss the extension of the joint six-month oil output cut agreement, effective from January 2017. Saudi Arabia and Russia have already announced that they are willing to prolong their output cuts by another nine months to March 2018. A number of countries have expressed support and Saudi Arabia has since noted that there is broad consensus amongst the group. We believe that the deal will be extended, with target production levels remaining steady from the 1H2017 quotas. The impact on the oil price is expected to be limited unless the output cut is greater than the previous agreement, or the duration of the new deal extends beyond 1Q2018. Oil prices have already rallied with prospects building for an extension over the last two weeks, with Brent crude at USD54.1 p/b at the time of publishing. The continuation of the deal highlights that more time is needed to rebalance the oil market. Recently, OPEC increased its 2017 forecast for non-member production by over 60% from its earlier estimate to almost 1 million bpd. Our GCC forecast already assumes that the lower production levels will be extended for all of 2017.

I. Recent Events and Data Releases

A. MENA Economies

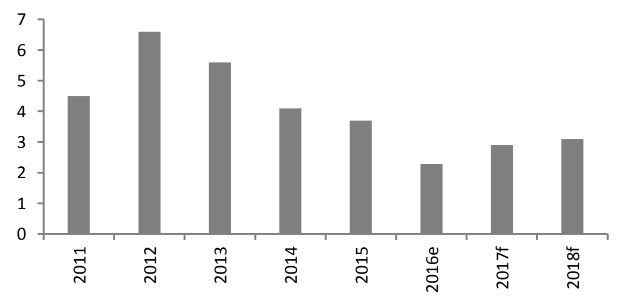
UAE: IMF sees non-oil activity strengthening in 2017

IMF growth forecasts slightly stronger than our estimate

The IMF provided a positive assessment of the UAE economy following the completion of its 2017 Article IV mission. In line with our expectations, the IMF sees real non-oil GDP growth accelerating in 2017 driven by a pick-up in global trade, strengthening investment partly linked to Expo 2020 and gradual fiscal consolidation. However, the IMF forecasts that real non-oil GDP growth will accelerate to 3.3% in 2017 – above our estimate of 2.9%. The IMF highlighted that the existing financial buffers will enable fiscal consolidation to proceed more gradually, and that capital buffers are helping the UAE to cope with lower oil prices. The UAE remains our top economic pick in the GCC over the outlook period, supported by its more diversified structure, expected economic pick-up in activity and strong fiscal and external buffers.

Fig. 1. UAE: We see real non-oil GDP strengthening in 2017, albeit by a lesser magnitude than the IMF

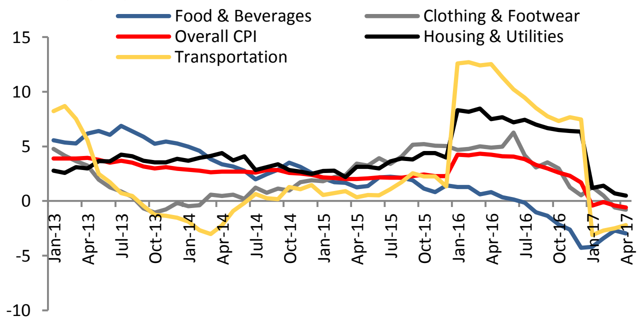
% change y-o-y



Source: National Bureau of Statistics, ADCB estimates

Fig. 2. Saudi Arabia: CPI contracts for fourth consecutive month in April in yearly terms

% change y-o-y



Source: General Authority for Statistics

Saudi Arabia: IMF suggests weaker pace of fiscal reform; Trump's visit

Low debt and strong financial assets support balanced progress with fiscal reforms

Meanwhile on Saudi Arabia, the IMF noted that the government is "adapting its fiscal policy to lower oil prices". However, the Fund also said that Saudi Arabia's target of balancing the budget does not have to be met by 2019, as outlined in the Fiscal Balance Program (FBP), given Saudi Arabia's strong financial asset position and its low debt. A more gradual pace of fiscal consolidation would help to limit the negative impact on economic activity, while still preserving fiscal buffers to help manage future risks. The pace of fiscal reform has already weakened in 2017 compared to the fast pace set in 2016. Recent official comments continue to suggest the focus shifting to other key areas of Saudi Arabia's transformation plan, including measures to support growth.

