The Week Ahead: Central banks in focus with both ECB and BoJ to remain on hold

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Eurozone: ECB likely to temper QE tapering expectations

The ECB is likely to maintain its present accommodative monetary stance at its 20 July meeting, allaying any expectations of a further reduction in its monthly asset-purchase target of EUR60 billion in the near term. The central bank should continue to emphasise the ongoing need for loose monetary policy to allow inflation to converge towards its medium-term target of 2%, especially given the deceleration in headline inflation since April. However, we expect the ECB to sound more positive, potentially removing a reference to its readiness to increase the size or duration of its asset-purchase programme. This is as the risks of deflation have fallen markedly, alongside a strengthening in private confidence and economic momentum. We only expect the ECB to begin further reducing its asset purchases from 1Q2018 onwards, potentially making an announcement in this regard in 4Q2017. We estimate that asset purchases could be reduced to EUR40 billion per month from January 2018, with further tapering expected in 2H2018 resulting in the end of the QE programme in December.

Japan: BoJ remains committed to its yield curve control policy

The BoJ is also expected to keep monetary policy steady at its 19-20 July meeting. This includes keeping the 10-year yield target at 0%, even as the rise in US yields creates upward pressure on JGBs, and maintaining interest rates. Indeed, the BoJ has continued to reiterate that it will purchase an unlimited amount of bonds to meet its yield curve objectives. Inflation remains substantially below the central bank's target level, with no sign of accelerating, despite some pickup in economic momentum and lending activity. We believe that the BoJ could raise its growth forecasts for FY2017-18 (April 2017-March 2018).

Global Data: UK inflation, China GDP decelerates in 2Q

The key releases this week include Chinese 2Q GDP data and UK CPI for June. China's 2Q real GDP growth (released this morning) remained steady at 6.9% y-o-y (1Q: 6.9%), well above the government's 2017 GDP growth target of 6.5%. GDP growth was supported in 2Q by a solid consumption and investment backdrop, alongside rising external demand. Consensus had expected a moderate slowdown in economic activity to 6.8% y-o-y as a result of the tighter monetary stance in the early part of the quarter. However, recent trends in monetary data (page 5) indicate that the government is becoming more tolerant of short-term credit growth ahead of the Communist Party Congress in November. In the UK, consensus envisages that headline inflation remained steady at 2.7% y-o-y, with lower petrol prices counterbalancing the import-led inflation (due to GBP weakness). In a relatively quiet US data week, the main release will be housing starts, which likely strengthened in June after three months of decline.

I. Recent Events and Data Releases

A. MENA Economies

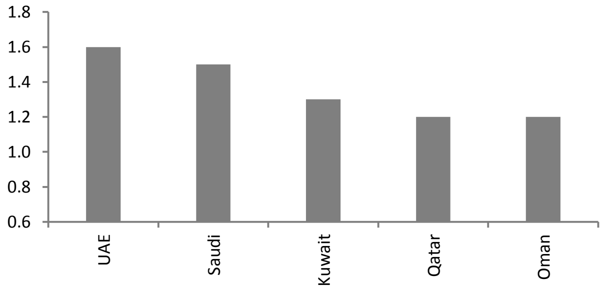
UAE: VAT classifications and ADNOC strategy to strengthen fiscal position

Residential real estate to be exempt under VAT classification – positive for demand

