The Week Ahead: US durable goods and European business sentiment in focus

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US: Durable goods orders expected to contract

Globally, the week will be relatively quiet with largely secondary data and events ahead of the Easter period. Markets will continue to digest the dovish statement from the Fed which came despite ongoing signs of a pickup in inflation and an improvement in the labour market. JOLTS data showed that the number of job openings increased by 260K in January to 5,541K. Meanwhile, goods inflation is showing tentative signs of picking up, with limited USD appreciation in 2016. A number of FOMC members speak this week and markets will look for greater clarity on Fed expectations and concerns. The FOMC now expects two rate hikes of 25 bps in 2016, in line with our forecast. The key focus of the data will be the February durable goods orders, where the market expects a monthly contraction given the strong growth in January and the volatile nature of the series.

Eurozone: Market sentiment data in focus

There are a number of Eurozone surveys released this week for March, including PMI, IFO, ZEW, and consumer confidence. Overall, the market expects a stabilisation to some moderate weakening following a deterioration over the last two months. If there is some improvement in the expectations components of the surveys, this could reflect the positive impact of the ECB's comprehensive stimulus package and improved global market sentiment. In the UK, the focus will be on retail sales and inflation for February. Headline inflation is forecast to rise to 0.4% m-o-m, from -0.8% m-o-m, due to higher energy, food, and goods inflation partly on the back of the weaker GBP. Meanwhile, consensus expects a monthly fall in retail sales, after exceptionally strong growth in January due to price discounting. However, the main focus will remain on political developments with signs emerging of widening divisions in the ruling Conservative party.

Turkey: No change in monetary policy expected

We expect the CBRT to remain on hold at its 24 March meeting, despite the need for tighter monetary policy. Inflationary pressure and expectations have picked up recently. However, still low oil prices (despite the rise from mid-January), stability in the TRY, and the Fed remaining on hold reduce near-term pressure for the CBRT to move. Meanwhile, the Central Bank of Egypt (CBE) raised policy rates by 150 bps at its 17 March meeting. This was greater than our expectation of 50-100 bps and follows a 13% depreciation of the EGP vs the USD last week. We see the magnitude of the hikes as intended to anchor inflation expectations, and reduce EGP depreciation expectations and dollarisation in the economy. The government indicated exchange rate policy would be more flexible. The degree of that flexibility will now be critical for the macro outlook.

I. Recent Events and Data

A. MENA Economies

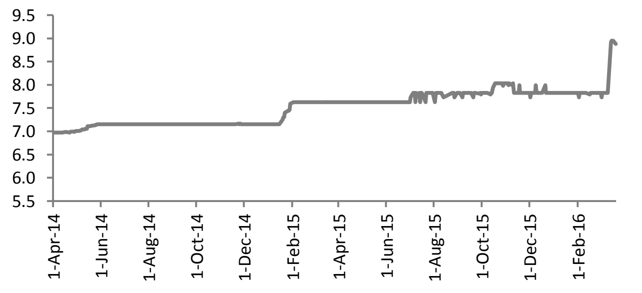
Egypt: Devalues EGP, indicates more flexibility

EGP devalued by -13% on 14 March

The Central Bank of Egypt (CBE) weakened the EGP by around -13% at an FX auction on 14 March. The bank sold USD198.1 million at EGP8.85/USD, -13% softer than the previous day's closing price of EGP7.83 and -14.5% lower than the CBE's official auction rate of EGP7.73. Concurrently with the devaluation, the CBE announced that it would adopt a more flexible exchange rate which should reflect a fairer value for the EGP, though no details were provided. The devaluation has substantially narrowed the gap between the official rate and the parallel market's EGP9.5/USD. We see the move as highly positive, especially if the EGP becomes more flexible. Moreover, in a further move to eradicate the USD black market and stabilise the EGP, the CBE offered USD1.5 billion at a special FX auction on 15 March. This was the third auction last week, amounting to a total of USD2.4 billion.