Potential US-Saudi investment deal could take time to materialise

Boosting investment activity (both ways) has been a key economic objective for Saudi Arabia from US President Donald Trump's visit to the Kingdom. Deals valued over USD350 billion have already been announced between US companies and Saudi Arabia in various areas including in hydrocarbon, mining, power, healthcare and defence. A number of the deals are aimed at increasing Saudi Arabia's domestic production base. As we have highlighted in our research, Saudi Arabia needs to boost foreign investment and technology to meet its ambitions to diversify the economy and create job opportunities for nationals. However, we expect the deals to have limited economic impact in the short term. Many of the agreements will likely be memorandums of agreement, which will need further time to be negotiated before progress can be made.

Saudi Arabia: Stronger yearly deflation in April

Reversal of public sector wage cuts should provide upward support to prices from May

The CPI fell by -0.6% y-o-y in April (March: -0.4%); this was the fastest pace of deflation seen so far this year and the fourth consecutive month of prices falling. As we highlighted earlier, this deflation is a result of the yearly fall in food prices (partly due to price discounting), fiscal reforms dropping out of the annual data series, and a weak demand backdrop. However, on a monthly basis, prices saw positive growth of 0.1% m-o-m from a contraction of the same magnitude in the previous month. We believe that the moderate weakening in the USD likely provided some support. The data point to a moderate pick-up in consumer activity in March, which may have been reflected in April's consumer prices if it continued. The reversal of public sector wage cuts (announced end-April) will likely provide some upward support to prices from May onwards. Moreover, Saudi Arabia is looking to introduce an excise tax on harmful products such as tobacco and soft drinks in 2Q2017. We believe that any marked rise in inflation will be driven by fiscal reforms as domestic demand remains weak.

B. G4 Economies

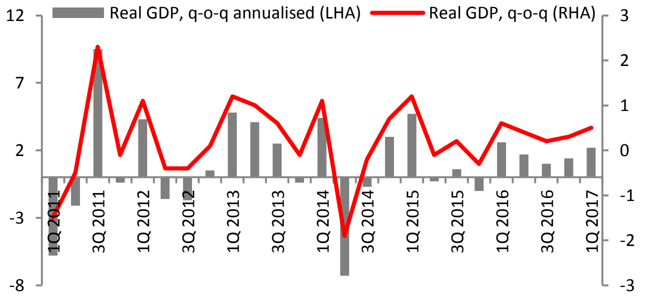
Japan: 1Q2017 real GDP growth accelerates, but nominal GDP contracts

No change expected to BoJ economic outlook at 15 June meeting

Japan's 1Q GDP data released last week showed sharply divergent trends in GDP growth on a real and nominal basis. Real GDP growth in 1Q beat the market's expectations, expanding by 2.2% q-o-q saar (consensus: 1.7%; 4Q: 1.4%) whereas GDP on a nominal basis (current prices) contracted by 0.1% q-o-q saar (4Q: 1.7%). Real GDP has now expanded for the fifth successive quarter, marking the longest period of economic expansion since the global financial crisis. On the other hand, the sharp decline in nominal GDP was mainly due to a 0.2% q-o-q contraction in the GDP deflator (4Q: 0%), implying that persistent disinflationary pressures are prevailing in the economy. We do not expect last week's GDP data to prompt any change in the BoJ's economic outlook – positive on growth but concerned about disinflation – at its 15 June monetary policy meeting. No changes are expected to the central bank's extremely accommodative monetary policy stance either.

Fig. 3. Japan: GDP has now expanded for longest stretch since 2008-09 financial crisis

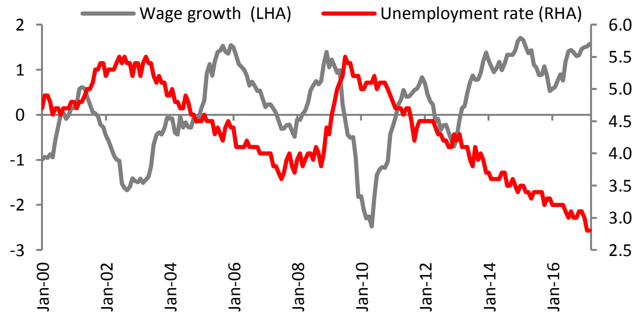
% change q-o-q



Source: Cabinet Office

Fig. 4. Japan: Stagnant pace of wage growth unlikely to sustain rebound in consumer spending