The UAE has been one of the most proactive within the GCC on fiscal reforms, especially following the collapse of the oil price since end-2014. The planned introduction of VAT in January 2018 is expected to be the next key reform aimed at deepening and diversifying the government's revenue base. The Ministry of Finance has announced the VAT classifications for the real estate sector. Residential properties (sales or leases) will be exempt whilst commercial properties will be taxable at the standard VAT rate of 5%. These classifications are in line with the communications from the ministry in its workshops and briefing sessions aimed at disseminating details on the new VAT system. We had assumed these classifications when estimating the economic impact of the introduction of VAT. Please see our note – **GCC: Assessing the economic impact of VAT**, published on 14 June 2017. We believe that the classification of residential real estate under the exempt category aims to balance VAT revenue generation with maintaining support for a number of key sectors. If the standard 5% rate is applied to residential properties, we would expect to see a dampening in real estate demand and especially sales. Meanwhile, the Ministry of Finance highlighted that education and healthcare will be zero-rated, whilst local passenger traffic will fall under the exempt category. This is again in line with our assumptions. We estimate that VAT will boost government revenue by c.1.6% of GDP in 2018 while adding c.3.1 percentage points to headline inflation.

Fig. 1. GCC: Estimated government revenue from first year of VAT post-introduction

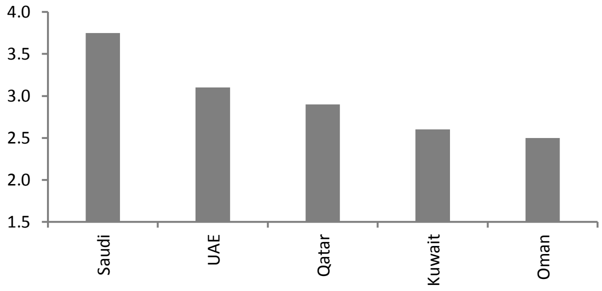
% of GDP



Source: ADCB estimates

Fig. 2. GCC: Expected percentage-point rise in headline inflation after introduction of VAT

PP rise in headline annual inflation



Source: ADCB estimates

Part sale of assets will support fiscal position

Separately, the UAE's consolidated fiscal position will also benefit from ADNOC's plans to sell minority stakes in some of its services businesses, including the distribution business. UAE fuel prices are liberalised and have followed international market prices since August 2015, which should support any partial sale of the distribution unit in our view. Other areas of focus include developing new revenue streams, such as establishing a new trading arm.

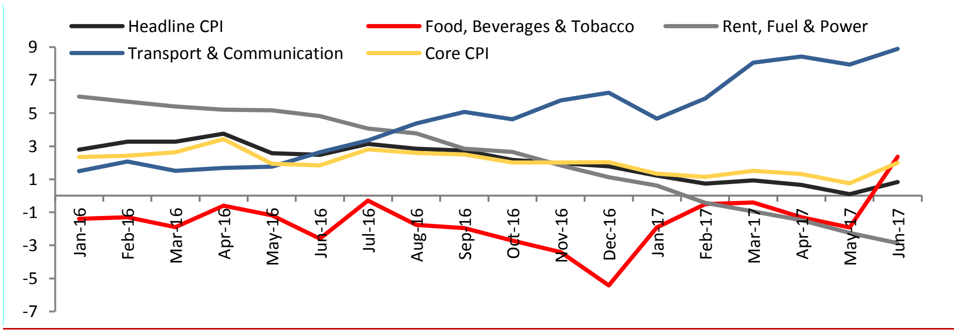
Qatar: Inflation accelerates in June, with food prices higher

Inflation remains relatively contained – we see some potential for weaker food inflation in July

Core CPI (ex-rent, fuel and utilities) in Qatar accelerated to 2% y-o-y in June, up from a recent low of 0.8% in May. Headline CPI also strengthened to 0.8% y-o-y (May: 0.1% y-o-y), albeit it remained weak given the ongoing yearly contraction in rental, fuel and utility prices. Most of the areas that saw rising price pressure were imported, likely reflecting the regional dispute. Food and beverage prices rose by 2.4%, after seeing deflation since January 2016. Notably the cost of transportation accelerated to 8.9% y-o-y, up from 7.9% in May. We had highlighted in our research that the time and cost of importing goods into Qatar would have increased from June, please see our note – ***Qatar Economic Update – Economic risks and supports***, published on 13 July 2017. However, we believe that the greatest impact of this will likely be on investment linked goods, and thus not reflected in CPI data. As noted earlier, we expect the impact on consumer inflation to be relatively contained, with signs of fast import substitution. We see the potential for core CPI to moderate in July, potentially led by a deceleration in food prices.

