

## The Week Ahead: Fed to remain on hold; US and UK 2Q GDP data

### ► **US: Focus will be on Fed's communication**

We expect the Fed to remain on hold at its 25-26 July meeting, in line with consensus, after it raised the FFTR by 25 bps at its previous meeting to 1.25% (upper bound). The main focus will be on the meeting statement; there will be no conference held by Fed Chair Janet Yellen or new economic forecasts. Markets will particularly watch for any guidance regarding announcements on the balance sheet reinvestment policy and any changes to the inflation outlook. We expect the FOMC to reiterate its commitment to starting balance sheet normalisation this year, though only see the Fed announcing the reduction process at the September meeting (to start in October). On inflation, we expect some tweaks to the language highlighting the recent weakness in inflation, despite the strong labour market backdrop. A more bearish comment on inflation could place further downward pressure on the USD, which came under renewed pressure last week against most major currencies after the Republican Party's healthcare reform bill faltered again. This raised further concerns over the administration's ability to push through its proposed reforms and progress pro-growth policies. Savings from healthcare reforms are central to the fiscal stimulus programme that aims to boost wider spending. Investigations into President Donald Trump's business and Russia links also added to downward pressure on the USD.

### ► **US and UK: First print of 2Q2017 GDP data**

Consensus forecasts that US GDP growth accelerated to 2.5% q-o-q SAAR in 2Q, up from 1.4% in 1Q. The pickup is expected largely on the back of stronger private consumption activity, despite some signs of softening at the end of the quarter. Indeed, private consumption is envisaged to strengthen to 2.8% q-o-q SAAR in 2Q, from 1.1% in 1Q. Non-residential investment is likely to show broad-based growth, albeit down from the strong pace of expansion in 1Q. Consumer confidence (July) and durable goods orders data (June) will also be released for the US this week. Meanwhile, UK GDP growth is expected to accelerate moderately in 2Q to 0.3% q-o-q, up from 0.2% in 1Q, though remaining weak. This quarterly rise is expected largely on the back of stronger service activity, including retail.

### ► **GCC: OPEC and non-OPEC members to meet in Russia**

Oil ministers from OPEC and non-OPEC countries involved in the deal to cut production (started on 1 January 2017) are to meet in Russia on 24 July. Kuwait, which heads the joint ministerial committee, indicated that the attendees will discuss continuing the production cuts. We expect discussion of compliance with the cuts and the increased recent production by Nigeria and Libya. Both OPEC countries are exempted from the cuts but are invited to the meeting. We do not expect any deeper cuts to be announced at this point, or lower output targets for Nigeria and Libya. Rather, we see the oil producers reiterating their continued commitment to the current agreement.

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## I. Recent Events and Data Releases

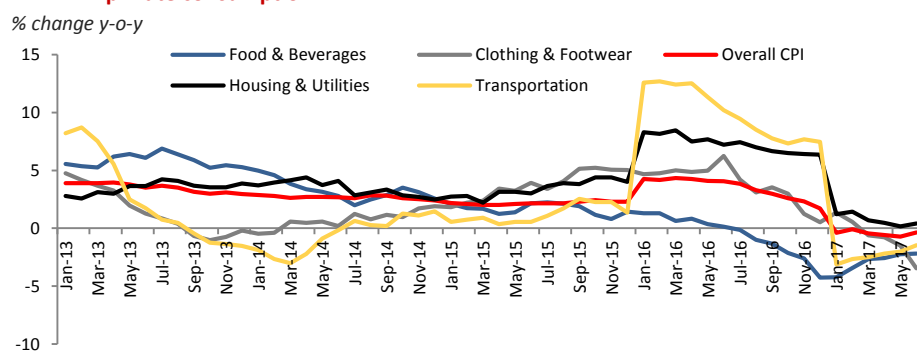
### A. MENA Economies

#### Saudi Arabia: Deflation moderates in June due to excise tax

The pace of CPI deflation slowed in June, following the introduction of the excise tax on tobacco and sugary drinks. The yearly contraction moderated to 0.4% y-o-y from 0.7% in May with a sixth consecutive month of deflation. On a monthly basis, CPI rose by 0.7% m-o-m in June after contracting 0.1% in May. The introduction of the excise tax (100% on tobacco and energy drinks, and 50% on soft drinks) was reflected in the food and beverage component of the inflation basket. As a result, the fall in food prices moderated to 2.2% y-o-y in June (from -2.3% in May), whilst tobacco prices rose by 74.4% y-o-y.

