The Week Ahead: ECB's comments and UK elections the key events

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Eurozone: No change to ECB's QE programme expected yet

Markets will look to the ECB's monetary policy meeting (8 June) for any change in forward guidance on its QE programme, given the relatively solid GDP growth data since its last meeting. Thus, we expect a less bearish tone to the ECB meeting, with a likely removal of the references to downside risks to growth. However, at this stage, we do not expect the ECB to announce any further reduction to its monthly pace of asset purchases (EUR60 billion). Some key underlying drivers of inflation (wage growth and credit demand) have remained lacklustre so far this year, despite easing political risks and improving labour market conditions. The ECB is also likely to quell any market expectations of a rise in interest rates even next year. We expect the MPC members to re-affirm that benchmark policy rates are likely to remain at the current low levels, well after its asset purchases have ended. Another notable aspect of the meeting will be the ECB's release of its growth and inflation forecasts for 2017-19, where we do not expect any significant revisions. Meanwhile in the US, markets are still expecting the Fed to raise rates in mid-June, despite the recent softening in labour and core inflation data (page 3).

India: RBI likely to be more dovish, hints at 2H2017 rate cut

We expect a significant shift in the RBI's monetary policy guidance in its MPC meeting (7 June), from "neutral" to "dovish", and for it to cut its inflation forecasts for FY18 (April 2017-March 2018). Inflation has remained well below the RBI's medium-term mandate of 4% and undershot consensus expectations since February. Furthermore, the sharp deceleration in economic activity in 1Q2017 (page 5) indicates that demand-side pressures on prices are weaker than the RBI had observed in its April MPC minutes. That said, we expect the central bank to remain on hold at its June meeting, though it could hint at the likelihood of monetary policy easing in 2H2017 if inflation dynamics remain muted. In our view, a favourable monsoon in 3Q2017 should pave the way for a 25bps rate cut in August.

UK: Polls suggest narrow victory for Conservative Party

Financial markets will be closely tracking the developments in the UK's parliamentary elections (8 June), where the ruling Conservatives are in a tight race against the Labour Party. Opinion polls give Prime Minister Theresa May's Conservatives a narrow 9 point lead over Labour, though the possibility of a hung parliament has also arisen, in which no party wins the 326 seats required for a parliamentary majority. In our view, a thinly held majority for the Conservative Party could pose a risk to Brexit negotiations, since it would increase its reliance on hardliner MPs who advocate a "hard Brexit" with no deal between the UK and EU. A hung parliament is likely to trigger some further sell-off in the GBP, as markets begin to factor in the risk of weak political consensus in the UK during Brexit talks.

I. Recent Events and Data Releases

A. MENA Economies

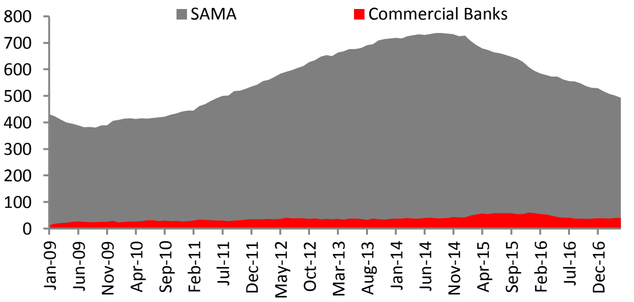
Saudi Arabia: SAMA net FX reserves post another sharp fall in April

SAMA NFAs fell despite government raising USD9 billion in maiden sukuk

SAMA's net foreign assets (NFAs) saw another sharp fall of USD8.5 billion in April to USD492.9 billion. This was the first time that its NFAs have been below USD500 billion since June 2011. We were surprised by this drop as Saudi Arabia raised USD9 billion at its first international sukuk issuance in April. We believe that the government received the proceeds of the sukuk as they were indicated in the April numbers. For example, the government's deposits in the commercial banking sector rose by USD1.7 billion in the month. This came after an average monthly decrease of USD7.2 billion in 1Q2017. Moreover, there was a moderate rise in the government's current account with SAMA (USD0.3 billion) after seeing average monthly falls of USD4.5 billion in 1Q. We therefore believe that the government placed the sukuk revenue in these accounts, which could imply that it is looking to increase spending linked to its private sector stimulus plans soon. Nevertheless, the magnitude of the fall in the SAMA NFAs implies that government spending is still strong, though we are not seeing signs of it in the Saudi economy. The fiscal data for 1Q2017 suggests that the government spending could be ex-budget. Other factors that could have contributed to the drawdown of FX reserves in 4M2017 include corporate repatriation of funds (especially after payment of government arrears) and capital outflows.