Fig. 1. Egypt: CBE weakens EGP by -13% against USD, injects FX liquidity to reduce parallel market

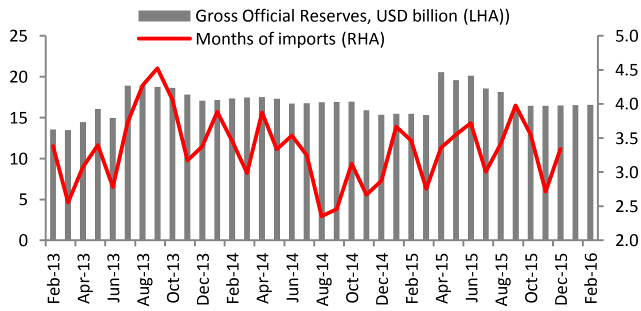
USD:EGP



Source: Bloomberg

Fig. 2. Egypt: Key CBE objective to be increasing FX reserves towards USD25 billion

USD billion (LHA); months (RHA)



Source: Central Bank of Egypt, Bloomberg

More flexible exchange rate to be highly positive for macro outlook

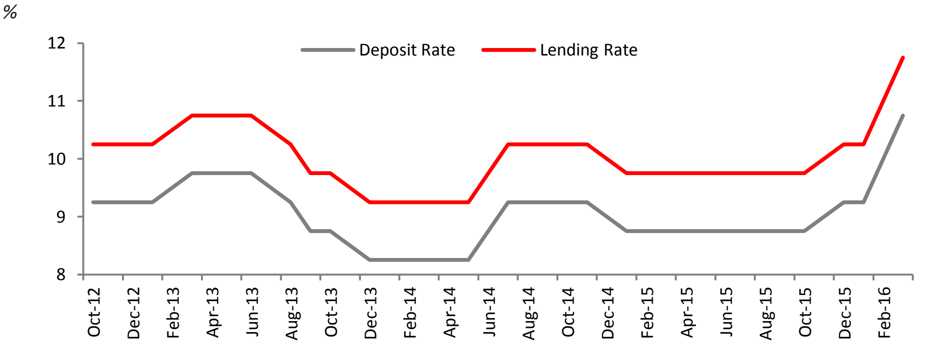
The overvalued EGP and resultant USD shortages in the economy have hampered economic activity. This has included erosion of FX reserves to support the EGP and difficulties in accessing vital consumption- and investment-linked imports. Moreover, EGP uncertainties and USD shortages have been a key bottleneck in attracting foreign capital and investment, which are critical to meeting the government's funding requirements and bolstering investment. Ahead of the devaluation, the CBE introduced a number of measures to ease FX restrictions, including the level of FX deposits required to be held at commercial banks by corporates and individuals. The more flexible exchange rate will be positive for the macro outlook and for easing external imbalances. The degree of EGP flexibility will be critical for the macro outlook and for the degree of confidence in the reforms. Nevertheless, wider structural economic reforms are also required to place the economy on a better footing.

Bolstering FX reserves to be key objective

We see the possibility of further gradual EGP weakening in the coming week, and we expect the EGP to trade at EGP9-10/USD in 2016. A statement by the CBE indicated that most of the moves will take place in the near term, though the EGP has thus far remained broadly steady since the devaluation. A key objective for the bank will now be building up FX reserves towards USD25 billion by end-2016, with greater FX inflows.

This compares to FX reserves of USD16.6 billion in February 2016. The reduction of the parallel market will also be vital in bringing FX liquidity back into the official banking system. A number of public banks are offering 60-day CDs with 15% yields to retail customers selling FX. Furthermore, in a bid to attract flows to the T-bill market, the CBE (through the National Bank of Egypt) is offering foreign investors an instrument that guarantees against FX and interest rate risk (details of the scheme have not yet been made public).

Fig. 3. Egypt: CBE raises benchmark interest rates 150 bps at March meeting; greater than our expectation of 50-100 bps



Source: Central Bank of Egypt

Interest rate hike to support carry trade flows into the EGP

Moreover, the CBE front-loaded 150 bps of interest rate hikes at its 17 March meeting. We see this as intended to: i) contain pressure for a secondary inflation increase; ii) lower EGP depreciation expectations; and iii) support the carry trade and EGP deposits in the system. The overnight deposit rate now stands at 10.75% and the overnight lending rate at 11.75%. The statement from the CBE indicated that the moderation of inflation in February supported the timing of the depreciation decision.

Kuwait: Cabinet approves fiscal reform package

No indication regarding timing of fiscal reform package

Kuwait's cabinet has approved a package of fiscal reforms aimed at strengthening the country's fiscal position. The six-point plan includes the imposition of a 10% corporate tax on profits, according to Finance Minister Anas Al Saleh. Corporate taxes are currently levied on foreign companies at a flat rate of 15%, having been lowered from 55% in 2008. However, Kuwait does not impose income tax on companies wholly owned by nationals of Kuwait (or the other GCC countries). Other measures in the package include selling stakes in state-owned entities, lowering subsidies, and increasing the cost of government services.

