The Week Ahead: Fed and BoE to remain on hold; BoJ likely to loosen

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US: Fed to remain on hold; projections in spotlight

The FOMC is expected to remain on hold on 15 June, keeping the FFTR range at 0.25-0.5%. We believe that the Fed will need time to reassess the overall macro picture following the disappointing NFP data for May. Focus will be on the statement, the Fed's economic projections and Chair Janet Yellen's press conference. We anticipate that the Fed's overall outlook will remain balanced, in line with Yellen's speech last week. There will likely be an acknowledgement of the weak NFP number and domestic and global uncertainties, though still pointing to the need to gradually raise rates. We believe that the median "dot plot" will continue to indicate two rate increases for 2016, albeit with some FOMC members having lowered the number of hikes they expect. We foresee limited changes in the FOMC's economic projections, though see 2016 growth forecasts being lowered marginally whilst expecting the PCE inflation forecast to be raised moderately.

US: July meeting live, if data supportive

We believe that the July meeting will be "live" (ie a hike could happen) though do not expect explicit guidance from the Fed on timing; the market continues to sees a greater probability of a September rate hike (Fig. 3). We expect the Fed to hike in July if the May NFP data proves to be an outlier and inflation continues to tick up. Other data (released last week) continued to show the labour market was healthy. Key releases this week will be inflation and retail spending data for May. Consensus forecasts core inflation to rise by 0.2% m-o-m, the same as in April albeit pushing the y-o-y rate to 2.2% (from 2.1%).

UK: EU referendum concerns to dominate BoE meeting

We also expect the BoE to keep monetary policy steady at its 16 June meeting, with a unanimous vote. We believe that the MPC will focus on contingency plans and its response to market volatility ahead of the UK's EU referendum on 23 June. Any details of additional liquidity measures, such as long term repurchase operations, which could limit volatility ahead of the referendum, will be closely examined by financial markets. We see an increased risk that the BoE may keep rates unchanged beyond 1Q2017, as the ruling Conservative Party could face leadership struggles even if the Remain camp wins.

Japan: Additional easing expected by BoJ on 16 June

We see a strong case for the BoJ to ease either at this week's meeting or in July (28-29), after a further fall in inflation expectations, softening corporate sentiment and the strong JPY activity. An expansion in the asset purchase programme of around JPY10 trillion (to JPY90 trillion) is most likely, largely centred on ETFs. Meanwhile, we cannot rule out a cut in interest rates, despite the poor sentiment around negative rates. We believe that any rate cuts would likely target funding for lending programmes, currently at 0% (negative interest rates have hitherto focused on excess financial institution reserves at the central bank).

I. Recent Data and Events

A. MENA Economies

Oman: Raises USD2.5 billion through dual tranche bond

First international bond since 1997

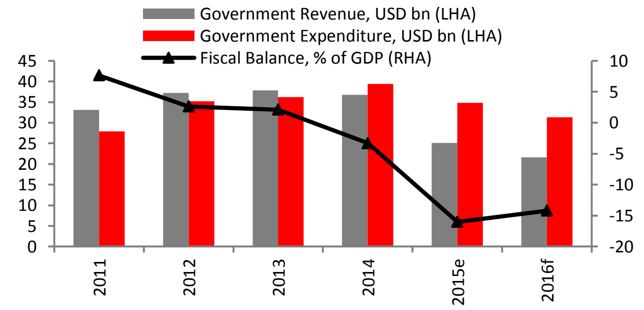
Oman become the latest GCC country to issue sovereign debt to help cover its fiscal deficit; this was Muscat's first international government debt placement since 1997. Oman sold a total of USD2.5 billion last week: i) USD1 billion of five year notes at a yield of 245 bps over the benchmark midswap rate; and ii) USD1.5 billion of 10 year bonds at 320 bps over that rate. The pricing was tightened from the initial guidance of around plus-250 bps for the five-year notes and plus-325 bps for the 10-year tranche. The pricing of Oman's bond reflects the fact that the country's fiscal deficit is wider than for other recent GCC issuers (Abu Dhabi and Qatar). We forecast a fiscal deficit of around -14.2% of GDP in 2016 despite the measures to cut government spending. Oman's government budget for 2016 incorporates a -11.7% cut from 2015's actual level. We expect real GDP growth to slow sharply on the pullback in government spending, though investment activity has been buoyed somewhat by frameworks to support private investment.

