Economic Research

ADCB بنك أبوظبي التجاري

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The Week Ahead: FOMC minutes and Eurozone developments in focus

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US: Minutes of the FOMC meeting

The key focus in the US will be the minutes of the last FOMC meeting (ended 1 February) released on 22 February. The post-meeting statement was only mildly more hawkish than the previous one, especially compared to recent comments by FOMC members. We believe that the minutes will show rising confidence over the economic outlook, including the economy moving towards maximum employment and the Fed's inflation goals being reached. Improvements in business and consumer sentiment surveys will also likely be highlighted, alongside higher market expectations for inflation. The Fed likely discussed the suitability of another rate hike, if the economy progressed in line with its expectations. However, the FOMC will likely stress any rate hiking cycle will be gradual and data dependent, especially as there are significant uncertainties (including over fiscal policy). Markets will also look for any mention of changes to balance sheet policy (see page 3), given signs of increasing debate over the issue. The minutes will be scrutinised for any clues regarding the timing of any move, though we do not expect much detail at this point.

Eurozone: Eurogroup meeting to discuss Greek bailout deal

Finance ministers from the Eurozone will meet in Brussels (20 February) to discuss ways in which Greece's fiscal and structural reform targets can be modified to allow the IMF's participation in the Greek bailout deal (EUR86 billion). Germany and northern European states have made the IMF's participation in the bailout a prerequisite for release of funds to Greece; EUR54 billion of committed funds still remain unpaid. In the meeting, we believe the Eurozone governments are unlikely to concede to most of the demands made by the IMF (easier fiscal and debt targets than the EU) to ensure its participation. That said, we expect the Greek government to agree to legislate income tax and pension reforms over the coming months and the Eurozone to offer it some debt relief in return. Successful implementation of these measures, possibly by April, will likely bring the IMF on board with the deal, as a supervisor and financial contributor. This will help Greece pay its creditors EUR7 billion, due in July, thereby avoiding a default.

Europe: Eurozone CPI and UK 4Q GDP in focus

Eurozone CPI data for January (22 February), will likely show a pick-up in inflation to 1.8% y-o-y (1.1% in December). This should largely reflect the higher crude prices and the one-off impact of bad weather on food supplies. Markets expect core inflation to remain unchanged at 0.9% y-o-y, highlighting the weak wage growth dynamics. We believe the ECB is likely to look through this transient acceleration in headline inflation (see page 5) and retain its accommodative stance. Meanwhile, a detailed breakdown of UK 4Q GDP data will be released (22 February). GDP is expected to be unchanged at 0.6% q-o-q (first print and 3Q). GDP is likely to have been boosted by a lower drag from net exports, supported by the weaker GBP.