*Yearly contraction in food prices diminishes marginally in June*

**Fig. 1. Saudi Arabia: Breakdown of CPI basket continues to reflect broad-based weakness in private consumption**



Source: General Authority for Statistics

Nevertheless, the inflation data continues to reflect the weak domestic demand environment. Indeed, excluding the impact of the excise tax, we estimate that the CPI would have fallen by c.0.9% y-o-y. The yearly contraction seen in the clothing and furniture components actually increased, which we believe was partly due to the timing of Ramadan. We believe that signs of a gradual rise in private consumption activity in 2Q2017 and the weaker USD will take time to filter into inflation data (likely in 3Q). Despite this, we expect headline inflation to remain well in deflation territory. We only expect a meaningful pick-up in inflation when the government progresses with its subsidy reform programme. As noted in our earlier research, official comments indicate a possible delay to further energy price reforms, initially slated for mid-2017, to later in 2017 or early 2018.

*Deflation likely to continue until further subsidy reforms introduced*

### B. G4 Economies

#### Eurozone: ECB bearish at July meeting, including on inflation

The ECB kept its monetary policy steady at its 20 July meeting, including interest rates, the QE programme and forward guidance. However, the tone was seen as being more dovish than markets and we had expected. This is especially as the policy statement surprised by fully retaining the easing bias regarding the asset purchase programme.

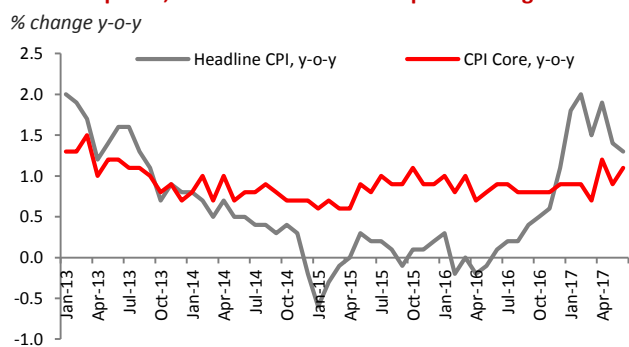
*QE tapering will only be discussed in autumn*

Overall, the meeting statement was little changed from June. Moreover, the ECB did not provide a strong signal of when it will announce changes to its QE programme, implying that its options were open. ECB President Mario Draghi indicated that a decision will only be taken in the “autumn”, which could include the 7 September meeting. On inflation, Draghi highlighted that there are “no convincing signs of a pick-up in underlying inflation” and that inflation needed to strengthen.

The communication for the July meeting makes us comfortable in our view that the pace of QE tapering in 2018 will be very gradual. We only expect the first interest rate hike at the end of 1Q2019. Despite the overall bearish tone, the EUR continued to strengthen against the USD. Accelerating Eurozone growth, diverging political risk premia and softening US consumer and inflation trends are behind the EUR’s strength in our view. Moreover, the EUR found further support after Draghi did not cite the strengthening in the EUR as a problem nor did he directly try to talk the currency down. Separately, the ECB’s Q2 Bank Lending Survey (BLS) showed rising demand for loans in all categories – consumer, corporate and mortgages – with signs of greater optimism and ongoing recovery. Banks are also expecting a further rise in credit demand in 3Q given some signs of easing of credit standards.