Fiscal position weaker than other GCC countries, though low government debt supportive

Oman's wider deficit is reflected in its higher budget breakeven oil price, which we estimate at USD84 p/b (Brent). However, Oman has low government debt (estimated at around 12% of GDP in 2016), and its FX reserves stand at around 45% of GDP (though this is weaker than for other GCC countries). These factors provide fiscal space, providing stability to the economy and the OMR's peg to the USD. In January 2016, Oman's government raised a USD1 billion syndicated loan from international banks (five year tenor at 120 bps over LIBOR). In previous years, Oman had relied heavily on the domestic banking sector to fund its fiscal deficit. The greater external borrowing in 2016 will help to limit the degree of tightening in banking sector liquidity.

Fig. 1. Oman: Fiscal deficit to remain large in 2016, despite reforms to reduce the shortfall

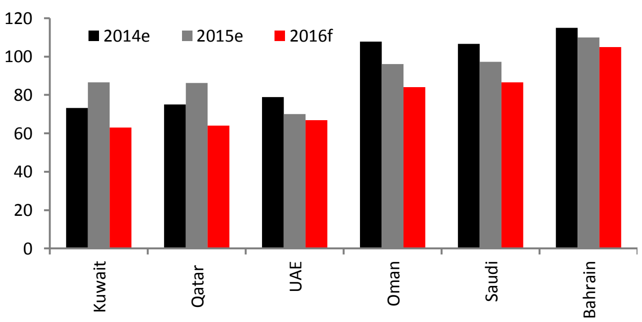
USD billion (LHA); % of GDP (RHA)



Source: IMF, Central Bank of Oman, ADCB estimates

Fig. 2. GCC: Budget breakeven oil prices of Bahrain, Saudi Arabia and Oman remain substantially above oil price

USD p/b



Source: IMF, regional central banks, ADCB estimates

Saudi Arabia: Approves National Transformation Plan, details limited

Tax on unutilised land expected to be finalised shortly

The key regional event last week was the approval by Saudi Arabia's cabinet of the National Transformation Plan (NTP), which provides key economic and social objectives for Vision 2030. Please see our note – **Saudi Arabia: Economic reform plan approved; details limited so far**, published on 7 June. As highlighted, the fiscal targets within the plan are ambitious, though there were limited details on how to achieve them. We did not change our government spending or non-revenue estimates following release of the plan. On the revenue side, there were no indications of imminent measures/reforms that would further bolster government revenue. A number of press conferences following the release of the NTP provided some further details, albeit still sparse. Saudi Arabia is to finalise details of the 2.5% tax on unutilised land within two weeks, which could be one of the next measures to increase non-oil revenue. However, the Saudi media have previously indicated that landowners will have six months to get their documentation in order, so the benefit would be from 2017. We have highlighted in previous research that government-led coordination of land development will be needed to meet the housing shortage.

Spending linked to NTP will be covered by cutbacks in other areas

Meanwhile, Economy and Planning Minister Adel Fakeih indicated that further subsidy cuts will take some time. Income tax for expatriates was raised as an option, though any plans will have to be studied carefully. Thus, we do not expect this to be introduced in the short to medium term. On the spending front, the NTP includes SAR268 billion of expenditure on projects and initiatives over the five-year period; 60% of this spending will be covered by the government. Comments by Finance Minister Ibrahim Alassaf indicate that this spending will be met by efficiency savings and cutting back on existing projects. This is in line with our assumption.