Fig. 3. Qatar: Higher food and transportation prices drive up inflation in June

% change y-o-y



Source: Ministry of Development Planning and Statistics

B. G4 Economies

US: Yellen's testimony more bearish on fiscal support and inflation

Yellen generally positive on economy

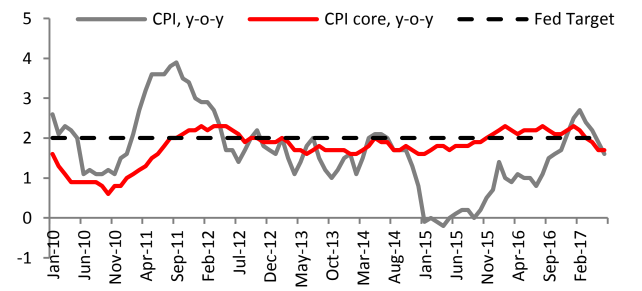
There were limited new details in Fed Chair Janet Yellen's semi-annual testimony to Congress on monetary policy. Yellen noted that the US economy should continue to expand over the next few years, allowing the Fed to keep raising interest rates. However, she stressed the need to move gradually given the low inflation environment. Yellen also mentioned that upside and downside risks to economic growth are "roughly equal", whilst highlighting that the economy continued to add jobs. Moreover, she outlined the recent rise in business investment alongside the steady household consumption.

Higher inflation required for Fed to keep raising rates

However, Yellen's comments were moderately more bearish than the prepared statement following the June FOMC meeting. This was largely due to greater uncertainties over the inflation outlook and fiscal support to the economy. She remained consistent that balance sheet normalisation would start this year. However, no further details were provided on the reduction process beyond what has already been communicated. There was no indication of a possible announcement date. On rates, Yellen said that the FFTR remains "somewhat below its neutral level" but policy makers would not have to raise it "all that much further" to get to neutral. Thus, a pick-up in inflation would be needed to increase the neutral rate and allow the Fed to raise rates further. Yellen continued to suggest that the recent weakness in inflation was due to special factors, though acknowledged concern and risks to the inflation outlook. Recent comments by FOMC members have also indicated greater uncertainty over the outlook.

Fig. 4. US: Headline inflation slowed to 1.6% y-o-y in June, a level last seen in October 2016

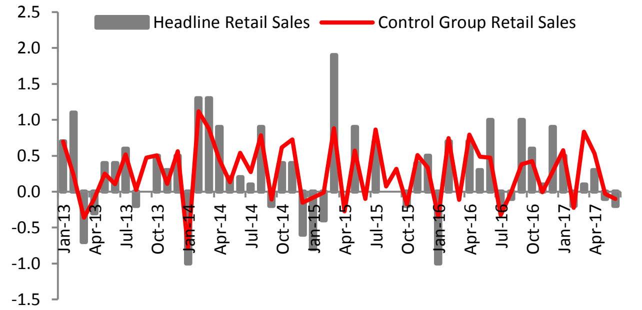
% change y-o-y



Source: Bureau of Labor Statistics

Fig. 5. US: Both headline and control growth retail sales contracted in May and June

% change m-o-m



Source: US Census Bureau

US: June inflation and retail spending disappoint, falling short of market expectations