Fig. 1. Saudi Arabia: SAMA's NFAs fell to below USD500 billion in April

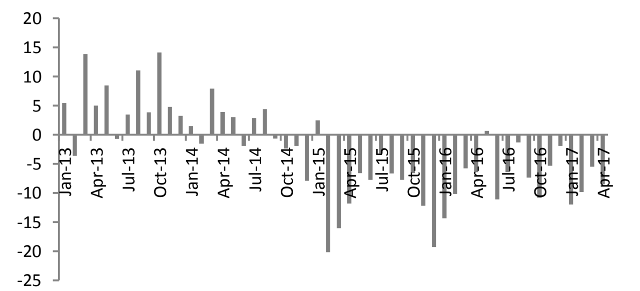
USD billion



Source: SAMA

Fig. 2. Saudi Arabia: SAMA's NFAs fell by USD35.7 billion in 4M2017 versus USD36.7 billion in 4M2016

Monthly change in SAMA's NFAs, USD billion



Source: SAMA

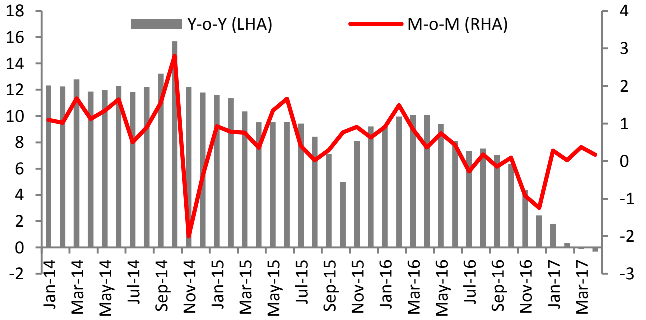
No meaningful signs of fiscal support entering domestic economy

SAMA data continued to point to weak economic activity in April. As noted above, we are not seeing any meaningful signs of fiscal support entering the domestic economy, which is vital if non-oil GDP growth is to be boosted. On the private consumption side, point of sales transactions (values) and ATM withdrawals saw some further gradual improvement to 4.2% y-o-y growth combined, though they fell on a monthly basis. We believe there could be some further moderate rise in May once the wage-cut reversals are felt. However, any rise will likely be moderate with further fiscal measures expected to be announced. These include the SAR100 levy per month on the dependents of expatriates, starting mid-2017, and the introduction of an excise tax on tobacco and sugary drinks from 10 June. We expect the excise tax to add c.0.2-0.3 pp to headline inflation. Import data continues to show a contraction of both imports for consumption and investment whilst the fall in cement sales reflects the weak investment backdrop.

Meanwhile, private sector credit growth fell by 0.3% y-o-y – a second consecutive month of y-o-y contraction. Credit to the government (bonds) increased in May, likely due to domestic banks buying the new sukuk.

Fig. 3. Saudi Arabia: Private sector credit growth contracted for second consecutive month on y-o-y basis

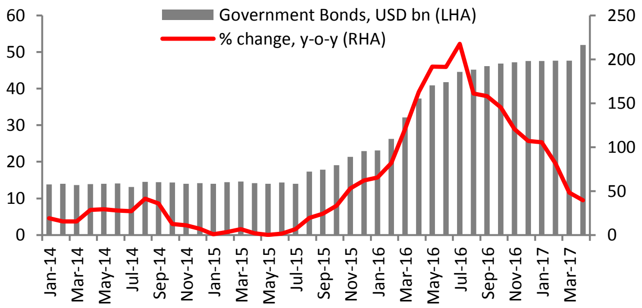
% change



Source: SAMA

Fig. 4. Saudi Arabia: Banking sector holdings of government debt rose in April with sukuk issuance