B. G4 Economies

US: Yellen indicates rate hike ahead, no guidance given on timing

Comments again indicate rates to be raised

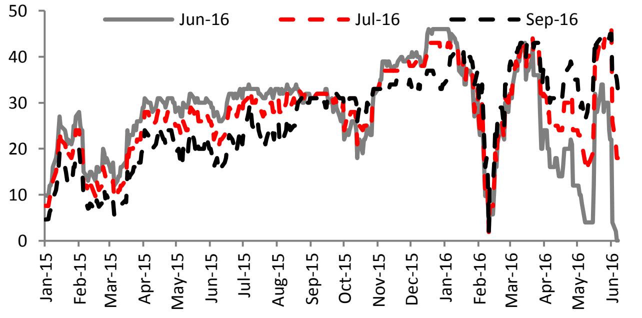
The key event last week was Fed Chair Janet Yellen’s speech in Philadelphia, which was especially pertinent after the exceptionally weak NFP data for May (38K increase). Yellen again indicated that that a rate hike was likely, though unlike in previous comments, she did not indicate that this was imminent. Yellen said that she expected the US economy to continue improving, meaning further gradual increases in the federal funds rate would be appropriate. She indicated that the positive drivers, namely employment growth and higher inflation, are set to continue outweighing the negative ones. Moreover, she emphasised that recent economic data again suggested that a rate hike will be warranted in the near future. Regarding the poor May labour data, she said that there should not be too much emphasis on any single monthly report, though the print was concerning. Yellen even found some encouragement in the numbers, as wage gains picked up. Adding further support for rate hikes, she remained optimistic that inflation would rise to the Fed’s 2% target given the rise in oil prices and the USD’s stabilisation after a long period of strengthening.

Concerns remain, both domestic and global

However, Yellen did not repeat her recent comments that rate hikes would probably be appropriate in the “coming months”. She highlighted a number of uncertainties, including whether the low inflation expectations will rise and over the resilience of business investment. Internationally, risks from China’s economic rebalancing and Brexit were highlighted. Our main takeaway was that the Fed still feels that normalising interest rates gradually is appropriate, but would like further data to support its economic outlook. We believe that the June labour data will be particularly important to gauge how much of an anomaly were the May data. We believe that the May labour data and rising concerns over the Brexit vote will lead the Fed to remain on hold this week. We still believe that a July rate hike is possible if the interim data are supportive. However, if the expected rate hike is delayed until September, then we would envisage only one in 2016 (versus our current expectation of two, in July and December).

Fig. 3. US: Markets not expecting June rate hike after dismal May jobs number

% probability of 25 bps rate hike



Source: Bloomberg

Fig. 4. US: Job openings rise to series high of 5.8 million in April, pointing to rebound in job creation

Million, SA

Source: Bureau of Labor Statistics

Wider labour data points to still healthy backdrop

Data releases: the data released last week point to a solid and improving economic backdrop. The April Job Openings and Labor Turnover Survey (JOLTS) showed that job openings increased sharply to 5.788 million. This was a record high for the series (alongside the July 2015 figure) and suggests that the pace of hiring is likely to rebound. Moreover, initial jobless claims unexpectedly declined by 4K to 264K (week ending 4 June), indicating that layoffs in the economy were minimal despite the weak NFP data for May. The four-week moving average of claims fell 7.5K to 269K; a figure below 300K is associated with strong job markets.

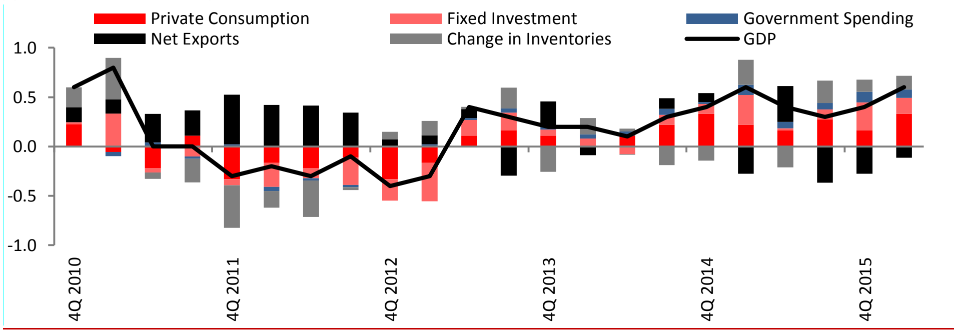
Eurozone: 1Q GDP revised up, led by domestic consumption