I. Recent Events and Data Releases

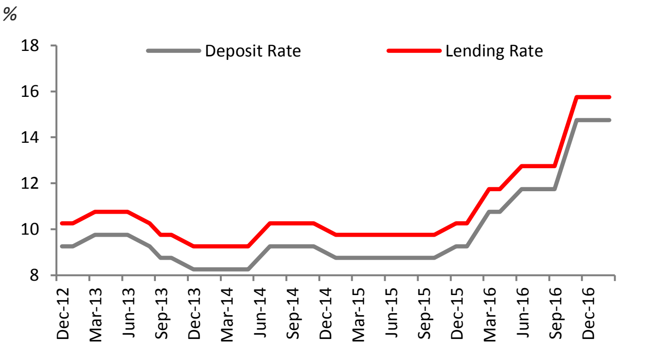
A. MENA Economies

Egypt: CBE holds rates, highlighting transience of inflation rise

CBE: inflation mainly being driven by reform measures

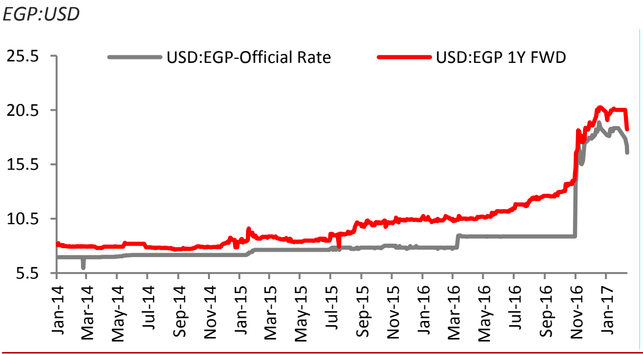
The CBE kept benchmark interest rates on hold at its 16 February meeting, in line with our and consensus expectations. The overnight deposit rate remained at 14.75% and the overnight lending rate at 15.75% for the third consecutive meeting. The steady policy was despite headline consumer inflation accelerating to 28.1% y-o-y and core inflation to 30.9% y-o-y in January. The CBE noted that inflation is mainly being driven by the reform measures (fiscal and EGP liberalisation), reflecting mainly in prices of tradable goods, particularly food. The acceleration in inflation in January (to 4.1% m-o-m, from 3.1% in December) was largely due to seasonal trends and the introduction of higher custom tariffs at the end of 2016. The CBE also highlighted the rise in inflation was transitory and should subside, resulting in a deceleration in monthly inflation rates.

Fig. 1. Egypt: Benchmark interest rates were kept steady after CBE pre-emptively hiked in early November 2016



Source: Central Bank of Egypt

Fig. 2. Egypt: EGP has strengthened to c. 16 to USD, supported by capital inflows



Source: Bloomberg

We still expect interest rate hikes in 2017, given further fiscal reforms

We had not expected a hike given the CBE's pre-emptive moves (raising rates by 300 bps in early November) and the potential impact it might have had on already slowing GDP growth. Further, a rate hike would have had limited ability to lower inflation at this point, in our view. Nevertheless, we believe that the CBE will still have to increase rates in 2017, as there are signs of some secondary inflation and real rates are highly negative. We believe that the CBE will look to maintain its firepower so as to have the ability to hike rates when further fiscal reforms are introduced. Meanwhile, the EGP has strengthened over the last few weeks, supported by increased capital inflows taking advantage of the carry trade. This should reduce some of the inflationary pressure, albeit inflation will remain high. The increased confidence in the EGP (and government treasuries) is supported by the build-up in FX reserves, and in turn, has resulted in the further rise in capital inflows. The completion of the IMF's first review and disbursement of the second tranche (potentially at end-February) could be a further positive catalyst for capital inflows and EGP strengthening.

B. G4 Economies

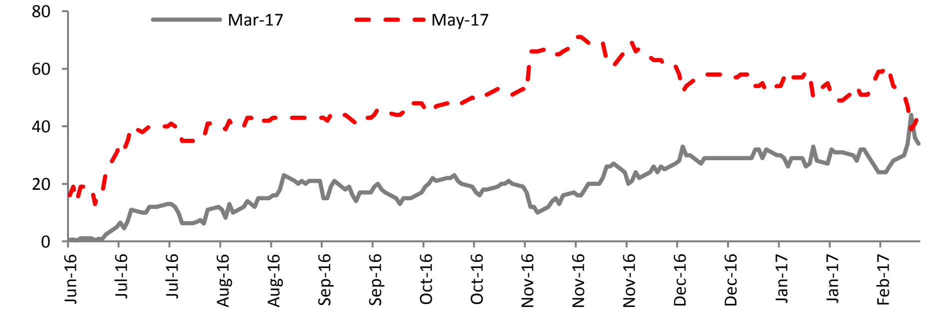
US: Hawkish slant to Yellen's testimony to Congress

Yellen indicates need for Fed to raise rates at an upcoming meeting

Fed Chair Janet Yellen's semi-annual testimony to Congress had a hawkish bias, resulting in a sharp initial sell-off in treasuries and providing support to the USD. Notably, Yellen highlighted that the Fed will likely need to raise interest rates at an upcoming meeting and that "waiting too long to remove accommodation would be unwise". She outlined expectations that inflation will rise to 2% and that there will be a further tightening in the labour market. Yellen said that a delay in raising rates could leave the Fed behind the curve, which could then result in a faster pace of hikes, eventually leading to a recession. There were no indications of how many hikes the Fed saw as appropriate or when the next hike would be – "whether it's March or May or June". However, Yellen's comments were tempered by the fact she saw only a moderate firming in economic activity, due to weak foreign growth, the strong USD and muted household-income growth. Moreover, the pickup in inflation was mainly being driven by the diminishing effects of the earlier energy price declines and the fact that any rate hikes would be gradual. Yellen also highlighted uncertainties, including around fiscal and other policies and their impact on economic activity. She outlined her hopes that upcoming fiscal policy would be consistent with a sustainable fiscal trajectory. On the issue of balance sheet policy, Yellen noted that the Fed would start discussing how to eventually reduce the size of its bond portfolio. The main objective would be for interest rates to go back to being the Fed's main tool of monetary policy.