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



Source: Bloomberg, Ministry of Internal Affairs and Communication

We expect GDP growth to moderate over remainder of 2017

Looking deeper into the details of real GDP, consumer spending (0.8pp) and net exports (0.6pp) continued to drive the economy, with a more modest contribution from investment growth (0.2pp). We had already expected a strong contribution to GDP from net exports, especially given the robust export orders for machinery from China and other Asian manufacturers throughout 1Q2017. Consumer spending rebounded from a flat reading in 4Q, largely on durable goods, helped by a steady increase in home sales.

Looking ahead, we expect a moderation in the pace of GDP growth, to an average of 1.0% q-o-q saar, for the rest of 2017. We believe that the export growth that underpinned Japan's recovery in 1Q2017 is likely to soften over the rest of this year as economic activity in China is expected to decelerate from 2H2017 onwards (see page 5). Furthermore, the rebound in consumer spending is unlikely to sustain itself strongly, considering the weakness in wage growth seen so far this year. Indeed, real employee compensation (proxy for wages) fell by -0.2% q-o-q saar in 1Q17 (4Q: 0.5%), underscoring the weak wage support to consumption activity. We expect public and private capital expenditure to drive growth from 2H2017 onwards as work on housing and transportation projects related to the 2020 Tokyo Olympics commences.

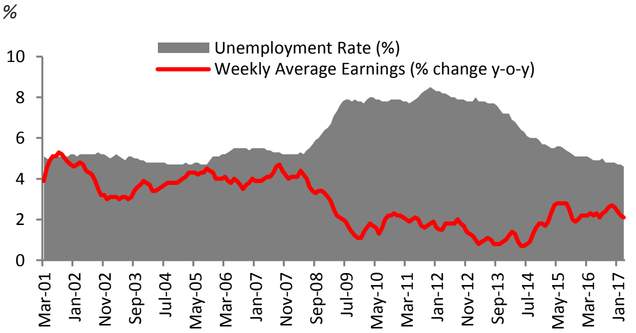
UK: Employment growth at 42-year high but real wage growth slides into negative territory; inflation picks up in April

Consumer spending likely to moderate further as real wage growth contracts

The UK's March labour market data extended a familiar trend seen since 2H2016 of a solid increase in jobs, accompanied by weakening wage growth. Employment rose by 122K between Jan-Mar (consensus: 21K; Nov-Feb: 43K), and the unemployment rate fell to 4.6% (February: 4.7%) – its lowest level since 1975. Other labour market indicators also pointed towards the slack in the economy gradually diminishing; the number of full-time jobs rose by 200K and part-time employment declined by 78K. Looking ahead, we expect employment growth to gradually ease from the current pace. Hiring activity usually lags the economic cycle, and the impact of the slowdown seen in 1Q2017 is likely to be felt on the pace of job creation from 2H2017 onwards, in our view.

Meanwhile, wage growth (ex-bonus, BoE's preferred measure) moderated to 2.1% y-o-y in March (consensus: 2.1%; February: 2.2%) – its slowest pace since December 2015. We note that the relatively subdued wage growth (2.3-2.5% y-o-y) vis-à-vis a firm pick-up in job creation since 2H2015 reflects a proliferation (c.20% growth) in flexible work contracts (zero-hour contracts), notwithstanding the decline seen in part-time employment in the March report. We believe that workers on such contracts tend to have less bargaining power. Furthermore, anecdotal evidence suggests that EU workers presently working in the UK are getting limited wage increases despite a tight labour market, given the uncertainty around their long-term employment status in the country once the UK leaves the EU. Lower wage growth is also likely to weigh on consumer spending, further decelerating the economic momentum for the rest of this year. We expect GDP growth to come in at 1.5% y-o-y in 2017 (consensus: 1.7%, BoE: 1.9%). In another data release, inflation accelerated to 2.7% y-o-y in April (consensus: 2.6%; March: 2.3%), slightly above the market's expectations. Much of the increase reflected the impact of Easter effects on transport prices (0.3pp), though the impact of previous GBP depreciation was also visible in clothing, food and durable goods (furniture and household equipment).