Oil accounts for around 90% of government revenues

There has been no indication of when these measures will be introduced. However, they will likely require approval from the National Assembly, which could either delay the process or require changes. If the package is implemented as-is, it would stand out within the GCC for its focus on taxation. The other GCC countries (except Oman) are currently focusing on subsidy reforms, with the expected introduction of VAT in 2018 to be the first main tax reform. We believe that the fiscal reforms will be an important step in diversifying government revenues, though we see Kuwait as having one of the smallest fiscal deficits in the GCC in 2016E, at -4.5%. The need to increase non-oil revenues is reflected in the fact that oil accounts for around 90% of total government revenues.

Raises water prices for government and corporate sectors

Oman: In a further fiscal reform, Oman's Public Authority for Electricity and Water (PAEW) announced that it will raise water prices for government, commercial, and industrial bodies. The change will become effective in March 2016, having been announced in the February invoices. The new tariff will be a flat rate of 3.5 baisa (OMR0.0035) per gallon, up from the earlier 3 baisa. However, the adjusted price is still below the average cost of production and distribution of water of nearly 7 baisa per gallon. This is the latest fiscal reform from Oman aimed at limiting the widening deficit resulting from the lower oil price. Earlier measures (in January) included liberalising fuel prices and increasing the corporate tax rate to 15% (from 12% previously).

Saudi Arabia: Raises home buyers' loan-to-value limit to 85%

Affordable-housing shortage a key bottleneck

In a further move to improve housing affordability, SAMA has announced that it will increase the loan-to-value ratio that mortgage companies can lend up to, from 70% to 85%. This is the latest move by Saudi Arabia to increase the availability of home financing and boost investment in the housing sector. In February, the government announced an "affordable mortgage" programme whereby the Ministry of Finance would guarantee 15% of the financing for a home purchase (please see our **Global Data Watch** from 7 March). However, we see the shortage of affordable housing as a key constraint, and a significant challenge to increasing home ownership.

B. G4 Economies

US: Leaves rates unchanged, sees only two hikes in 2016

Tone of meeting more bearish than expected

The FOMC kept rates on hold at its 15-16 March meeting, in line with our forecast and the market's expectation. However, the communication of the meeting was substantially more dovish than expected despite the recent improvements in US data (especially on the inflation front) and on global financial markets. Despite the more bearish tone, we continue to expect two 25 bps hikes in 2016, in June and December. However, this will depend on global market stability.

US inflation and global developments key concerns for Fed

Two key concerns were highlighted: i) the fragile global and economic conditions; and ii) the US inflation outlook. Fed Chair Janet Yellen noted that inflation had picked up over the last two months. However, she also said that inflation expectations remain low and that the recent price gains may prove temporary on the back of USD and oil developments. This was reflected in the downward revisions to the Fed's near-term forecasts, including for inflation and growth. The core PCE inflation forecast was maintained at 1.6% for 2016, despite the measure having risen to 1.7% in January; the 2017 forecast was cut by -0.1 ppt to 1.8%. Moreover, the GDP growth forecast was lowered by -0.2 ppt to 2.2% for 2016 and by -0.1 ppt to 2.1% for 2017. However, the Fed retained its expectation that trend growth would be 2%.

Fed projects just two rate hikes in 2016, versus four predicted in December

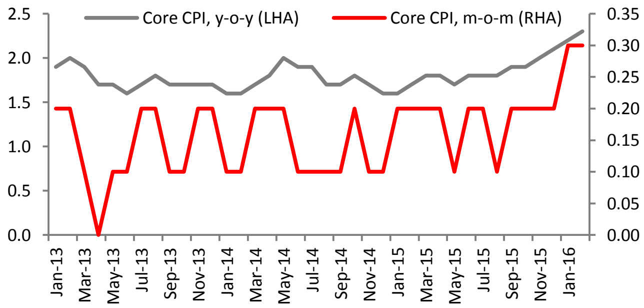
However, more significantly, all FOMC members lowered their federal funds target rate projections (dot plot) by -50 bps for 2016 and 2017. This indicates a much shallower rate-hiking cycle than was implied in December. The Fed now sees two 25 bps rate hikes in 2016, in line with our view, followed by four in 2017. The longer-run equilibrium (or neutral) funds rate was also lowered by 25 bps to 3.25%. The low neutral rate, despite the economy being close to full employment, reflects a number of uncertainties, according to Yellen.