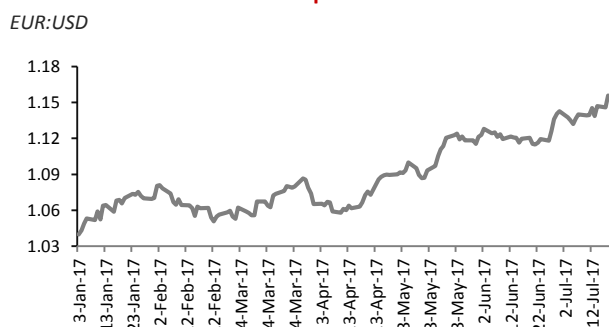
*Draghi did not cite the recent EUR strength as a problem, or try to talk it down*

**Fig. 2. Eurozone: Headline inflation moderates due to energy prices; core inflation close to April 2017 high**



Source: Eurostat

**Fig. 3. Eurozone: Strengthening in EUR likely to place additional downside pressure on inflation**



Source: Bloomberg

**Eurozone June inflation:** Headline inflation data remained weak in June, though there were some positive signs of a tentative build-up in services inflation. Headline inflation moderated to 1.3% y-o-y in June (May: 1.4%) as the low base effect from energy prices moderated. Core inflation increased to 1.1% y-o-y in June (May: 0.9%), driven by services inflation, which rose from 1.3% to 1.6%. This was led by categories such as recreation and culture, alongside restaurants and hotels, which likely found support from the start of the holiday season. However, these categories are also among the most sensitive to the output gap, which could be positive for the inflation outlook. Nevertheless, the picture is still one of a weak inflation backdrop, with the recent EUR appreciation potentially adding some downward pressure. As such, we expect the ECB to remain patient and keep monetary policy accommodative in 2H2017.

*Some pick-up in services inflation in June but inflation backdrop still weak*

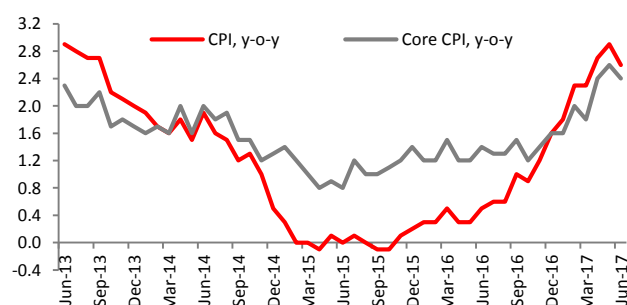
## UK: June inflation rate surprises to downside

The pace of inflation surprisingly moderated in June to 2.6% y-o-y, markedly below the May print and consensus expectations of 2.9%. Part of this deceleration was due to weaker energy-related inflation. However, core inflation also slowed to 2.4% y-o-y in June from 2.6% in May. This was partly due to volatile components within core inflation, such as clothing and recreation & culture, which could prove to be temporary. However, we see the potential for imported inflation, the key driver of inflation, to moderate somewhat from June onwards. This is after the sharp weakening in the GBP in June 2016, following the Brexit referendum, falls out of the yearly base effect. This will particularly be the case for imported inflation from September, especially if the GBP remains at its current levels. We believe that the soft domestic demand backdrop could also increasingly affect the inflation data. The June deceleration in the inflation rate provides more space for the BoE to remain on hold. We continue to see monetary policy remaining steady for the remainder of the year.