Dual mandate difficulties for Fed – benign inflation but tight labour market

Both CPI and retail spending data came in weaker than consensus expectations. The CPI data continues to point to a benign inflation outlook, with the data remaining soft for the fourth consecutive month. Headline inflation was unchanged, i.e. 0% m-o-m. Core CPI increased by 0.1% m-o-m in June, in line with May, though below market expectations of a 0.2% rise. A key factor remains the further decline in the cost of mobile services on a y-o-y basis. Moreover, there were also yearly decreases in air fares and prices for apparel, household furnishings, new motor vehicles, and used cars. Rental and medical care costs both increased in June, though not as rapidly as they were earlier in 2017. As noted in our earlier research, it will be difficult for the Fed to raise the FFTR for the third time in 2017 without some pickup in inflation from the current levels. We expect the Fed to sound more cautious on the inflation outlook going forward. How it deals with its dual mandate will be critical, with the labour market continuing to tighten. However, with the next FFTR hike only expected in December, the Fed has time to see how the data develops. We still expect it to announce balance sheet reduction, likely to commence in October, at its September meeting.

Weak consumer spending momentum heading into 3Q

Meanwhile, June retail sales unexpectedly fell by -0.2% m-o-m (consensus: +0.1%), the second consecutive month of spending contraction. This was partly due to lower prices, with receipts from service stations declining. Spending was also weaker in other areas such as clothing and at supermarkets. Core control retail sales, which most closely corresponds with consumer spending in GDP data, contracted by 0.1% m-o-m. The weak momentum of consumer spending at the end of 2Q2017 could point to challenges to the third-quarter consumption outlook.

C. Emerging Market Economies

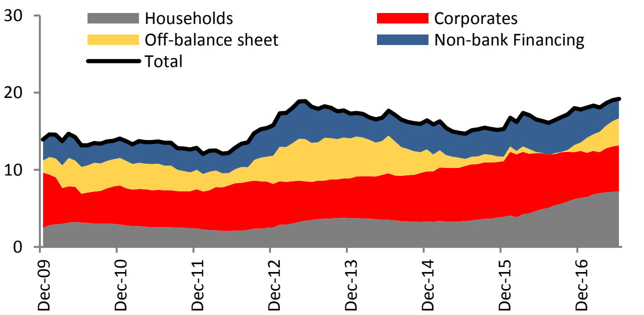
China: Credit growth and exports surprise to upside in June

Export demand from developed countries steadily rising

Trade data came in stronger than market expectations for a second consecutive month in June, with exports rising by 11.3% y-o-y (May: 8.7%) and imports up 17.2% y-o-y (May: 14.8%). Much of the surge in China's export demand for 2Q2017 has come from developed markets (June: 15.8% y-o-y), whereas growth in exports to emerging markets has lagged behind (June: 4.7%). We believe that a pick-up in investment demand in Europe and improving trade ties with the US (following the US-China bilateral trade talks in April-May) have been behind this boost. Specifically, exporting firms in capital goods, technology and electronic products have been major beneficiaries of this dynamic. We expect the stronger-than-expected export growth in 2Q2017 to have contributed positively to GDP growth in the quarter, offsetting the impact of slower domestic capex growth due to the curbs imposed on property markets by the government.

Fig. 6. China: PBoC likely turned more lenient on financial tightening; off-balance-sheet loans rose in June

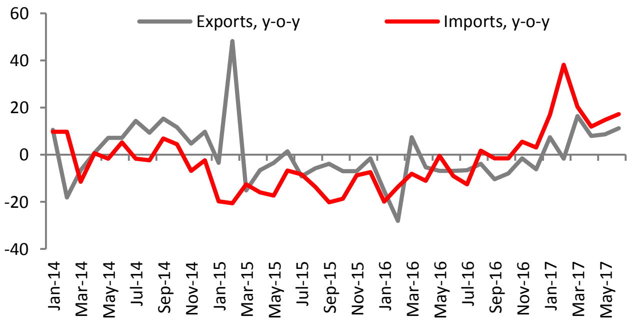
CNY trillion (12m rolling sum)



Source: PBoC

Fig. 7. China: Exports have risen steadily this year, supported by firming demand from developed economies

