The Week Ahead: UK to trigger Article 50, US personal spending and PCE data in focus

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UK: Start of Brexit process with the triggering of Article 50

The key event this week will be the UK government's formal application to start the Brexit process, by triggering Article 50 of the Lisbon Treaty (29 March). Consequently, as per the treaty, the UK will exit the EU in March 2019. In our view, FX and rates markets have already priced in this event since Prime Minister Theresa May's speech in January. Nevertheless, market participants will still focus on a white paper likely to be released alongside the application which will likely spell out the UK's proposals for a new EU-UK trade deal, compensation payments and its position on the rights of EU migrants in the UK. Brexit talks prompted by the triggering of Article 50 will run on a tight timetable, with formal exit negotiations and contours of a future EU-UK trade deal required to be finalised and ratified by national parliaments within two years. The EU's position on Brexit will be clear only in late April-early May, post French elections, when EU finance ministers outline their positions on the issue. In the interim 5-7 weeks, markets will continue to digest comments from EU politicians on their vision of a post-Brexit EU-UK trade deal.

US: February personal spending and PCE data

Consensus expects that personal spending expanded by 0.2% m-o-m in February, maintaining a steady pace since January. Core PCE is also forecast to remain steady at 1.7% y-o-y in February, after rising by 0.2% m-o-m. The other key data release will be the final print of 4Q2016 GDP (30 March), which will likely be revised up to 2% q-o-q SAAR (from 1.9%) on higher inventories. Additionally, markets will look to digest the impact of the Republicans failing to repeal the Affordable Care Act (ACA, Obamacare) at the end of last week, and the implications for wider economic policy. The focus of the new administration will shift to tax reform, a key component of reflation expectations. However, the failure to repeal the ACA will not provide the fiscal savings expected (over USD330 billion over a decade) to partially support tax cuts and has already raised questions over the divisions within the Republican Party. At the very least, it could result in more time being required to gain consensus for tax reforms. This includes for controversial aspects of the House Republicans' tax plan, specifically the border adjustment tax.

Egypt: CBE expected to remain on hold, despite inflation surge

We and consensus expect the CBE to keep benchmark rates on hold despite the ongoing rise in consumer inflation. We believe that the CBE will look to keep interest rates steady at this point, so as not to add an additional headwind to GDP growth with the rise in inflation already suppressing domestic demand. The CBE continues to reiterate that the strengthening in inflation is transitory and there are signs that inflation is likely close to reaching its peak, as the monthly rise in the CPI softened in February. We believe that the central bank will also look to maintain its policy space to raise rates later in the year if required, especially with further fiscal reforms likely in 2017, including a reduction in fuel subsidies and an increase in the VAT rate.

I. Recent Events and Data Releases

A. MENA Economies

Saudi Arabia: Fitch downgrades rating by one notch; outlook stable

Downgrade reflects fiscal and CA deficits and doubts regarding reform implementation

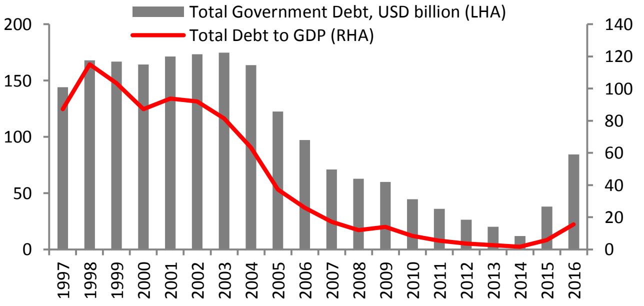
Fitch Ratings downgraded Saudi Arabia's Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) to A+ from AA-. The outlook for these categories is “Stable”. The downgrade reflects “the continued deterioration of public and external balance sheets, the significantly wider-than-expected fiscal deficit in 2016 and continued doubts about the extent to which the government's ambitious reform programme can be implemented”. Fitch estimates that Saudi Arabia’s fiscal deficit will narrow to 9.2% of GDP in 2017, smaller than our estimate of 10.9% of GDP. Fitch noted the strong commitment of the leadership to the reform programme, though the scale of the reform agenda risks overwhelming the government's administrative capacity. Following the downgrade, the government highlighted Saudi Arabia’s strong fundamentals.