*Moderation in inflation provides more space for BoE to stay on hold*

**Fig. 4. UK: Both headline and core inflation soften surprisingly in June**

% change y-o-y



Source: Office for National Statistics

**Fig. 5. UK: Impact of weaker GBP on inflation should moderate in 2H, especially in 4Q2017**

GBP:USD



Source: Bloomberg

## Japan: BoJ remains bearish, lowering inflation forecasts

The BoJ kept its monetary policy steady at its 20 July meeting, holding its 10-year government bond yield target at 0% and the short-term interest rate at -0.1%. The bank maintained that it would keep buying government bonds to meet its annual target of JPY80 trillion of asset purchases. The overall communication continued to be bearish with Governor Haruhiko Kuroda reiterating the bank's resolve to maintain ultra-easy policy as inflation is sustainably below target. Moreover, the BoJ cut its inflation targets from 2017 to 2018, resulting in a further extension in the time required for the economy to meet its inflation target, after reducing its inflation forecasts. The 2% inflation target is now only forecast to be met in FY2019-20 (April 2019 – March 2020). We believe that the BoJ's inflation forecasts are still too optimistic. The central bank noted that the risks to inflation and the wider economy are skewed to the downside. However, the BoJ raised its GDP growth forecasts and noted that the economy is "expanding moderately". The FY2017-18 real GDP growth forecast was raised to 1.8% from 1.6% earlier.

*We still believe that BoJ's lower inflation forecasts are too optimistic*

The impact of the BoJ meeting on the JPY was limited with market expectations in line with the policy outcome. However, the JPY strengthened against the USD last week, as concerns rose over the US policy backdrop. The BoJ is expected to lag behind other major central banks in scaling back its monetary stimulus programme, and we expect the bank to maintain its current monetary policy well into 2018. The internal opposition to Kuroda's loose policy objectives is expected to moderate. The terms of two members

*Monetary policy will continue to remain loose due to weak inflation dynamics*

who have consistently challenged the consensus are ending, and we expect their replacements' views to be more in line with those of the other committee members.

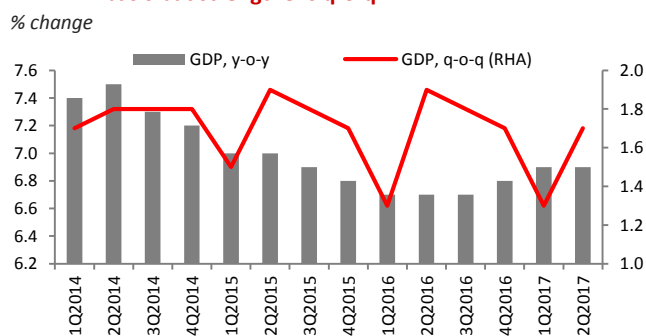
## C. Emerging Market Economies

### China: 2Q GDP growth remains steady despite monetary tightening

China's 2Q real GDP growth remained steady at 6.9% y-o-y (1Q: 6.9%), well above the government's 2017 target of 6.5%. 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. The sector breakdown showed that retail sales and industrial production growth remained solid. The strong industrial production likely reflected the pick-up in external demand, especially from the US and Eurozone (as seen in the trade data). Notable, the monthly data for June showed a marked pick-up in economic momentum at the end of 2Q. Industrial production growth accelerated to 7.6% y-o-y in June, up from 6.5% the previous month. Meanwhile, retail sales strengthened to 11% y-o-y in June from 10.7% in May.

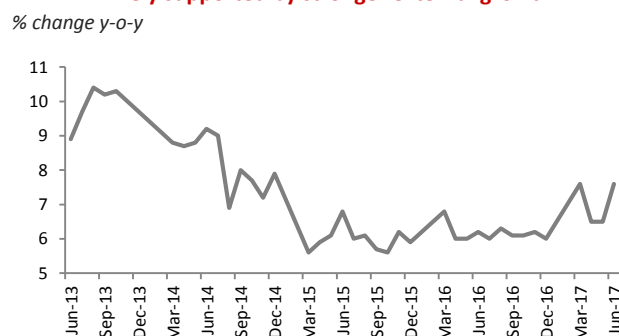
*Data points to healthy domestic and external demand backdrop*

**Fig. 6. China: Real GDP growth remains steady in 2Q on y-o-y basis but strengthens q-o-q**



Source: National Bureau of Statistics of China

**Fig. 7. China: Industrial production growth strengthens in 2Q, likely supported by stronger external growth**



Source: National Bureau of Statistics of China

The June data shows strong economic momentum heading into 3Q2017. Nevertheless, we see the potential for a moderate softening in China's GDP growth in 2H2017, especially as the fiscal support is likely to moderate from 1H. The pace of inventory build-up is also expected to moderate. GDP growth should still remain comfortably above the government's 2017 growth target of 6.5%. We see the PBoC keeping interest rates on hold in 2H2017, with signs of slower credit growth and a benign inflation backdrop.