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



Source: SAMA

B. G4 Economies

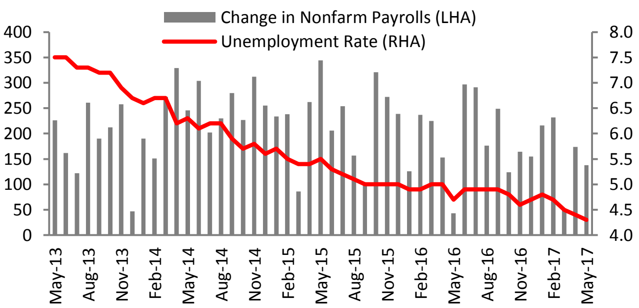
US: Fed still likely on course to raise rates despite patchy jobs and softening inflation data

Jobs data still points to some gradual tightening in labour market, despite disappointing overall

Markets are still expecting the Fed to raise the FFTR by 25 bps at the 13-14 June meeting, despite the recent choppy data out of the US recently and last week. Indeed, the market probability of a 25 bps June rate hike remains high at 89%, albeit down from 95% at end-May, following the softer-than-expected May NFP data. Jobs growth weakened to 138K in May (consensus: 182K; April: 174K), whilst the previous two months saw net downward revisions of 66K. Consequently, the 6M pace of jobs growth moderated, though to a still healthy 160K. Wage growth remained steady in May, both on a m-o-m (0.2%) and y-o-y (2.5%) basis. On the surface, the bright spot was the unemployment rate which declined further to 4.3%, from 4.4% in April. However, this was partly due to a fall in the labour force participation rate to 62.7% (April: 62.9%). Despite disappointing consensus expectations, the May labour report is likely still sufficient for the FOMC to hike, particularly with the unemployment rate falling to 4.3% - below the Fed's forecast for 2017 and the long-run estimate. Moreover, the May jobs growth was still above the neutral rate of c. 100K per month, i.e. the pace required for jobs growth to keep up with labour market expansion and thus keep unemployment steady. Furthermore, with the blackout period now in force, the Fed is not in a position to change market views ahead of the meeting.

Fig. 5. US: Jobs growth weakens to 138K in May, but unemployment rate falls to 4.3%

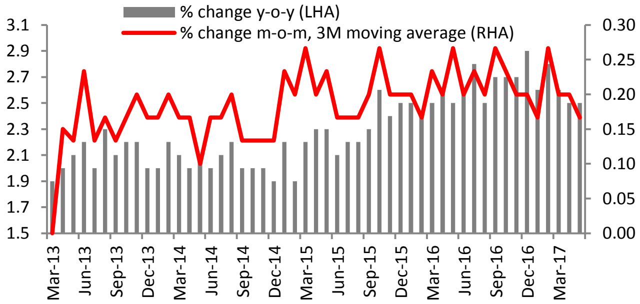
'000 (LHA); % (RHA)



Source: Bureau of Labor Statistics

Fig. 6. US: Wage growth remains tepid, despite fall in unemployment rate to below long-term expectations

% change



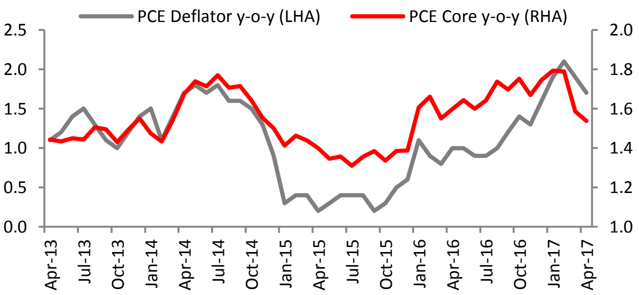
Source: Bureau of Labor Statistics

We believe an improvement in data will be critical for further rate hikes by the Fed post-June, especially on the core inflation front. PCE data released last week confirmed the deceleration in core prices in April, as witnessed in the CPI data. Core PCE rose by 0.2% m-o-m in April, resulting in the annual rate slowing to 1.5% y-o-y (March: 1.6%). If core inflation continues to disappoint and wider economic data remains patchy, we see downside risks to our forecast of a total of three rate hikes by the Fed in 2017. The next major data releases will be May CPI and retail sales, though they are due during the two days of the June FOMC meeting.