% change y-o-y



Source: Customs General Administration

Off-balance-sheet lending rebounds indicating more lax PBoC stance

CPI and lending data (June): Headline inflation remained unchanged in June at 1.5% (consensus: 1.6%). Food prices fell by 1.2% y-o-y in the month, although this is slower than May's -1.6% decline. We expect inflation to remain muted over the coming months at under 2% y-o-y, as ample supply in food products drags down prices. The current retail and producer price inflation dynamics create little urgency for the PBoC to move its monetary policy further in either direction (easing or tightening). Meanwhile, aggregate lending data for June came in significantly stronger than our and the market's expectations, rising by CNY1.78 trillion (consensus: 1.5, May: 1.06). There was a broad-based increase in lending both for traditional and off-balance-sheet loans. In our view, the June monetary data likely marks a reversal in the PBoC's monetary policy stance of a sharp credit tightening, specifically focused on off-balance-sheet lending. This is in line with comments from the PBoC in June, where it expressed the need to balance short-term economic growth targets with the long-term requirement of financial deleveraging.

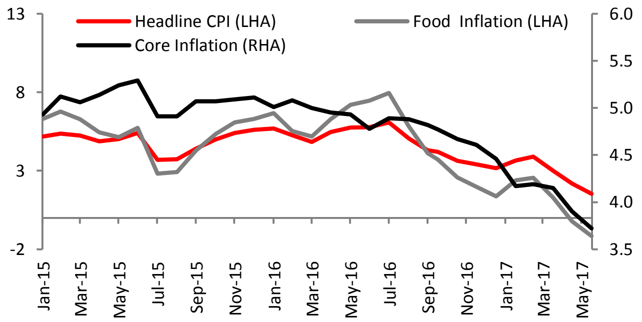
India: Inflation continues to ease sharply; RBI likely to cut rates

Headline and core inflation pressures remain benign

India's CPI inflation came in at a record low of 1.5% y-o-y in June (consensus: 1.6%; May: 2.2%), easing for the fifth straight month. Specifically, food inflation dipped further into deflationary territory, contracting by 1.2% y-o-y (May: -0.2%), with sharp declines in the prices of pulses and vegetables. Moreover, core inflation softened to 3.7% y-o-y (May: 3.9%) as a variety of consumer durables were discounted by retailers ahead of the implementation of a new GST regime in July in order to clear their stocks. That said, the slowdown in core inflation was driven by more than such one-off factors, with all components of services inflation (household services, personal care, health, education, recreation and transport) weakening.

Fig. 8. India: Inflation likely to pick up from July onwards but remain below RBI's 4% target through FY18

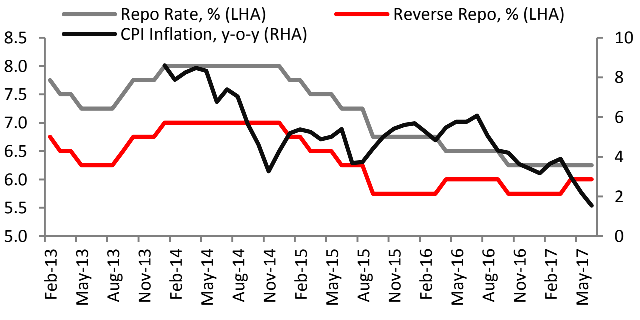
% change y-o-y



Source: Central Statistical Office, Bloomberg

Fig. 9. India: Upside risks to RBI's inflation target unlikely to materialise in FY18; 25 bps cut likely at August meeting

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



Source: RBI, Central Statistical Office

RBI likely to cut rates by 25 bps in August; another 25 bps cut likely in 1Q2018

In light of the inflation dynamics seen since the RBI's last meeting in June, we expect the central bank to cut its benchmark policy rate by another 25 bps to 6% at its meeting on 1-2 August. Indeed, at its last policy meeting, the MPC members indicated some flexibility in terms of easing policy rates if inflation came in below the lower bound of the RBI's target range of 2-6%. Furthermore, the upside risk that the central bank had highlighted from an increase in housing rent allowances for government employees from July onwards is likely to be mitigated by the oversupply in food markets, muted demand conditions and marginally lower oil prices in INR terms. In line with our forecast of inflation averaging below 4% in FY18, we expect another rate cut by the RBI in 1Q2018.