*GDP growth could soften marginally in 2H, as fiscal support is front-loaded*

## II. Economic Calendar

Fig. 8. The week ahead

Time*	Country	Event	Period	Prior	Consensus
<b>GCC Data</b>					
	UAE	Central Bank Foreign Assets	Jun	322.41B	--
	Saudi Arabia	M2 Money Supply, y-o-y	Jun	3.4%	--
	Saudi Arabia	SAMA Net Foreign Assets, SAR	Jun	1843.9b	--
	Saudi Arabia	Non-oil Exports, y-o-y	May	1.9%	--
	Kuwait	CPI, y-o-y	Jun	2.7%	--
	Oman	Nominal GDP, YTD y-o-y	1Q	-5.1%	--
	Oman	Oil Output, y-o-y	Jun	-2.9%	--
<b>Monday, 24 Jul</b>					
4:30	Japan	Nikkei Japan PMI Mfg	Jul P	52.4	--
12:00	Eurozone	Markit Eurozone Services PMI	Jul P	55.4	55.4
12:00	Eurozone	Markit Eurozone Composite PMI	Jul P	56.3	56.2
17:00	China	Conference Board China June Leading Economic Index			
17:45	US	Markit US Services PMI	Jul P	54.2	54
17:45	US	Markit US Composite PMI	Jul P	53	--
18:00	US	Existing Home Sales	Jun	5.62M	5.57M
18:00	US	Existing Home Sales, m-o-m	Jun	1.1%	-1.4%
<b>Tuesday, 25 Jul</b>					
3:50	Japan	BOJ Minutes of June 15-16 Meeting			
12:00	Germany	IFO Business Climate	Jul	115.1	114.9
12:00	Germany	IFO Expectations	Jul	106.8	106.5
12:00	Germany	IFO Current Assessment	Jul	124.1	123.8
18:00	US	Conf. Board Consumer Confidence	Jul	118.9	116
18:00	US	Richmond Fed Manufact. Index	Jul	7	7
<b>Wednesday, 26 Jul</b>					
12:30	UK	GDP, q-o-q	2Q A	0.2%	0.3%
12:30	UK	GDP, y-o-y	2Q A	2%	1.7%
15:00	US	MBA Mortgage Applications	21-Jul	6.3%	--
18:00	US	New Home Sales	Jun	610K	615K
18:00	US	New Home Sales, m-o-m	Jun	2.9%	0.8%
22:00	US	FOMC Rate Decision (Upper Bound)	26-Jul	1.25%	1.25%
22:00	US	FOMC Rate Decision (Lower Bound)	26-Jul	1%	1%
<b>Thursday, 27 Jul</b>					
16:30	US	Durable Goods Orders, m-o-m	Jun P	-0.8%	3.5%
16:30	US	Durables, ex-transportation, m-o-m	Jun P	0.3%	0.4%
16:30	US	Cap Goods Orders, nondef ex-air, m-o-m	Jun P	0.2%	0.3%
16:30	US	Initial Jobless Claims	22-Jul	233K	240K
18:00	US	Fed nominee Quarles confirmation hearing at Senate Banking			
<b>Friday, 28 Jul</b>					
3:30	Japan	Natl CPI, y-o-y	Jun	0.4%	0.4%
3:30	Japan	Natl CPI, ex-fresh food, y-o-y	Jun	0.4%	0.4%
3:30	Japan	Natl CPI, ex-fresh food & energy, y-o-y	Jun	0.0%	-0.1%
3:50	Japan	BOJ Summary of Opinions at July 19-20 Meeting			
13:00	Eurozone	Consumer Confidence	Jul F	111.1	110.8
16:30	US	GDP Annualized, q-o-q	2Q A	1.4%	2.5%
16:30	US	Personal Consumption	2Q A	1.1%	2.8%
16:30	US	Core PCE, q-o-q	2Q A	2%	0.70%
18:00	US	U. of Mich. Sentiment	Jul F	93.1	93.1
21:20	US	Fed's Kashkari Speaks at Townhall Event			
	Bahrain	Bahrain Sovereign Debt to Be Rated by Moody's			
	Oman	Oman Sovereign Debt to be rated by Moody's			