A pickup in core inflation likely required for further Fed rate hikes

Fig. 7. US: Core PCE deflator decelerates further in April, which will likely be key concern for Fed

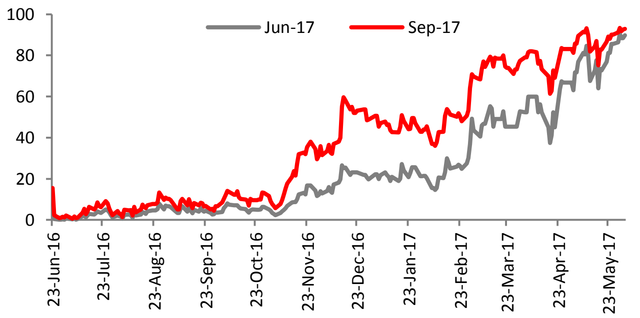
% change y-o-y



Source: Bureau of Economic Analysis

Fig. 8. US: Markets still expecting 25 bps rate hike in June, despite recent patchy data

Market expectations of FFTR rising to 1-1.25%



Source: Bloomberg

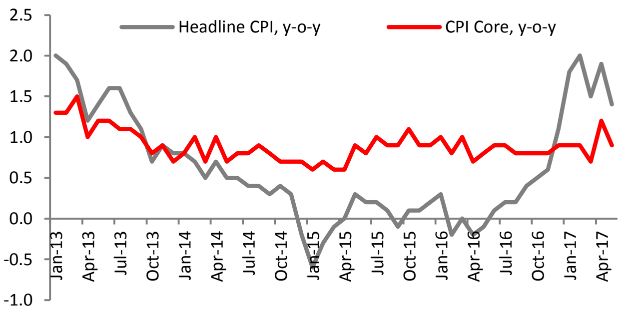
Eurozone: Inflation softens in May; reduction in pace of QE purchases by ECB unlikely in June

Eurozone inflation rose by 1.4% y-o-y in May (April: 1.9%), slightly undershooting the market expectation of a 1.5% increase. Disinflationary impulses were broad-based with core inflation falling to 0.9% y-o-y (April: 1.2%) and the rise in energy prices softening to 4.6% y-o-y (April: 7.6%). The decline in inflation could be attributed to a certain extent to the fading of the one-off impact of the Easter effect on services prices. However, softer energy prices in May and a strengthening in the EUR following the victory of Emmanuel Macron in the French presidential elections also weighed on prices. Meanwhile, in

Weaker energy prices and stronger EUR also weighed on prices another data release, the Eurozone unemployment rate fell to 9.3% in April (consensus: 9.4%; March: 9.4%) with job creation rising across the bloc, especially in Spain and Italy.

Fig. 9. Eurozone: Inflation eased sharply in May as Easter effects faded and energy prices softened

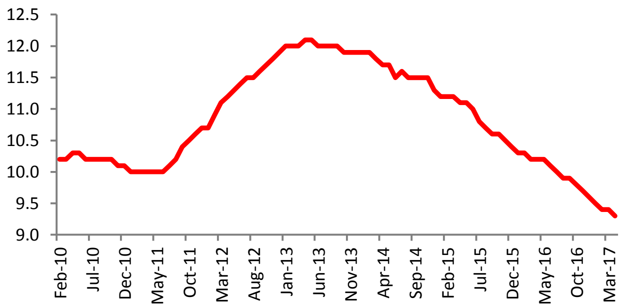
% change y-o-y



Source: Eurostat

Fig. 10. Eurozone: Unemployment rate now close to pre-recession levels, but wage growth remains tepid