Stronger consumption activity in France behind upward revision

Eurostat has revised up its Eurozone 1Q growth estimate to 0.6% q-o-q (from the previous 0.5% estimate). This was due mainly to a stronger than expected rebound in consumption in France after the contraction in 4Q that followed the Paris terror attacks. Public spending growth in the Eurozone remained supportive, rising 0.4% q-o-q (unchanged), while investment growth was cut to 0.8% q-o-q (from 1.4%).

Fig. 5. Eurozone: 1Q growth driven mainly by private consumption

pp contribution to GDP growth



Source: Bloomberg

We expect growth to moderate in 2Q to about 0.3% q-o-q, as investment activity is likely to slow further in response to concerns about Brexit and weaker export demand from

EMs. That said, the second round effects of the ECB's QE are likely to continue supporting domestic consumption, as is already being seen in the leading indicators of household credit demand. We expect the bank's fiscal stance to remain stimulatory too, with its government bond purchases having already reduced the costs of refinancing government debt significantly.

We expect GDP growth to moderate somewhat in 2Q on weaker investment activity

C. EM Economies

India: RBI cautious on inflation; focus on improving monetary transmission

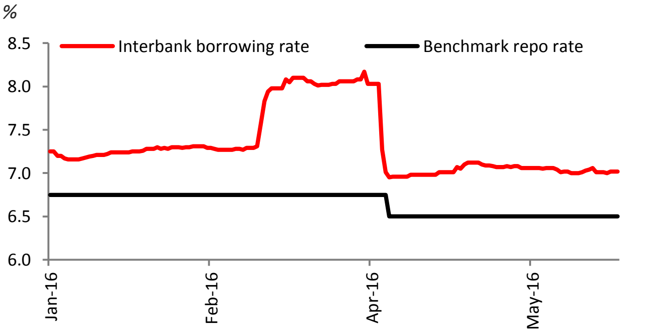
The RBI kept its benchmark policy rate unchanged at 6.5% at its policy meeting last week, in line with our expectation and the consensus. The outlook on inflation was more cautious overall than in the last statement, with the RBI suggesting some degree of upward inflationary pressure from the higher crude prices and public sector pay hikes, possibly from 4Q2016-1Q2017 onwards. We had said earlier that we expected inflation to accelerate from 4Q2016 on strong consumption activity and higher energy prices, though to stay below the 6% y-o-y top end of the RBI's target range. We continue to expect another 25 bps rate cut at the bank's 9 August meeting, mainly to lower funding costs further for financial institutions holding stressed loan assets. However, we expect a lengthy pause in interest rate movements following the August meeting, with the RBI keeping an eye on inflation and allowing the impact of previous rate cuts and generous fiscal spending to filter through to the economic data.

We expect inflation to rise starting in 4Q2016

We expect the bank's monetary policy over the next 12 months to focus on improving the efficiency of monetary policy transmission into banks' lending rates. Moreover, following the RBI's announcement in April of a new liquidity management framework, we expect more liquidity to be injected into repo markets at various maturities to help bring interbank rates closer to the policy rate. We also expect the RBI to provide more details in the coming months about its Marginal Cost Lending Rate (MCLR) framework, which requires banks to set lending rates in line with current funding costs (which have been trending lower).