Fig. 3. US: Expectations of a 25 bps March rate hike have risen to 34% following Yellen's comments last week; we still see June as the most likely timing

Market expectations of a 25 bps rise in the FFTR



Source: Bloomberg

June still most likely month for next rate hike

Yellen's comments keep alive the possibility of a rate hike at the Fed's March meeting (though no explicit mention), which we believe was the key surprise for markets. The market-implied probability of a March rate hike rose to 34% following the comments (see Fig. 3). Our core scenario envisages the next hike in June. Comments by other senior FOMC members last week (Vice Chair Stanley Fischer and NY Fed President William Dudley) indicate less urgency to move. We think the Fed will need to see stronger wage growth before hiking, and we do not expect to see fiscal support until 2H2017. Nevertheless, following Yellen's comments, the probability of an earlier hike will increase if upcoming core inflation and labour data is particularly strong. However, even if the Fed does move earlier than June, we do not expect it to do so at the March FOMC meeting, as many drivers that pushed up inflation in January (including core) were linked to energy prices.

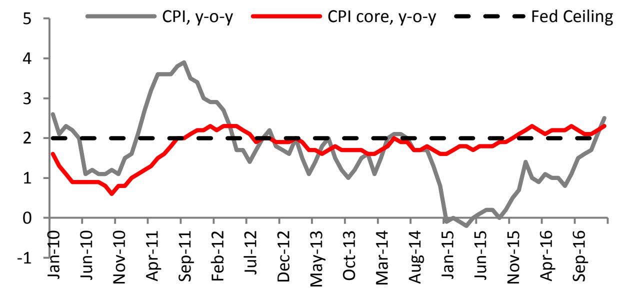
US: Strong print for January inflation, beating consensus expectations

Core inflation accelerated to 2.3% y-o-y in January

January consumer inflation and retail spending data printed stronger than consensus expectations. Headline inflation accelerated to 0.6% m-o-m (consensus: 0.3% m-o-m), resulting in the annual rate strengthening to 2.5% y-o-y. The rise in headline inflation was largely driven by higher energy prices, which increased by 4% m-o-m and 10.8% y-o-y. We expect a further acceleration in headline inflation in 1Q2017, before it tapers off from 2Q due to energy prices. Core inflation also beat consensus expectations (0.2% m-o-m) in January, printing at 0.3% m-o-m and 2.3% y-o-y. The rise in core inflation was mostly due to goods prices, with the pass through of the higher energy prices. Rental inflation (owner equivalent) actually moderated slightly in January.

Fig. 4. US: Both headline and core inflation accelerate, beating consensus expectations

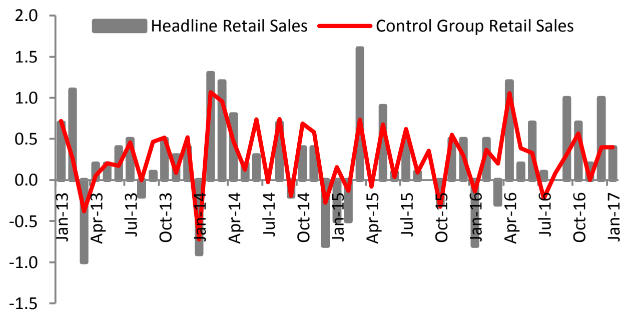
% change y-o-y



Source: Bureau of Labor Statistics

Fig. 5. US: Control group retail sales rose by 0.4% m-o-m in January, reflecting solid personal spending

% change m-o-m



Source: US Census Bureau

Consumption activity strong despite the rise in inflation

Meanwhile, control group retail sales (which feed into GDP data) increased by 0.4% m-o-m in January (consensus: 0.3%). Moreover, December data was revised up to 0.4% m-o-m, from 0.2% initially. The data points to healthy consumption activity into 2017, despite the pickup in inflation.