%



Source: Eurostat

ECB likely to be more upbeat in growth outlook but cautious on inflation

Looking ahead, we expect the ECB to refrain from announcing any further reduction to its pace of QE purchases at its June policy meeting given the weak inflation numbers. We expect the central bank to acknowledge the improvement in the economic data since its last meeting in April, possibly dropping its assessment of “downside risks” to growth from its statement. The ECB is likely to emphasise that a sustained return of inflation towards its 2% target has yet to materialise. In our view, the Eurozone’s inflation and labour market dynamics are currently analogous to those of the US in 2H2014 when the first signs of a steady decline in the US unemployment rate after a long recession were visible. As with the US, we expect a recovery in inflation to lag an improvement in the labour market in the Eurozone, with a sustained increase in area-wide inflation only visible from 4Q2017. Therefore, we do not expect any guidance towards a reduction in QE before the ECB’s December meeting, when we expect the central bank to announce a scaling back in its asset purchases from 1Q2018.

C. Emerging Market Economies

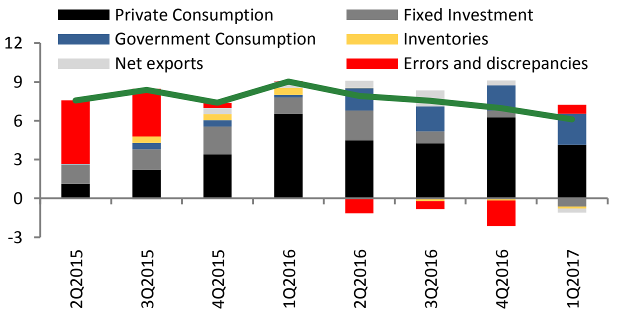
India: GDP decelerates sharply as investment growth contracts for first time in two years

Construction sector output contracts, leading to fall in overall capex

India’s GDP growth decelerated sharply to 6.1% y-o-y in 1Q2017 (consensus: 7.1%; 4Q2016: 7%), largely reflecting the ongoing impact of demonetisation. Specifically, capex growth contracted by 2.1% y-o-y (4Q2016: +1.7%) – the first reduction in two years. Indeed, construction output, which comprises c.40% of investment activity, fell 3.7% y-o-y (4Q2016: 3.4%) as the cash crunch and new measures undertaken by the government to curb tax-evasive real-estate transactions weighed on construction demand. Additionally, consumption growth also decelerated to 7.3% y-o-y (4Q: 11.1%) – in line with our expectations. We had previously noted (please see our **Global Data Watch 6-10 March 2017**) that consumption activity was likely overestimated in 4Q2016 given the surge in indirect tax collections and utility bill payments (used to measure urban consumer spending) in the wake of demonetisation to avoid prosecution for tax avoidance. On the other hand, government spending accelerated to a robust 31.9% y-o-y in the quarter compared to 21% in 4Q2016, which partly cushioned the adverse impact of the investment contraction on the economy. We believe that much of this jump in government spending is likely to be a one-off, as it reflects the one-time payment of arrears to public sector employees following an increase in their salaries for FY17 (April 2016-March 2017).

Fig. 11. India: GDP decelerated in 1Q2017 as investment contracted and consumer spending eased

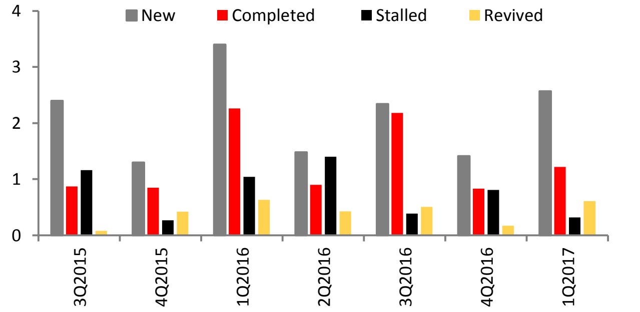
Pp contribution to y-o-y GDP growth



Source: Central Statistical Office

Fig. 12. India: Project completions again fall short of announcements, weighing on capex growth