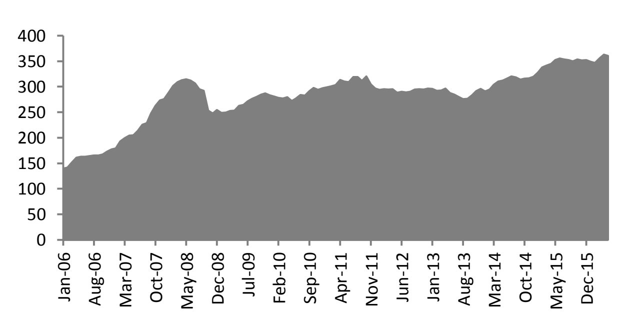
Key focus: policy transmission to bank lending rates

Fig. 6. India: RBI focusing since April on bringing interbank rate closer to policy rate



Source: Bloomberg

Fig. 7. India: FX reserves currently well above 4Q 2013 levels, when FCNR scheme was launched



Source: Bloomberg

At the post meeting press conference, Governor Raghuram Rajan soothed concerns regarding potential INR volatility in 4Q2016. In November, payments of close to USD20 billion are scheduled to nonresident depositors in the RBI's Foreign Currency Non-Resident (FCNR) deposit scheme, which was launched in 2013. The RBI said that it was adequately hedged on forwards markets to prevent any dislocation in the INR as a result of capital outflows, and that it will act against any extreme volatility. We consider this assurance to be credible, as the bank's FX reserves have risen by USD80 billion (from USD280 billion in 4Q2013 to USD360 billion May 2016) since the FCNR scheme was launched.

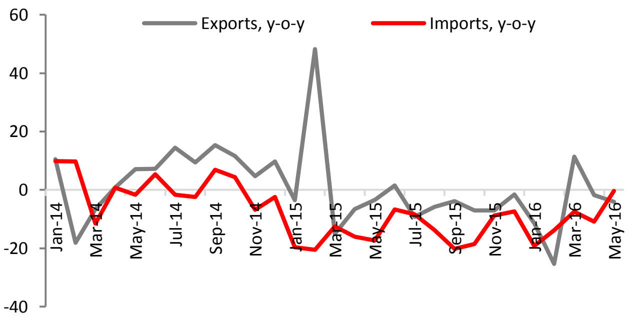
China: May import data shows tentative signs of investment demand stabilisation

Import data show encouraging demand trends

May import data for China provided further evidence that fiscal spending on infrastructure had begun to stabilise investment demand, even as monetary policy became more prudent. Imports fell -0.4% y-o-y in May (consensus: -6.8% y-o-y; April: -10.9% y-o-y), though there was a double-digit increase in import volumes of some commodities, including iron ore, copper, and oil. We believe that this spurt in infrastructure goods imports was related to the government's announcement of significant project awards relating to transportation and pollution control. Nonetheless, we believe that the magnitude of the improvement in commodities imports might have been exaggerated, due mainly to the large share of such imports going to Hong Kong (up 243% y-o-y), a trend which has in the past been related to questionable commodity invoices used to disguise capital outflows from China. Nevertheless, we do not expect a double-digit contraction in import growth in 2Q2016-3Q2016, as seen in the previous few quarters, as public spending on housing and infrastructure is likely to remain supportive, alongside the rising energy prices.

Fig. 8. China: Rising infrastructure linked demand supports imports in May; exports decline despite weaker CNY

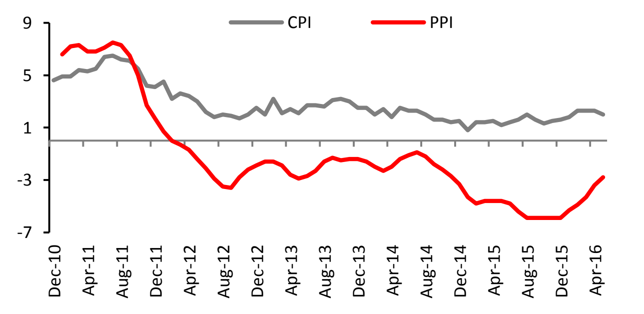
% change y-o-y



Source: Bloomberg

Fig. 9. China: Headline CPI moderates in May; producer price contraction weakens

% change y-o-y`



Source: Bloomberg

Exports contract for second consecutive month

Meanwhile, exports declined -4% y-o-y in May (consensus: -4.2%; April: -1.8% y-o-y), for a second consecutive month. We attribute this to the overall slowdown in demand from East Asia (Taiwan, South Korea, ASEAN), which imports most of its intermediate products from China. Exports to the G3 economies were down too, reflecting the global manufacturing slump. With export PMIs declining steadily and a structural slowdown in global demand for electronic products, we expect export growth to continue to subtract from China's GDP for the rest of this year (despite the significant CNY depreciation YTD).