Inflation: Inflation fell -0.2% m-o-m in February, in line with market expectations. The decline came on the back of lower gasoline and energy prices, which shaved 0.9 ppt from y-o-y headline inflation. However, core inflation again surprised to the upside at 0.3% m-o-m, as it had in January. On an annual basis, core inflation rose to 2.3% in February, up from 2.2% in January. The acceleration was driven by an increase in services prices (especially medical care), but also a small pickup in goods prices. We attribute the tentative strengthening in goods prices to the fading of base effects related to past USD appreciation. We believe that the drag from the strong USD is likely to moderate in 2016. However, some of the uptick in goods prices was likely seasonal.

Core inflation rises to 2.3% y-o-y, highest level since 2012

Fig. 4. US: Core inflation again surprises to upside, driven by medical and goods prices

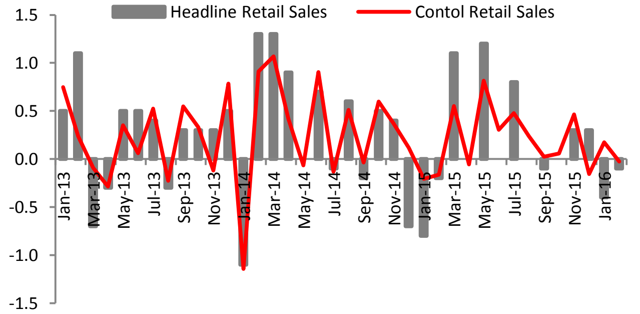
% change y-o-y (LHA); % change m-o-m % (RHA)



Source: Bloomberg

Fig. 5. US: Control retail sales flat in February; weaker recovery in 1Q retail sales

% change m-o-m



Source: Bloomberg

Retail sales: The overall number came in weaker than the market had expected. Headline retail sales for January were revised down to show a contraction of -0.4% m-o-m, versus 0.2% growth initially. February headline retail sales fell -0.1% m-o-m, slightly less than the consensus expectation of -0.2%. However, control-group sales, which feed into GDP data, remained flat in February, having grown 0.2% m-o-m in January. Whilst the data point to weaker private-consumption recovery in 1Q, they nevertheless indicate a gradual pickup, especially on an annual basis.

Japan: BoJ keeps monetary policy steady, but adopts more cautious economic outlook

The BoJ kept its key monetary policy tools unchanged at its March meeting, in line with our forecasts and market expectations. This included expanding the monetary base by JPY80 trillion p.a. The benchmark policy rate remained at -0.1%, with the macro add-on balance rate at 0% and the basic balance rate at 0.1%. However, some minor adjustments were made to the negative interest rate policy, which should help to reduce the adverse impact on banks. Overall, the statements and actions indicate that the BoJ is reassessing its January shift to negative interest rates, which was not well received by markets. The bank also widened the exemptions from negative rates, including USD90 billion in short-term funds (money-reserve funds). Moreover, the BoJ removed the assertion from its statement that it would cut rates even further into negative territory if required. However, it maintained that it will take additional easing measures if it deems them necessary.

BoJ appearing to reassess negative interest rate framework

Further easing expected, possibly as early as April

The BoJ provided a weaker assessment of the economy on the back of the financial market volatility at the beginning of the year and sluggish EM demand. Moreover, the bank highlighted the recent moderation in inflation expectations. Having downgraded its economic assessment, we expect the bank to introduce further easing. This expectation is heightened by indications of weak spring wage negotiations. The BoJ will likely cut its growth and inflation forecasts at its quarterly review in April, which should lead to further easing. We believe that expanding QQE further remains an option. While the BoJ's comments in March indicated less focus on interest rate moves going forward, we do preclude the possibility of further reductions. With the latest moves, the BoJ has addressed some of the technical problems created by the initial introduction of negative rates. This could clear the way for a deeper move into negative territory at its April meeting. At the post-meeting conference, BoJ Governor Haruhiko Kuroda said that "it would be theoretically possible to lower the rate to -0.5%."

C. EM Economies

India: Inflation surprises on downside in February

Weaker inflationary pressure and fiscal discipline support April rate cut

CPI decelerated to 5.2% y-o-y in February, below the consensus of 5.5% and January's 5.7%. The moderation was due to food prices (vegetables and pulses) dragging the headline number down. We believe that the weaker-than-expected February print and fiscal discipline in the 2016-17 budget supports our outlook for a -25 bps policy repo rate cut at the RBI's next meeting on 5 April.