INR trillion



Source: Centre for Monitoring Indian Economy

We expect growth to only modestly recover in FY18

Looking ahead, we expect an acceleration in GDP growth from the current levels to 6.8% y-o-y (consensus: 7.5%) in FY18 (April 2017-March 2018), albeit at a slower pace than in FY17 (7.1%). This is mainly because we only expect a feeble rebound of 1% y-o-y in investment activity this fiscal year (consensus: 4.8%, FY17:0%). We believe that structural impediments to private sector capex growth – the rising debt servicing burden, falling corporate credit demand and ample spare capacity – are likely to be felt even more strongly this year. In particular, we estimate that banking sector non-performing assets (including restructured loans) will rise to 12.5% of total advances in FY18 (11.2% in FY17), which could further dampen banks' appetite to lend to the industrial sector. We also expect less support to growth from consumer spending, which we expect to rise by 6.8% y-o-y in FY18, down from 8.7% in FY17. Here, urban consumer spending is likely to be the drag as the leading indicators of activity show a significant slowdown in the pace of job creation, especially in the highly remunerative IT, finance and business services sectors. Given these trends, we believe that domestic demand-related pressures on inflation are likely to be benign. This factor, combined with the favourable impact of a likely good monsoon on food prices, should prompt the RBI to re-think its monetary stance at its June MPC meeting. We expect the central bank to be more dovish in its inflation outlook and to hint at the likelihood of policy rate cuts in 2H2017 if growth continues to disappoint and inflation remains below the 4% target.

II. Economic Calendar

Fig. 13. The Week Ahead

Time*	Country	Event	Period	Prior	Consensus
Expected this week					
	Qatar	CPI, y-o-y	May	0.6%	--
	Egypt	Gross Official Reserves	May	28.6B	--
Monday, 5 Jun					
8:15	UAE	UAE PMI	May	56.1	--
8:15	Saudi Arabia	Saudi Arabia PMI	May	56.5	--
8:15	Egypt	Egypt PMI	May	47.4	--
12:30	UK	UK Services PMI	May	55.8	55
18:00	US	ISM Non-Manf. Composite	May	57.5	57.1
18:00	US	Factory Orders, m-o-m	Apr	0.5%	-0.2%
18:00	US	Durable Goods Orders, m-o-m	Apr F	-0.7%	-0.5%
18:00	US	Durables, ex-Transportation, m-o-m	Apr F	-0.4%	--
18:00	US	Cap Goods Orders, Nondef ex-Air, m-o-m	Apr F	0%	0.1%
Tuesday, 6 Jun					
4:00	Japan	Labor Cash Earnings, y-o-y	Apr	0%	0.3%
13:00	Eurozone	Retail Sales, y-o-y	Apr	2.3%	2.1%
18:00	US	JOLTS Job Openings	Apr	5743	5738
Wednesday, 7 Jun					
	China	Foreign Reserves	May	$3029.5B	$3045B
11:30	UK	Halifax House Prices, m-o-m	May	-0.1%	-0.2%
13:00	Eurozone	Gross Fix Cap, q-o-q	1Q	0.6%	0.8%
13:00	Eurozone	Govt Expend, q-o-q	1Q	0.5%	0.4%
13:00	Eurozone	Household Cons, q-o-q	1Q	0.5%	0.4%
13:00	Eurozone	GDP SA, q-o-q	1Q F	0.5%	0.5%
13:00	Eurozone	GDP SA, y-o-y	1Q F	1.8%	1.7%
13:00	India	RBI Repurchase Rate	7-Jun	6.25%	6.25%
15:00	US	MBA Mortgage Applications	2-Jun	-3.4%	--
23:00	US	Consumer Credit	Apr	$16.431B	$15B
Thursday, 8 Jun					
	UK	General Elections			
	Egypt	CPI, y-o-y	May	31.5%	--
	Egypt	CPI Core, y-o-y	May	32.1%	--
	China	Imports, y-o-y	May	11.9%	9%
	China	Exports, y-o-y	May	8%	7%
	China	Trade Balance	May	$38.03B	$48B
3:50	Japan	GDP SA, q-o-q	1Q F	0.5%	0.6%
3:50	Japan	GDP Annualized SA, q-o-q	1Q F	2.2%	2.4%
3:50	Japan	GDP Private Consumption, q-o-q	1Q F	0.4%	0.4%
3:50	Japan	GDP Business Spending, q-o-q	1Q F	0.2%	0.5%
3:50	Japan	Trade Balance BoP Basis	Apr	¥865.5B	¥494B
15:45	Eurozone	ECB Main Refinancing Rate	8-Jun	0%	0%
15:45	Eurozone	ECB Marginal Lending Facility	8-Jun	0.3%	0.3%
15:45	Eurozone	ECB Deposit Facility Rate	8-Jun	-0.4%	-0.4%
15:45	Eurozone	ECB Asset Purchase Target	Jun	EU60B	EU60B
16:30	Eurozone	ECB President Mario Draghi Holds Press Conference			
16:30	US	Initial Jobless Claims	3-Jun	248K	240K