Downside risk to consumer inflation limited

In another data release, a deceleration in food prices slowed headline CPI growth in May to 2% y-o-y (from 2.3% in April), though core inflation was stable at 1.1% y-o-y. Construction activity and public spending look likely to limit any downside risk to inflation in the coming months. Further evidence that public spending led demand was stabilising came from the contraction in producer prices moderating to -2.8% y-o-y (from -3.4% y-o-y in April).

II. Economic Calendar

Fig. 10. Upcoming events and data releases

Time*	Country	Data point	Period	Prior	Consensus
Expected this week					
	Qatar	CPI, y-o-y	May	3.4%	--
	UAE	Central Bank Foreign Assets	May	--	323.8B
	Saudi Arabia	May Cement Output YTD, y-o-y			
	Saudi Arabia	CPI, y-o-y	May	4.2%	--
	Oman	CPI, y-o-y	May	1.1%	--
	China	Aggregate Financing CNY	May	751B	1000B
	China	New Yuan Loans, CNY	May	555.6B	750B
	China	Money Supply M2, y-o-y	May	12.8%	12.5%
Monday 13 June					
06:00	China	Industrial Production YTD, y-o-y	May	5.8%	5.9%
06:00	China	Retail Sales YTD, y-o-y	May	10.3%	10.2%
06:00	China	Fixed Assets, ex-Rural YTD, y-o-y	May	10.5%	10.5%
16:00	India	CPI, y-o-y	May	5.4%	5.6%
Tuesday 14 June					
08:30	Japan	Industrial Production, m-o-m	Apr F	0.3%	--
12:30	UK	CPI, m-o-m	May	0.1%	0.3%
12:30	UK	CPI, y-o-y	May	0.3%	0.4%
12:30	UK	CPI Core, y-o-y	May	1.2%	1.3%
13:00	Eurozone	Industrial Production SA, m-o-m	Apr	-0.8%	0.8%
16:30	US	Retail Sales Advance, m-o-m	May	1.3%	0.3%
16:30	US	Retail Sales, ex-Auto and Gas, m-o-m	May	0.6%	0.2%
16:30	US	Retail Sales Control Group, m-o-m	May	0.9%	0.3%
Wednesday 15 June					
12:30	UK	Jobless Claims Change	May	-2.4K	0K
12:30	UK	Average Weekly Earnings, 3M/y-o-y	Apr	2%	1.7%
12:30	UK	ILO Unemployment Rate 3Mths	Apr	5.1%	5.1%
12:30	UK	Employment Change 3M/3M	Apr	44K	60K
15:00	US	MBA Mortgage Applications	10-Jun	9.3%	--
16:30	US	Empire Manufacturing	Jun	-9	-4
17:15	US	Industrial Production, m-o-m	May	0.7%	-0.2%
22:00	US	FOMC Rate Decision (Upper Bound)	15-Jun	0.5%	0.5%
22:00	US	FOMC Rate Decision (Lower Bound)	15-Jun	0.25%	0.25%
Thursday 16 June					
	Japan	BOJ Annual Rise in Monetary Base	16-Jun	¥80T	--
	Japan	BOJ Policy Rate	16-Jun	-0.1%	--
	Egypt	Deposit Rate	16-Jun	10.75%	10.75%
12:30	UK	Retail Sales, ex-Auto & Fuel, m-o-m	May	1.5%	0.3%
12:30	UK	Retail Sales, ex-Auto & Fuel, y-o-y	May	4.2%	3.8%
15:00	UK	Bank of England Bank Rate	16-Jun	0.5%	0.5%
15:00	UK	BOE Asset Purchase Target	Jun	375B	375B
16:30	US	Initial Jobless Claims	11-Jun	264K	270K
16:30	US	CPI, m-o-m	May	0.4%	0.3%
16:30	US	CPI, ex-Food and Energy, m-o-m	May	0.2%	0.2%
16:30	US	CPI, y-o-y	May	1.1%	1.1%
16:30	US	CPI, ex-Food and Energy, y-o-y	May	2.1%	2.2%
Friday 17 June					
16:30	US	Housing Starts	May	1172K	1150K
16:30	US	Building Permits	May	1130K	1145K
19:00	Eurozone	ECB President Mario Draghi Speaks in Munich			