II. Economic Calendar

Fig. 10. The week ahead

Time*	Country	Event	Period	Prior	Consensus
	UAE	Central Bank Foreign Assets	Jun	322.41B	--
	UAE	M2 Money Supply, y-o-y	Jun	0.1%	--
	UAE	CPI, y-o-y	Jun	1.9%	--
	Saudi Arabia	CPI, y-o-y	Jun	-0.7%	--
	Bahrain	M2 Money Supply, y-o-y	May	--	--
	Bahrain	CPI, y-o-y	Jun	0.7%	--
	Egypt	Trade Balance	May	-1920M	--
Monday, 17 Jul					
3:01	UK	Rightmove House Prices, m-o-m	Jul	-0.4%	--
6:00	China	Retail Sales, YTD y-o-y	Jun	10.3%	10.3%
6:00	China	Fixed Assets, ex-Rural, YTD y-o-y	Jun	8.6%	8.5%
6:00	China	Industrial Production, y-o-y	Jun	6.5%	6.5%
6:00	China	GDP, y-o-y	2Q	6.9%	6.8%
13:00	Eurozone	CPI, y-o-y	Jun F	1.4%	1.3%
13:00	Eurozone	CPI Core, y-o-y	Jun F	1.1%	1.1%
Tuesday, 18 Jul					
5:30	China	China June Property Prices			
12:00	Eurozone	ECB Bank Lending Survey			
12:30	UK	CPI, y-o-y	Jun	2.9%	2.9%
12:30	UK	CPI Core, y-o-y	Jun	2.6%	2.6%
12:30	UK	PPI Input NSA, y-o-y	Jun	11.6%	9.3%
Wednesday, 19 Jul					
0:00	US	Net Long-term TIC Flows	May	$1.8B	--
15:00	US	MBA Mortgage Applications	14-Jul	-7.4%	--
16:30	US	Housing Starts	Jun	1092K	1160K
16:30	US	Building Permits	Jun	1168K	1210K
Thursday, 20 Jul					
	Japan	BOJ Monetary Policy Statement			
	Japan	BOJ Policy Balance Rate	20-Jul	-0.1%	-0.1%
	Japan	BOJ 10-Yr Yield Target	20-Jul	0%	0%
3:50	Japan	Trade Balance Adjusted	Jun	¥133.8B	¥129.5B
3:50	Japan	Exports, y-o-y	Jun	14.9%	9.5%
8:30	Japan	All Industry Activity Index, m-o-m	May	2.1%	-0.8%
10:30	Japan	BOJ Kuroda speaks at press conference after MPM			
12:30	UK	Retail Sales, ex-auto fuel, m-o-m	Jun	-1.6%	0.5%
12:30	UK	Retail Sales, ex-auto fuel, y-o-y	Jun	0.6%	2.5%
15:45	Eurozone	ECB Main Refinancing Rate	20-Jul	0%	0%
15:45	Eurozone	ECB Marginal Lending Facility	20-Jul	0.25%	0.25%
15:45	Eurozone	ECB Deposit Facility Rate	20-Jul	-0.4%	-0.4%
15:45	Eurozone	ECB Asset Purchase Target	Jul	60B	60B
16:30	US	Initial Jobless Claims	15-Jul	247K	245K
Friday, 21 Jul					
	Abu Dhabi	S&P Sovereign Rating Review			
	Saudi Arabia	Sovereign Debt to be rated by Moody's			