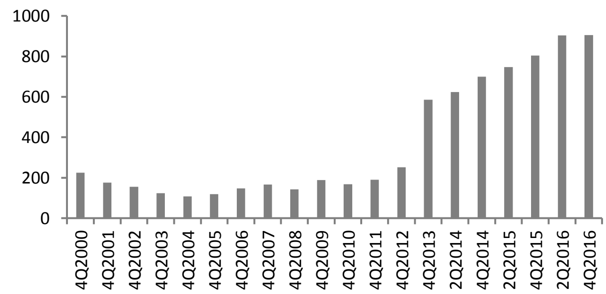
Fig. 5. UK: Wage growth has remained stuck at low levels since 2015 while unemployment has steadily fallen



Source: Office for National Statistics

Fig. 6. UK: Pick-up in zero-hour contracts a key reason behind low wage growth

Number of zero-hour contract workers ('000)



Source: Office for National Statistics

Labour market and inflation data further reinforce BoE's dovish inflation outlook

In our view, April's inflation numbers, as well as the labour market data, provide further evidence of the BoE's dovish view on underlying inflation for two reasons. First, although inflation picked up in April, we believe that it is likely to stabilise slightly under the BoE's 2017 forecast of 2.9% y-o-y from July 2017 onwards. At the current levels, the GBP is likely to be only marginally weaker than the levels seen in 2H2016, which should ease import price pressures from 1H levels. Furthermore, barring the near-term increase in utility and gas prices in May, we expect energy and fuel price pressures on headline inflation to be more benign (in GBP terms) in 2H2017. Indeed, producer price inflation softened to 16.6% y-o-y in April (March: 17.4%), hinting that import price pressures on CPI might have peaked. Second, the weak wage growth in March lends further credence to the BoE's view in its May inflation report that underlying domestic inflationary pressures remain weak. Indeed, the combination of a weak 1Q GDP print, a high pace of hiring and low unemployment rate points towards depressed wage costs for employers, once again in line with the central bank's medium-term forecasts. We do not see a material improvement in these trends this year or next, as Brexit-related uncertainty prevails over the economic outlook. Consequently, we forecast the BoE to keep its benchmark policy rate on hold at 0.25% until 2Q2019 when Brexit will be out of the way.

C. Emerging Market Economies

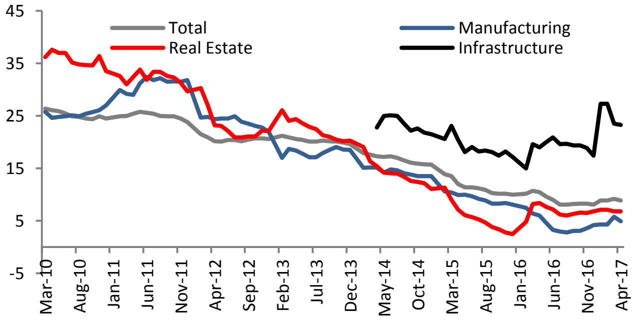
China: April data below market expectations; PBoC hints at less hawkish monetary policy stance

We expect some softening in GDP growth from 2Q2017 onwards

China's economic activity data for April came in well below market expectations. Industrial production slowed to 6.5% y-o-y (consensus: 7%; March: 7.6%), fixed asset investment growth softened to 8.9% y-o-y (consensus: 9.1%, March: 9.2%) and retail sales eased to 10.7% y-o-y (consensus: 10.8%; March: 10.9%). Much of the slowdown in industrial activity and fixed asset investment came from the manufacturing sector – investment in this segment decelerated to 4.9% y-o-y (5.8% in March).The bulk of the manufacturing demand in 1Q2017 was related to inventory restocking, as improving global demand prospects and robust domestic infrastructure spending encouraged firms to build up stocks. The April dynamics reflect a saturation in this demand. Similarly, the deceleration in retail sales was largely due to the expiration of last year's tax breaks on car purchases, which dampened auto demand. Overall, we expect China's economic activity indicators to stabilise at the current levels, pointing towards a somewhat softer growth rate compared to 1Q2017. In particular, we expect a further softening in real estate investment, as leading indicators (property prices, floor space sold) have begun to ease in response to the government's measures to ease property prices in big cities.