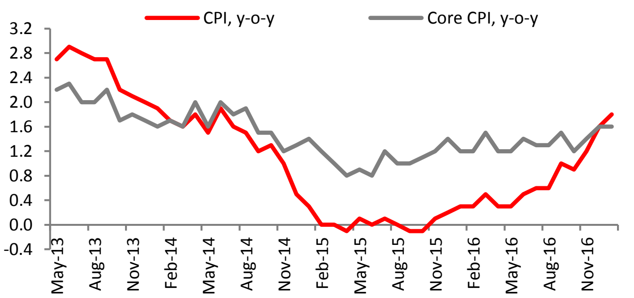
UK: CPI data and labour market report support BoE's dovish stance

Headline inflation at 1.8% y-o-y in January; wage growth moderates

Data on inflation and labour markets released last week provided further evidence of a gradual deceleration in wage growth and soft core inflation, supporting the BoE's dovish stance. January inflation came in at 1.8% y-o-y (consensus: 1.9%; December: 1.6%), slightly under market expectations. Much of the increase was due to higher fuel prices pushing up transport costs (0.8 pp) and the weaker GBP. However, core inflation remained unchanged at 1.6% y-o-y (see Fig. 3), providing tentative signs of softening domestic demand. Meanwhile, labour market data for 4Q was mixed. Employment rose by 37K (consensus: 22K; November: -9K), albeit still pointing to a downward trend, and the unemployment rate remained at an 11-year low of 4.8%. However, wage growth softened slightly to 2.6% y-o-y (consensus: 2.8%; November: 2.8%). The labour market dynamics fit well with our view that the ongoing slack in the labour market is allowing employers to add jobs while softening the pace of wage growth (see Fig. 4). The lacklustre pace of wage growth, despite solid gains in jobs, is likely to keep a lid on consumption, dragging down core inflation.

Fig. 6. UK: Headline CPI up due to higher oil prices; core inflation unchanged in January

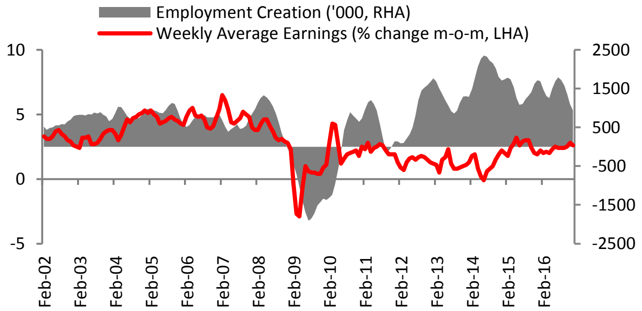
% change y-o-y



Source: Office for National Statistics, UK

Fig. 7. UK: Pace of job creation still robust; wage growth flagging

% change (LHA), 12m rolling sum (RHA)



Source: Office for National Statistics, UK

BoE likely to remain on hold until 2018

High frequency indicators for consumption activity have already begun to indicate a softening in momentum. January retail sales numbers released last week fell -0.3% m-o-m (consensus: 1%; December: -2.1%), registering their third consecutive monthly decline. The contraction was mainly led by lower consumption of household goods and restaurant services, indicating that a squeeze on real incomes and higher imported inflation has impacted discretionary spending. We believe that inflation is likely to accelerate above the BoE's 2% target. Any signs of a hard Brexit could push the GBP lower, adding to inflationary pressure. However, we expect the BoE to refrain from raising rates until 2018 despite inflation likely breaching its 2% target, provided that inflation expectations are well anchored and the pick-up merely reflects a weaker GBP.

Eurozone: ECB likely to keep QE programme in place through 2017

ECB sees downside risks to growth, remains comfortable on inflation trajectory

Minutes of the ECB's February monetary policy meeting revealed that the bank considered the current monetary policy stance "appropriate", given the downside risks to core inflation and growth. Furthermore, it remained comfortable with the recent spike in inflation, judging it a temporary outcome of higher fuel prices and unfavourable base effects. These comments support our view that the ECB is unlikely to taper its QE purchases anytime this year. Moreover, the dovish remarks over the economy highlight the ECB's watchfulness towards political uncertainties as major EU states head towards elections, despite the recent pick-up in credit demand and domestic spending. Indeed, there were suggestions by some ECB members about revaluing the proportion in which the central bank purchases sovereign bonds of different countries under its QE programme. We believe the ECB may change the proportion of its QE purchases to favour sovereign bonds from peripheral Eurozone members, in case their sovereign yields climb sharply in the run-up to the French and Dutch general elections.