* UAE time
Source: Bloomberg

Fig. 11. Last week's data

Time*	Country	Event	Period	Prior	Consensus	Actual
EM Data						
	Kuwait	M2 Money Supply, y-o-y	May	0.9%		0.5%
	Qatar	CPI, y-o-y	Jun	0.1%		0.8%
	Oman	CPI, y-o-y	Jun	2%		1%
	Bahrain	GDP Constant Prices, y-o-y	1Q	1.5%		2.9%
	China	Money Supply M2, y-o-y	Jun	9.6%	9.5%	9.4%
	China	New Yuan Loans, CNY	Jun	1110B	1300B	1540B
	China	Aggregate Financing, CNY	Jun	1063B	1400B	1780B
	China	Imports, y-o-y	Jun	14.8%	14.5%	17.2%
	China	Exports, y-o-y	Jun	8.7%	8.9%	11.3%
	China	Trade Balance	Jun	$40.8B	$42.6B	$42.8B
Monday, 10 Jul						
	Egypt	Urban CPI, y-o-y	Jun	29.7%		29.8%
	Egypt	CPI Core, y-o-y	Jun	30.6%		32%
3:50	Japan	Machine Orders, y-o-y	May	2.7%	7.6%	0.6%
3:50	Japan	BoP Current Account Adjusted	May	¥1807.4B	¥1629.5B	¥1400.9B
5:30	China	CPI, y-o-y	Jun	1.5%	1.6%	1.5%
5:30	China	PPI, y-o-y	Jun	5.5%	5.5%	5.5%
8:15	UAE	Dubai Economy Tracker SA	Jun	55		56.5
11:00	Turkey	Industrial Production, y-o-y	May	6.7%	5%	3.5%
23:00	US	Consumer Credit	May	$12.9B	$13.5B	$18.4B
Tuesday, 11 Jul						
18:00	US	JOLTS Job Openings	May	5967	5950	5666
Wednesday, 12 Jul						
8:30	Japan	Tertiary Industry Index, m-o-m	May	1.4%	-0.5%	-0.1%
12:30	UK	Average Weekly Earnings, y-o-y	May	2.1%	1.8%	1.8%
12:30	UK	Weekly Earnings, ex- Bonus, y-o-y	May	1.8%	1.9%	2%
12:30	UK	ILO Unemployment Rate, 3Mths	May	4.6%	4.6%	4.5%
12:30	UK	Employment Change, 3m/3m	May	109K	120K	175K
13:00	Eurozone	Industrial Production, y-o-y	May	1.2%	3.5%	4%
15:00	US	MBA Mortgage Applications	7-Jul	1.4%		-7.4%
16:00	India	CPI, y-o-y	Jun	2.2%	1.6%	1.5%
16:00	India	Industrial Production, y-o-y	May	2.8%	2%	1.7%
22:00	US	US Federal Reserve Releases Beige Book				
Thursday, 13 Jul						
16:30	US	PPI Final Demand, y-o-y	Jun	2.4%	1.9%	2%
16:30	US	PPI, ex- Food and Energy, y-o-y	Jun	2.1%	2%	1.9%
16:30	US	Initial Jobless Claims	8-Jul	250K	245K	247K
Friday, 14 Jul						
16:30	US	CPI, m-o-m	Jun	-0.1%	0.1%	0%
16:30	US	CPI, ex-food and energy, m-o-m	Jun	0.1%	0.2%	0.1%
16:30	US	CPI, y-o-y	Jun	1.9%	1.7%	1.6%
16:30	US	CPI, ex-food and energy, y-o-y	Jun	1.7%	1.7%	1.7%
16:30	US	Retail Sales Advance, m-o-m	Jun	-0.1%	0.1%	-0.2%
16:30	US	Retail Sales Control Group	Jun	0%	0.3%	-0.1%
17:15	US	Industrial Production, m-o-m	Jun	0.1%	0.3%	0.4%
18:00	US	U. of Mich. Sentiment	Jul P	95.1	95	93.1

* UAE time
Source: Bloomberg

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