Fig. 7. China: Much of April slowdown in investment led by dip in manufacturing capex

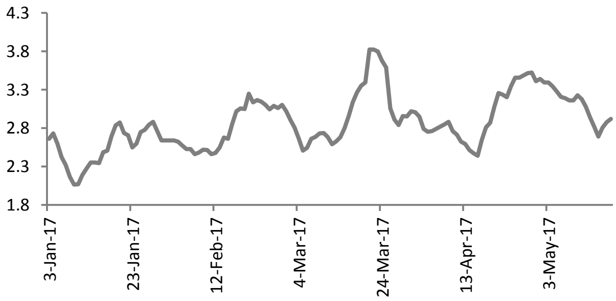
Fixed Asset Investment (% change YTD y-o-y)



Source: National Bureau of Statistics

Fig. 8. China: Interbank rates ease after PBoC's 1Q policy report; liquidity absorption likely eased

%



Source: Bloomberg

PBoC sounded more balanced in its approach towards managing deleveraging

In another development, the PBoC's 1Q2017 monetary policy report released last week struck a less hawkish tone compared to its 4Q2016 policy report. The PBoC emphasised the need to "strike a balance between deleveraging and ensuring basic stability in liquidity conditions" and assured that the necessary liquidity to ensure reasonable credit growth will be provided. This was followed by another comment by the China Banking Regulatory Commission, which warned that excessive emphasis on deleveraging could create further market risks. We interpret these measures as a careful calibration of China's monetary stance towards being less hawkish, as growth decelerates. On one hand, we expect some easing of interbank liquidity, which the PBoC has already begun by reducing the amount of liquidity absorption through repo operations since the beginning of this month. This has been supported by efforts undertaken to encourage medium-term lending by banks to corporates and households, which was visible in the April monetary data. On the other hand, we expect the strict regulations to prevent rapid growth in off-balance-sheet lending (announced in March) to remain in place. This measure has already had some impact: off-balance-sheet lending shrank dramatically in April for the first time in eight months. Furthermore, the approval of the China Bond Connect programme last week, which allows foreign institutional investors to invest in Chinese sovereign bond markets, is also a long-term positive for liquidity conditions, and could be a vital source of liquidity for domestic firms and local governments with strong balance sheets in the future.

II. Economic Calendar

Fig. 9. The week ahead

Time*	Country	Event	Period	Prior	Consensus
Expected this week					
	UAE	M2 Money Supply, m-o-m	Apr	2.3%	--
	UAE	CPI, y-o-y	Apr	3%	--
	Saudi Arabia	Current Account Balance	1Q	-1197M	--
	Kuwait	CPI, y-o-y	Apr	2.6%	--
	Bahrain	CPI, y-o-y	Apr	0.8%	--
	Egypt	Deposit Rate	21-May	14.75%	14.75%
	Egypt	Lending Rate	21-May	15.75%	--
Monday, 22 May					
	Eurozone	EU/Euro-Area Finance Ministers Meet in Brussels			
3:01	UK	Rightmove House Prices, m-o-m	May	1.1%	--
3:01	UK	Rightmove House Prices, y-o-y	May	2.2%	2%
3:50	Japan	Trade Balance Adjusted	Apr	¥172.2B	¥259.6B
3:50	Japan	Exports, y-o-y	Apr	12%	8%
18:00	US	Fed's Harker Speaks in Philadelphia			
Tuesday, 23 May					
5:10	US	Fed's Evans Speaks in Shanghai			
12:00	Germany	IFO Business Climate	May	112.9	113.1
18:00	US	New Home Sales	Apr	621K	610K
23:15	US	Fed's Kashkari Speaks in Minneapolis			
Wednesday, 24 May					
1:00	US	Fed's Harker Speaks in New York			
4:00	Japan	BOJ Kuroda speaks in Tokyo			
12:30	Eurozone	ECB Executive Board member Praet speaks in Sofia			
15:00	US	MBA Mortgage Applications	19-May	-4.1%	--
16:45	Eurozone	ECB President Draghi speaks in Madrid			
17:45	US	Markit US Manufacturing PMI	May P	52.8	53.1
18:00	US	Existing Home Sales	Apr	5.71M	5.65M
22:00	US	FOMC Meeting Minutes	3-May	--	--
Thursday, 25 May					
		OPEC Meeting in Vienna			
	Eurozone	EU's Tusk, Juncker Meet With U.S.'s Trump in Brussels			
2:00	US	Fed's Kaplan Speaks in Toronto			
2:30	US	Fed's Kashkari Speaks in Wisconsin			
12:30	UK	GDP, q-o-q	1Q P	0.3%	0.3%
12:30	UK	GDP, y-o-y	1Q P	2.1%	2.1%
12:30	UK	Private Consumption, q-o-q	1Q P	0.7%	0.3%
12:30	UK	Government Spending, q-o-q	1Q P	0%	0.4%
12:30	UK	Gross Fixed Capital Formation, q-o-q	1Q P	0.1%	-0.2%
12:30	UK	Exports, q-o-q	1Q P	4.6%	0.5%
16:30	US	Initial Jobless Claims	20-May	232K	238K
Friday, 26 May					
3:30	Japan	CPI, y-o-y	Apr	0.2%	0.4%
3:30	Japan	CPI, ex-Fresh Food, Energy, y-o-y	Apr	-0.1%	0%
6:00	US	Fed's Bullard Speaks on U.S. economy in Tokyo			
16:30	US	GDP Annualized, q-o-q	1Q S	0.7%	0.9%
16:30	US	Personal Consumption, q-o-q	1Q S	0.3%	0.4%
16:30	US	GDP Price Index	1Q S	2.3%	2.3%
16:30	US	Durable Goods Orders, m-o-m	Apr P	0.9%	-1.5%
16:30	US	Core PCE, q-o-q	1Q S	2%	2%
16:30	US	Durables, ex-Transportation, m-o-m	Apr P	0%	0.4%