*UAE time

Source: Bloomberg

Fig. 14. Last week's data

Time*	Country	Event	Period	Prior	Consensus	Actual
GCC data						
	UAE	Dubai Airport Cargo Volume, y-o-y	Apr	8.4%	--	1.9%
	Saudi Arabia	M2 Money Supply, y-o-y	Apr	4%	--	4.2%
	Saudi Arabia	SAMA Net Foreign Assets SAR	Apr	1880.3B	--	1848.5B
	Qatar	M2 Money Supply, y-o-y	Apr	2.4%	--	5.7%
Monday, 29 May						
12:00	Eurozone	M3 Money Supply, y-o-y	Apr	5.3%	5.2%	4.9%
Tuesday, 30 May						
3:30	Japan	Jobless Rate	Apr	2.8%	2.8%	2.8%
3:30	Japan	Job-To-Applicant Ratio	Apr	1.45	1.46	1.48
3:30	Japan	Overall Household Spending, y-o-y	Apr	-1.3%	-0.7%	-1.4%
3:50	Japan	Retail Sales, m-o-m	Apr	0.2%	-0.1%	1.4%
13:00	Eurozone	Economic Confidence	May	109.7	110	109.2
13:00	Eurozone	Consumer Confidence	May F	-3.3	-3.3	-3.3
16:30	US	Personal Income, m-o-m	Apr	0.2%	0.4%	0.4%
16:30	US	Personal Spending, m-o-m	Apr	0.3%	0.4%	0.4%
16:30	US	PCE Deflator, y-o-y	Apr	1.9%	1.7%	1.7%
16:30	US	PCE Core, m-o-m	Apr	-0.1%	0.1%	0.2%
16:30	US	PCE Core, y-o-y	Apr	1.6%	1.5%	1.5%
18:00	US	Conf. Board Consumer Confidence	May	119.4	119.8	117.9
Wednesday, 31 May						
3:50	Japan	Industrial Production, m-o-m	Apr P	-1.9%	4.2%	4%
13:00	Eurozone	Unemployment Rate	Apr	9.4%	9.4%	9.3%
13:00	Eurozone	CPI Estimate, y-o-y	May	1.9%	1.5%	1.4%
13:00	Eurozone	CPI Core, y-o-y	May A	1.2%	1%	0.9%
15:00	US	MBA Mortgage Applications	26-May	4.4%	--	-3.4%
16:00	India	GVA, y-o-y	1Q	6.6%	6.9%	5.6%
16:00	India	GDP, y-o-y	1Q	7%	7.1%	6.1%
Thursday, 1 Jun						
12:30	UK	Markit UK PMI Manufacturing SA	May	57.3	56.5	56.7
16:15	US	ADP Employment Change	May	174K	180K	253K
16:30	US	Initial Jobless Claims	27-May	235K	238K	248K
18:00	US	ISM Manufacturing	May	54.8	54.6	54.9
Friday, 2 Jun						
16:30	US	Change in Nonfarm Payrolls	May	174K	182K	138K
16:30	US	Unemployment Rate	May	4.4%	4.4%	4.3%
16:30	US	Average Hourly Earnings, y-o-y	May	2.5%	2.6%	2.5%
16:30	US	Underemployment Rate	May	8.6%	--	8.4%

* UAE time
Source: Bloomberg

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