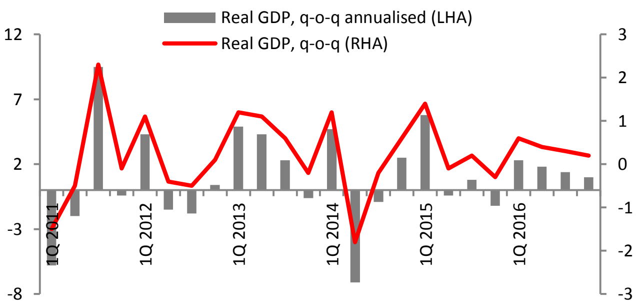
Japan: 4Q GDP data likely to prevent further easing by BoJ

Japan's 4Q GDP remained firm, supported by exports and private capex

Japan's 4Q GDP growth remained firm at 1% q-o-q SAAR (see Fig. 8), albeit slightly below consensus expectations of 1.1% and 3Q's 1.4%. Exports remained the main driver of growth in 4Q, rising 11% q-o-q saar (3Q: 8.5%) as a weaker JPY helped firms gain competitiveness, particularly in the transport equipment and electronics goods industries. A further lift came from private non-residential investment, which rose 3.8% q-o-q saar (3Q: -1.3%). Firms, especially in the construction sector, accelerated their capex in response to the government's efforts to stimulate private investment in infrastructure. However, domestic consumption remained flat after having risen by 1.3% q-o-q saar in 3Q2016 (see Fig. 9). Looking ahead, we expect economic growth to print in the 0.8-1.1% q-o-q saar range in 2017, supported by the fiscal stimulus of JPY28.1 trillion announced in 3Q2016. However, the boost to the economy from exports is likely to diminish as the support from the JPY fades.

Fig. 8. Japan: 4Q GDP remained above BoJ's estimate for trend GDP growth

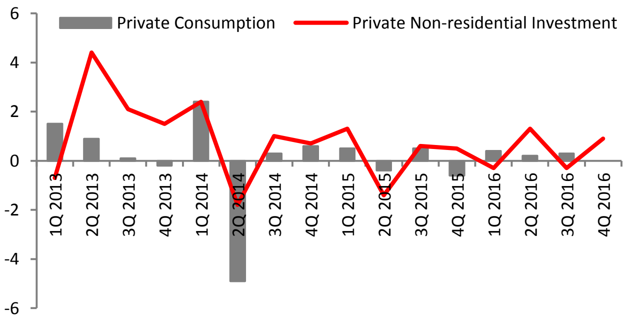
% change



Source: Economic and Social Research Institute, Japan

Fig. 9. Japan: Domestic consumption remained headwind to growth; non-residential investment recovered

% change q-o-q



Source: Economic and Social Research Institute, Japan

BoJ likely to remain on hold in 2017 and should continue to highlight downside risks to inflation and growth

We believe that last week's GDP numbers reduce the urgency for the BoJ to ease monetary policy further given that GDP growth in the past two quarters has been above the BoJ's trend GDP growth estimate (0.5%). That said, the central bank should continue to emphasise the downside risks to economic activity and the inflation outlook this year, for two reasons. First, any protectionist measures by the US to impose tariffs on Japanese exports could sharply set back economic growth. The near-term risks of such a scenario have moderated following successful talks between President Donald Trump and Prime Minister Shinzo Abe last week. However, any US tariffs on Korean and Chinese exports could still indirectly hurt Japan, since it exports a major share of intermediate and capital goods to these countries. Second, downside risks to growth and inflation from weak consumer spending persist. Household spending is set to remain subdued this year, as in 4Q, as annual wage hikes in 2017 are unlikely to improve much on the 2016 level.

C. Emerging Market Economies

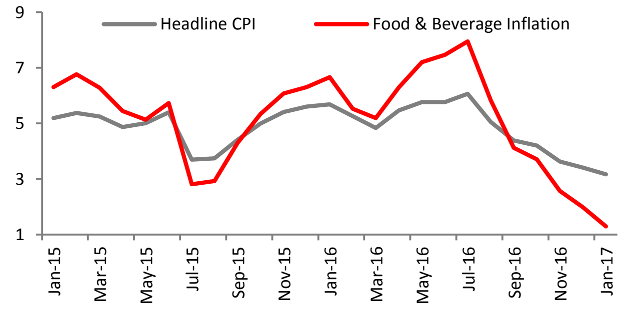
India: Inflation continued to soften in January