II. Economic Calendar

Fig. 6. Upcoming events and data releases

Time*	Country	Data point	Period	Prior	Consensus
Expected this week					
	UAE	M2 Money Supply, m-o-m	Feb	0.7%	--
Monday 21 Mar					
4:01	UK	Rightmove House Prices, m-o-m	Mar	2.9%	--
4:01	UK	Rightmove House Prices, y-o-y	Mar	7.3%	--
12:15	US	Fed's Lacker Speaks in Paris at Bank of France			
18:00	US	Existing Home Sales	Feb	5.47M	5.31M
18:00	US	Existing Home Sales, m-o-m	Feb	0.4%	-2.9%
20:40	US	Fed's Lockhart Speaks on US Economy in Savannah, Georgia			
Tuesday 22 Mar					
6:00	Japan	Nikkei Japan PMI Mfg	Mar P	50.1	50.5
13:00	Germany	IFO Business Climate	Mar	105.7	106
13:00	Germany	IFO Current Assessment	Mar	112.9	112.7
13:00	Germany	IFO Expectations	Mar	98.8	99.5
13:00	Eurozone	Markit Eurozone Manufacturing PMI	Mar P	51.2	51.4
13:00	Eurozone	Markit Eurozone Services PMI	Mar P	53.3	53.3
13:00	Eurozone	Markit Eurozone Composite PMI	Mar P	53	53
13:30	UK	CPI, m-o-m	Feb	-0.8%	0.4%
13:30	UK	CPI, y-o-y	Feb	0.3%	0.4%
13:30	UK	CPI Core, y-o-y	Feb	1.2%	1.2%
13:30	UK	Retail Price Index	Feb	258.8	260.2
14:00	Germany	ZEW Survey Current Situation	Mar	52.3	53
14:00	Germany	ZEW Survey Expectations	Mar	1	5.4
14:00	Eurozone	ZEW Survey Expectations	Mar	13.6	--
17:45	US	Markit US Manufacturing PMI	Mar P	51.3	51.9
21:30	US	Fed's Evans Speaks in Chicago			
Wednesday 23 Mar					
3:00	US	Fed's Harker Speaks in New York			
5:30	Japan	BOJ's Funo Speaks in Kobe			
15:00	US	MBA Mortgage Applications	18-Mar	-3.3%	--
18:00	US	New Home Sales	Feb	494K	510K
18:00	US	New Home Sales, m-o-m	Feb	-9.2%	3.2%
19:00	Eurozone	Consumer Confidence	Mar A	-8.8	-8.3
Thursday 24 Mar					
13:30	UK	Retail Sales, ex-Auto Fuel, m-o-m	Feb	2.3%	-1%
13:30	UK	Retail Sales, ex-Auto Fuel, y-o-y	Feb	5%	3.5%
13:30	UK	Retail Sales, inc Auto Fuel, m-o-m	Feb	2.3%	0.7%
13:30	UK	Retail Sales, inc Auto Fuel, y-o-y	Feb	5.2%	3.90%
16.00	Turkey	Benchmark Repurchase Rate	24-Mar	7.5%	7.5%
16:15	US	Fed's Bullard Speaks in New York			
16:30	US	Initial Jobless Claims	19-Mar	265K	268K
16:30	US	Durable Goods Orders	Feb P	4.7%	-3%
16:30	US	Durables, ex-Transportation	Feb P	1.7%	-0.3%
16:30	US	Cap Goods Orders, Nondef ex-Air	Feb P	3.4%	-0.5%
Friday 25 Mar					
3:30	Japan	Natl CPI, y-o-y	Feb	0%	0.3%
3:30	Japan	Natl CPI, ex-Fresh Food, y-o-y	Feb	0%	0%
3:30	Japan	Natl CPI, ex- Food, Energy, y-o-y	Feb	0.7%	0.8%
16:30	US	GDP Annualized, q-o-q	4Q T	1%	1%
16:30	US	Personal Consumption	4Q T	2%	2%