* UAE time
Source: Bloomberg

Fig. 10. Last week's data

Time*	Country	Event	Period	Prior	Consensus	Actual
GCC Data						
	UAE	Central Bank Foreign Assets	Apr	324.98B	--	317.44B
	Qatar	CPI, y-o-y	Apr	0.9%	--	0.6%
Monday, 15 May						
6:00	China	Retail Sales, y-o-y	Apr	10.9%	10.8%	10.7%
6:00	China	Fixed Asset Investment ,YTD y-o-y	Apr	9.2%	9.1%	8.9%
6:00	China	Industrial Production, y-o-y	Apr	7.6%	7%	6.5%
Tuesday, 16 May						
0:00	US	Total TIC Flows	Mar	$13.2B		-$0.7B
18:00	UK	CPIH, y-o-y	Apr	2.3%	2.6%	2.6%
12:30	UK	CPI, y-o-y	Apr	2.3%	2.6%	2.7%
12:30	UK	CPI core, y-o-y	Apr	1.8%	2.3%	2.4%
12:30	UK	PPI Input, y-o-y	Apr	17.4%	17%	16.6%
16:30	US	Housing Starts	Apr	1203K	1260K	1172K
16:30	US	Building Permits	Apr	1260K	1270K	1229K
17:15	US	Industrial Production, m-o-m	Apr	0.4%	0.4%	1%
Wednesday, 17 May						
3:50	Japan	Machine Orders, y-o-y	Mar	5.6%	1.2%	-0.7%
12:30	UK	Employment Change, 3m/3m	Apr	43K	21K	122K
12:30	UK	Unemployment Rate, 3m/y	Mar	4.7%	4.7%	4.6%
12:30	UK	Weekly Earnings, ex-bonus, y-o-y	Mar	2.2%	2.1%	2.1%
15:00	US	MBA Mortgage Applications	5-May	2.4%	--	-4.1%
Thursday, 18 May						
3:50	Japan	GDP, q-o-q	1Q	0.3%	0.5%	0.5%
3:50	Japan	GDP, q-o-q saar	1Q	1.4%	1.7%	2.2%
3:50	Japan	GDP Private Consumption, q-o-q	1Q	0%	0.5%	0.4%
3:50	Japan	GDP Business Spending, q-o-q	1Q	1.9%	-0.4%	0.2%
12:30	UK	Retail Sales, ex-Auto and Fuel, m-o-m	Apr	-1.2%	1%	2%
12:30	UK	Retail Sales, ex-Auto and Fuel, y-o-y	Apr	2.8%	2.6%	4.5%
16:30	US	Initial Jobless Claims	13-May	236K	240K	232K

* UAE time
Source: Bloomberg

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