Inflation falls to five-year low of 3.2% y-o-y

Inflation decelerated to its slowest pace in five years (3.2% y-o-y) in January (consensus: 3.2%; December: 3.4%). Food inflation, which comprises 54.2% of the CPI basket, moderated to 1.3% y-o-y (December: 2%). However, core inflation picked up to 5.1% y-o-y (4.6% previously) as higher fuel prices fed into transport costs (see Fig. 10). Looking ahead, we see upside risks to inflation from higher crude prices, a rebound in aggregate demand amid a recovery from the demonetisation shock, the implementation of the GST tax in mid-2017 and the likely increase in rent allowances for public sector employees. We expect inflation at 4.2% in March 2017 and 5.4% in March 2018. In our view, the RBI is unlikely to cut policy rates this year despite the slowdown in inflation in January given the upside risks to its recently modified inflation target of 4%.

Fig. 10. India: Decelerating food inflation drove down headline CPI in January, despite higher fuel prices

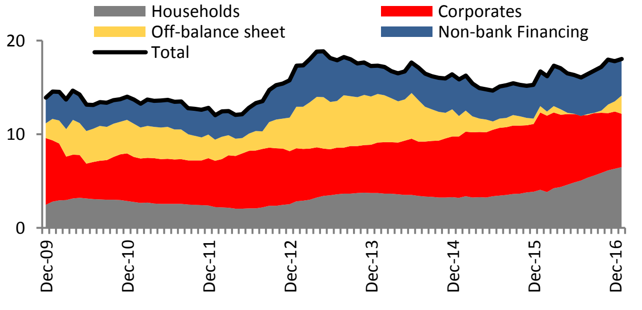
% change y-o-y



Source: Central Statistical Office

Fig. 11. China: Lending to corporates rebounded in January; household lending remained supportive too

CNY trillion (12m rolling sum)



Source: PBoC

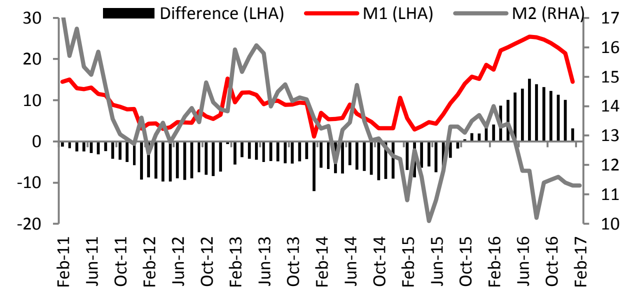
China: Lending activity remained strong in January

Aggregate lending remained steady in January; we expect the PBoC to continue supporting bank lending in 2017

Monetary data from China showed a steady pace of lending growth in January, with aggregate credit rising by CNY3.74 trillion (consensus: CNY3 trillion; December: CNY1.04 trillion). Corporate lending was the major driver of this surprise, rising by CNY1.56 trillion (December: CNY0.5 trillion). In our view, this suggests a nascent recovery in private sector borrowing following a sustained programme of infrastructure investment by the government over the past year (see Fig. 11). That said, some of the strength in corporate lending in January may also have come from the front-loading of corporate loan quotas. Notably, our indicator of monetary transmission to the corporate sector also improved (M1-M2 gap), suggesting greater confidence among banks towards long-term corporate lending (see Fig. 12). Meanwhile, loans to households continued to rise, to CNY0.75 trillion after December's CNY0.5 trillion, led by mortgage loans in non-metropolitan cities. We expect the PBoC to continue encouraging household and corporate lending this year as long as retail inflation remains below the upper bound of its target range (3%) and property prices stay contained. Nevertheless, we expect the central bank to announce further measures to control excessively leveraged operations in money markets and off-balance sheet lending by banks. To this end, we expect more reverse repo operations to mop up interbank liquidity and increases to marginal lending facility rates. However, any policy measures aimed at tightening bank lending, such as increases in reserve ratio requirements for banks or benchmark lending rates, are unlikely over the next 12 months.