* UAE time
Source: Bloomberg

Fig. 11. Last week's data

Time*	Country	Data point	Period	Prior	Consensus	Actual
Released last week						
	China	Foreign Reserves	May	$3200B	$3219.7B	$3191.7B
	China	Trade Balance, USD bn	May	$45.6B	$55.6B	$50B
	China	Exports, y-o-y	May	-1.8%	-4.2%	-4.0%
	China	Imports, y-o-y	May	-10.9%	-6.8%	-0.4%
	Kuwait	M2 Money Supply, y-o-y	Apr	3.0%	--	4.1%
	Egypt	CPI, y-o-y	May	10.3%	--	12.3%
Sunday 5 June						
09:30	Saudi Arabia	Saudi Arabia PMI	May	54.2		54.8
09:30	Egypt	Egypt PMI	May	46.9		47.6
09:30	UAE	UAE PMI	May	52.8		54
Monday 6 June						
10:00	Germany	Factory Orders, m-o-m	Apr	1.9%	-0.8%	0%
Tuesday 7 June						
09:30	India	RBI benchmark policy rate	7-Jun	6.5%	6.5%	6.5%
10:00	Germany	Industrial Production SA, m-o-m	Apr	-1.1%	0.7%	0.8%
11:30	UK	Halifax House Prices, m-o-m	May	-0.8%	0.3%	0.6%
13:00	Eurozone	GDP SA, q-o-q	1Q F	0.5%	0.5%	0.6%
13:00	Eurozone	GDP SA, y-o-y	1Q F	1.5%	1.5%	1.7%
23:00	US	Consumer Credit	Apr	$28.38B	$18B	$13.42B
Wednesday 8 June						
03:50	Japan	BoP Current Account Balance	Apr	¥2980.4B	¥2303B	¥1878.5B
03:50	Japan	Trade Balance BoP Basis	Apr	¥927.2B	¥919B	¥697.1B
03:50	Japan	GDP SA, q-o-q	1Q F	0.4%	0.5%	0.5%
03:50	Japan	GDP Annualized SA, q-o-q	1Q F	1.7%	1.9%	1.9%
03:50	Japan	GDP Deflator, y-o-y	1Q F	0.9%	0.9%	0.9%
12:30	UK	Industrial Production, m-o-m	Apr	0.3%	0%	2%
12:30	UK	Industrial Production, y-o-y	Apr	-0.2%	-0.4%	1.6%
15:00	US	MBA Mortgage Applications	3-Jun	-4.1%	--	9.3%
18:00	US	JOLTS Job Openings	Apr	5670	5675	5788
Thursday 9 June						
03:50	Japan	Machine Orders, m-o-m	Apr	5.5%	-3%	-11%
03:50	Japan	Money Stock M2, y-o-y	May	3.3%	3.3%	3.4%
05:30	China	CPI, y-o-y	May	2.3%	2.3%	2%
05:30	China	PPI, y-o-y	May	-3.4%	-3.2%	-2.8%
16:30	US	Initial Jobless Claims	4-Jun	268K	270K	264K
18:00	US	Wholesale Inventories, m-o-m	Apr	0.2%	0.1%	0.6%
Friday 10 June						
03:50	Japan	PPI, y-o-y	May	-4.2%	-4.2%	-4.2%
08:30	Japan	Tertiary Industry Index, m-o-m	Apr	-0.5%	0.6%	1.4
16:00	India	Industrial Production, y-o-y	Apr	0.3%	0.6%	-0.8
18:00	US	U. of Mich. Sentiment	Jun P	94.7	94	94.3

* UAE time
Source: Bloomberg

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