* UAE time

Source: Bloomberg

Fig. 7. Last week's data

Time*	Country	Data point	Period	Prior	Consensus	Actual
GCC data						
	UAE	CPI, y-o-y	Jan	3.6%	--	2.6%
	Qatar	CPI, y-o-y	Feb	2.8%	--	3.3%
Monday 14 Mar						
3:50	Japan	Machine Orders, m-o-m	Jan	1%	1.9%	15%
3:50	Japan	Machine Orders, y-o-y	Jan	-3.6%	-3.8%	8.4%
14:00	Eurozone	Industrial Production SA, m-o-m	Jan	-0.5%	1.7%	2.1%
14:00	Eurozone	Industrial Production WDA, y-o-y	Jan	-0.1%	1.6%	2.8%
16:00	India	CPI, y-o-y	Feb	5.7%	5.5%	5.2%
Tuesday 15 Mar						
03/15	Japan	BOJ Annual Rise in Monetary Base	15-Mar	¥80T	¥80T	¥80T
03/15	Japan	BOJ Policy Rate	15-Mar	-0.1%	-0.1%	99.9%
8:30	Japan	Industrial Production, m-o-m	Jan F	3.7%	--	3.7%
8:30	Japan	Industrial Production, y-o-y	Jan F	-3.8%	--	-3.8%
8:30	Japan	Capacity Utilization, m-o-m	Jan	-1%	--	2.60%
14:00	Eurozone	Employment, q-o-q	4Q	0.3%	--	0.3%
14:00	Eurozone	Employment, y-o-y	4Q	1.1%	--	1.2%
16:30	US	Retail Sales Advance, m-o-m	Feb	-0.4%	-0.2%	-0.1%
16:30	US	Retail Sales, ex-Auto and Gas, m-o-m	Feb	-0.1%	0.2%	0.3%
16:30	US	Retail Sales Control Group, m-o-m	Feb	0.2%	0.2%	0%
Wednesday 16 Mar						
13:30	UK	Jobless Claims Change	Feb	-28.4K	-9.1K	-18K
13:30	UK	Average Weekly Earnings, 3M/YoY	Jan	1.9%	2%	2.1%
13:30	UK	Weekly Earnings ex Bonus, 3M/YoY	Jan	2%	2.1%	2.2%
13:30	UK	ILO Unemployment Rate, 3Mths	Jan	5.1%	5.1%	5.1%
16:30	US	Housing Starts	Feb	1120K	1150K	1178K
16:30	US	Housing Starts, m-o-m	Feb	-3.4%	4.6%	5.2%
16:30	US	Building Permits	Feb	1204K	1200K	1167K
16:30	US	Building Permits, m-o-m	Feb	0%	-0.2%	-3.1%
16:30	US	CPI, m-o-m	Feb	0%	-0.2%	-0.2%
16:30	US	CPI, ex-Food and Energy, m-o-m	Feb	0.3%	0.2%	0.3%
16:30	US	CPI, y-o-y	Feb	1.4%	0.9%	1%
16:30	US	CPI, ex-Food and Energy, y-o-y	Feb	2.2%	2.2%	2.3%
17:15	US	Industrial Production, m-o-m	Feb	0.8%	-0.3%	-0.5%
22:00	US	FOMC Rate Decision (Lower Bound)	16-Mar	0.25%	0.25%	0.25%
22:00	US	FOMC Rate Decision (Upper Bound)	16-Mar	0.5%	0.5%	0.5%
Thursday 17 Mar						
3:50	Japan	Trade Balance	Feb	-¥648.8B	¥400.2B	¥242.8B
3:50	Japan	Trade Balance Adjusted	Feb	¥73.2B	¥235B	¥166.1B
3:50	Japan	Exports, y-o-y	Feb	-12.9	-3	-4
3:50	Japan	Imports, y-o-y	Feb	-18	-15.8	-14.2
14:00	Eurozone	CPI, m-o-m	Feb	-1.4%	0.1%	0.2%
14:00	Eurozone	CPI, y-o-y	Feb F	0.3%	-0.2%	-0.2%
14:00	Eurozone	CPI Core, y-o-y	Feb F	0.8%	0.7%	0.8%
16:00	UK	Bank of England Bank Rate	17-Mar	0.5%	0.5%	0.5%
16:00	UK	BOE Asset Purchase Target	Mar	375B	375B	375B
16:30	US	Initial Jobless Claims	12-Mar	258K	268K	265K
18:00	US	JOLTS Job Openings	Jan	5281	5500	5541
	Egypt	Deposit Rate	17-Mar	9.25%	--	10.75%
	Egypt	Lending Rate	17-Mar	10.25%	--	11.75%
Friday 18 Mar						
18:00	US	U. of Mich. Sentiment	Mar P	91.7	92.2	90

* UAE time
Source: Bloomberg

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