Fig. 12. China: M1-M2 gap, our preferred indicator for tracking monetary transmission, improves since 3Q16

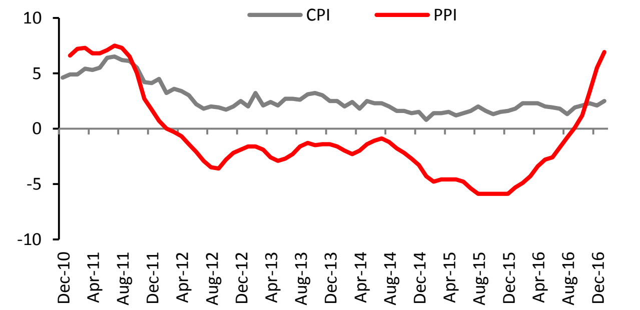
% change y-o-y (LHA), % change y-o-y (RHA)



Source: PBoC, China

Fig. 13. China: Headline inflation remains below PBoC's 3% threshold; producer prices pick up sharply

% change y-o-y



Source: National Bureau of Statistics, China

Consumer and producer prices both rose faster than expected in January

Prices: Consumer inflation rose to 2.5% y-o-y in January (consensus: 2.4%; December: 2.1%), coming in slightly above market expectations. Much of the jump in inflation, in our view, reflected the higher demand for food, entertainment and travel services ahead of the Lunar New Year (see Fig. 13). We expect these factors to reverse in the coming months, reducing the urgency for the PBoC to tighten its monetary stance. Encouragingly, producer prices surged too, to 6.9% y-o-y after December's 5.5% y-o-y. A weaker CNY on a y-o-y basis, higher commodity prices and steady infrastructure investment demand were the key drivers of the PPI, in our view. Looking ahead, we expect average PPI inflation of 6.5% y-o-y in 2017. This should improve the pricing power of firms in the manufacturing and mining sectors, allowing them to earn higher profits and improve debt servicing capability.

II. Economic Calendar

Fig. 14. Upcoming events and data releases

Time*	Country	Event	Period	Prior	Consensus
Expected Next Week					
	Saudi Arabia	Saudi Arabia Crude Oil Data Published: JODI			
	Saudi Arabia	CPI, y-o-y	Jan	1.7%	--
	Bahrain	CPI, y-o-y	Jan	2.3%	--
	Kuwait	CPI, y-o-y	Jan	3.5%	--
Monday, 20 Feb					
	Eurozone	Eurogroup meeting in Brussels			
3:50	Japan	Trade Balance	Jan	¥641.4B	-¥625.9B
3:50	Japan	Exports, y-o-y	Jan	5.4%	5%
4:01	UK	Rightmove House Prices, y-o-y	Feb	3.2%	2.8%
5:15	US	Fed's Mester to Speak at Global Interdependence Center Event			
19:00	Eurozone	Consumer Confidence	Feb A	-4.9	-4.9
Tuesday, 21 Feb					
4:30	Japan	Nikkei Japan PMI Mfg	Feb P	52.7	--
8:30	Japan	All Industry Activity Index, m-o-m	Dec	0.3%	-0.2%
13:00	Eurozone	Markit Eurozone Manufacturing PMI	Feb P	55.2	55
13:00	Eurozone	Markit Eurozone Services PMI	Feb P	53.7	53.7
17:50	US	Fed's Kashkari Speaks on Economy in Golden Valley, MN			
18:45	US	Markit US Manufacturing PMI	Feb P	55	54.6
21:00	US	Fed's Harker to Speak on Economic Outlook			
Wednesday, 22 Feb					
13:00	Germany	IFO Business Climate	Feb	109.8	109.6
13:30	UK	GDP, q-o-q	4Q P	0.6%	0.6%
13:30	UK	GDP, y-o-y	4Q P	2.2%	2.2%
13:30	UK	Private Consumption, q-o-q	4Q P	0.7%	0.6%
13:30	UK	Government Spending, q-o-q	4Q P	0%	0.1%
13:30	UK	Gross Fixed Capital Formation, q-o-q	4Q P	0.9%	0.2%
14:00	Eurozone	CPI, y-o-y	Jan F	1.1%	1.8%
14:00	Eurozone	CPI Core, y-o-y	Jan F	0.9%	0.9%
16:00	US	MBA Mortgage Applications	17-Feb	-3.7%	--
19:00	US	Existing Home Sales	Jan	5.49M	5.54M
23:00	US	FOMC Meeting Minutes	1-Feb	--	--
Thursday, 23 Feb					
17:30	US	Initial Jobless Claims	18-Feb	239K	240K
17:35	US	Fed's Lockhart to Speak on His 10-Year Tenure at the Fed			
Friday, 24 Feb					
19:00	US	New Home Sales	Jan	536K	571K
19:00	US	U. of Mich. Sentiment	Feb F	95.7	96