\* UAE time

Source: Bloomberg

Fig. 9. Last week's data

Time*	Country	Event	Period	Prior	Consensus	Actual
<b>MENA Data</b>						
	UAE	M2 Money Supply, y-o-y	Jun	0.1%	--	-0.6%
	Saudi Arabia	CPI, y-o-y	Jun	-0.7%	--	-0.4%
	Egypt	Trade Balance, USD	May	-1920M	--	-2326
<b>Monday, 17 Jul</b>						
3:01	UK	Rightmove House Prices, m-o-m	Jul	-0.4%		-0.4%
6:00	China	Retail Sales, YTD y-o-y	Jun	10.3%	10.3%	10.4%
6:00	China	Fixed Assets, ex-rural, YTD y-o-y	Jun	8.6%	8.5%	8.6%
6:00	China	Industrial Production, y-o-y	Jun	6.5%	6.5%	7.6%
6:00	China	GDP, y-o-y	2Q	6.9%	6.8%	6.9%
6:00	China	GDP SA, q-o-q	2Q	1.3%	1.7%	1.7%
13:00	Eurozone	CPI, y-o-y	Jun F	1.4%	1.3%	1.3%
13:00	Eurozone	CPI Core, y-o-y	Jun F	0.9%	1.1%	1.1%
<b>Tuesday, 18 Jul</b>						
12:30	UK	CPI, y-o-y	Jun	2.9%	2.9%	2.6%
12:30	UK	CPI Core, y-o-y	Jun	2.6%	2.6%	2.4%
12:30	UK	PPI Input NSA, y-o-y	Jun	12.1%	9.4%	9.9%
<b>Wednesday, 19 Jul</b>						
0:00	US	Net Long-term TIC Flows	May	\$9.7B	--	\$91.9B
15:00	US	MBA Mortgage Applications	14-Jul	-7.4%	--	6.3%
16:30	US	Housing Starts	Jun	1122K	1160K	1215K
16:30	US	Building Permits	Jun	1168K	1201K	1254K
<b>Thursday, 20 Jul</b>						
	Japan	BOJ Policy Balance Rate	20-Jul	-0.1%	-0.1%	-0.1%
	Japan	BOJ 10-Yr Yield Target	20-Jul	0%	0%	0%
3:50	Japan	Trade Balance Adjusted	Jun	¥122.7B	¥127.5B	¥81.4B
3:50	Japan	Exports, y-o-y	Jun	14.9%	9.5%	9.7%
3:50	Japan	Imports, y-o-y	Jun	17.8%	14.4%	15.4%
8:30	Japan	All Industry Activity Index, m-o-m	May	2.3%	-0.8%	-0.9%
12:30	UK	Retail Sales, ex-auto fuel, m-o-m	Jun	-1.5%	0.5%	0.9%
12:30	UK	Retail Sales, ex-auto fuel, y-o-y	Jun	0.6%	2.5%	3%
15:45	Eurozone	ECB Main Refinancing Rate	20-Jul	0%	0%	0%
15:45	Eurozone	ECB Marginal Lending Facility	20-Jul	0.25%	0.25%	0.25%
15:45	Eurozone	ECB Deposit Facility Rate	20-Jul	-0.4%	-0.4%	-0.4%
15:45	Eurozone	ECB Asset Purchase Target	Jul	60B	60B	60B
16:30	US	Initial Jobless Claims	15-Jul	248K	245K	233K

\* UAE time

Source: Bloomberg

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