* UAE time
Source: Bloomberg

Fig. 15. Last week's data

Time*	Country	Event	Period	Prior	Consensus	Actual
MENA and EM Data						
	UAE	Central Bank Foreign Assets	Jan	310.9B	--	290.8B
	UAE	M2 Money Supply, m-o-m	Jan	1%	--	0.4%
	UAE	CPI, y-o-y	Dec	2.6%	--	1.2%
	Qatar	CPI, y-o-y	Jan	1.8%	--	1.2%
	Oman	CPI, y-o-y	Jan	1.1%	--	1.8%
	Bahrain	M2 Money Supply, y-o-y	Nov	2.4%	--	3.2%
	China	Money Supply M2, y-o-y	Jan	11.3%	11.3%	11.3%
	China	New Yuan Loans, CNY	Jan	1040B	2440B	2030B
	China	Aggregate Financing, CNY	Jan	1626B	3000B	3740B
	India	Exports, y-o-y	Jan	5.7%	--	4.3%
Monday, 13 Feb						
3:50	Japan	GDP SA, q-o-q	4Q P	0.3%	0.3%	0.2%
3:50	Japan	GDP Annualized SA, q-o-q	4Q P	1.4%	1.1%	1%
3:50	Japan	GDP Private Consumption, q-o-q	4Q P	0.3%	0%	0%
3:50	Japan	GDP Business Spending, q-o-q	4Q P	-0.3%	1.2%	0.9%
16:00	India	CPI, y-o-y	Jan	3.4%	3.2%	3.2%
Tuesday, 14 Feb						
5:30	China	CPI, y-o-y	Jan	2.1%	2.4%	2.5%
5:30	China	PPI, y-o-y	Jan	5.5%	6.6%	6.9%
10:30	India	WPI, y-o-y	Jan	3.4%	4.4%	5.3%
13:30	UK	CPI, y-o-y	Jan	1.6%	1.9%	1.8%
13:30	UK	CPI Core, y-o-y	Jan	1.6%	1.7%	1.6%
14:00	Eurozone	Industrial Production SA, m-o-m	Dec	1.5%	-1.5%	-1.6%
14:00	Eurozone	GDP SA, q-o-q	4Q P	0.4%	0.5%	0.4%
14:00	Eurozone	GDP SA, y-o-y	4Q P	1.7%	1.8%	1.7%
Wednesday, 15 Feb						
13:30	UK	Average Weekly Earnings, 3m/y-o-y	Dec	2.8%	2.8%	2.6%
13:30	UK	ILO Unemployment Rate, 3m	Dec	4.8%	4.8%	4.8%
16:00	US	MBA Mortgage Applications	10-Feb	2.3%	--	-3.7%
17:30	US	CPI, m-o-m	Jan	0.3%	0.3%	0.6%
17:30	US	CPI, y-o-y	Jan	2.1%	2.4%	2.5%
17:30	US	CPI ex-Food and Energy, y-o-y	Jan	2.2%	2.1%	2.3%
17:30	US	Retail Sales Advance, m-o-m	Jan	1%	0.1%	0.4%
17:30	US	Retail Sales Control Group	Jan	0.4%	0.3%	0.4%
18:15	US	Industrial Production, m-o-m	Jan	0.6%	0%	-0.3%
Thursday, 16 Feb						
	Egypt	Deposit Rate	16-Feb	14.75%	14.75%	14.75%
	Egypt	Lending Rate	16-Feb	15.75%	--	15.75%
16:30	Eurozone	ECB account of the monetary policy meeting				
17:30	US	Housing Starts	Jan	1279K	1226K	1246K
17:30	US	Building Permits	Jan	1228K	1230K	1285K
17:30	US	Initial Jobless Claims	11-Feb	234K	245K	239K
Friday, 17 Feb						
13:30	UK	Retail Sales ex-Auto Fuel, m-o-m	Jan	-2%	0.7%	-0.2%
13:30	UK	Retail Sales ex-Auto Fuel, y-o-y	Jan	4.7%	3.9%	2.6%

* UAE time
Source: Bloomberg

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