Downgrade not expected to impact government’s ability to tap international debt market

We do not expect the downgrade to materially impact Saudi Arabia’s ability to tap the international debt capital markets or the pricing level. Indeed, Fitch’s rating for Saudi Arabia is now in line with Moody’s, which are both two notches above S&P’s. Foreign borrowing will remain critical to limiting drawdowns in FX reserves and maintaining comfortable domestic liquidity conditions at a time of ongoing large fiscal deficits. A key factor will be the pace of fiscal reforms and measures to diversify the economy. Saudi Arabia is due to implement a number of fiscal reforms in mid-2017, including a levy on expatriates and an excise on harmful goods (such as energy and soft drinks). Moreover, further reductions in electricity subsidies are expected once a safety-net programme is in place to protect the country’s most vulnerable citizens. We have highlighted that Saudi Arabia is at the beginning of its fiscal reforms programme, which will become progressively difficult for the economy to absorb, especially given the weak economic backdrop.

Fig. 1. Saudi Arabia: Government debt remains low and supportive of further borrowing, despite the rise

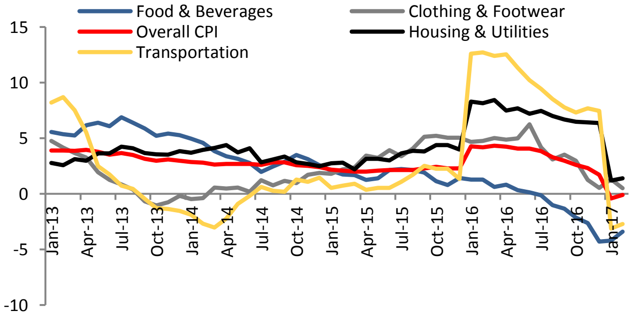
USD billion (LHA); % of GDP (RHA)



Source: SAMA, Budget Statements, ADCB estimates

Fig. 2. Saudi Arabia: Food and transportation sectors seeing negative inflation

% change y-o-y



Source: General Authority for Statistics

Saudi Arabia expected to meet minimum requirements for EM classification

Stock market developments: Saudi Arabia's stock exchange has announced that it will extend the period for settling trades to within two days of trade (T+2) and allow short-selling from 23 April. With the move to T+2 settlement, Saudi Arabia is expected to meet the minimum requirements for EM classification. This should pave the way for MSCI to add Saudi Arabia to its watchlist for possible EM inclusion in June.

Saudi Arabia: Softer pace of yearly deflation in February

Food prices rose m-o-m in February but remain down y-o-y

Saudi Arabia saw a second month of deflation in February, though there was a moderation in the pace. CPI contracted by -0.1% y-o-y in February from -0.4% in January. The sharp fall in inflation in early 2017 was largely the result of a yearly fall in food prices, fiscal reforms dropping out of the annual data series, and a weak demand backdrop. Food prices contracted by 3.4% y-o-y. However, on a m-o-m basis, food prices rose in February by 0.5%, resulting in headline inflation seeing its first positive expansion in five months. There were also signs of a monthly rise in non-food inflation, which we believe was due largely to a weakening in the USD from end-2016.

Private consumption to remain weak despite softer inflation in 1H2017

We expect to see y-o-y inflation gradually returning to weak positive growth in the next few months, in part due to higher imported food prices. We then expect an acceleration in 2H on the back of further fiscal reforms. We only expect a very moderate pick-up in consumer spending at best in 1H2017, despite the weaker inflation backdrop. Further expectations of fiscal reforms and a soft jobs market should keep household spending growth muted. The deflation in transportation prices (Fig. 2) is linked to the purchase of vehicles, reflecting particularly weak demand for high-ticket discretionary consumer goods.

B. G4 Economies

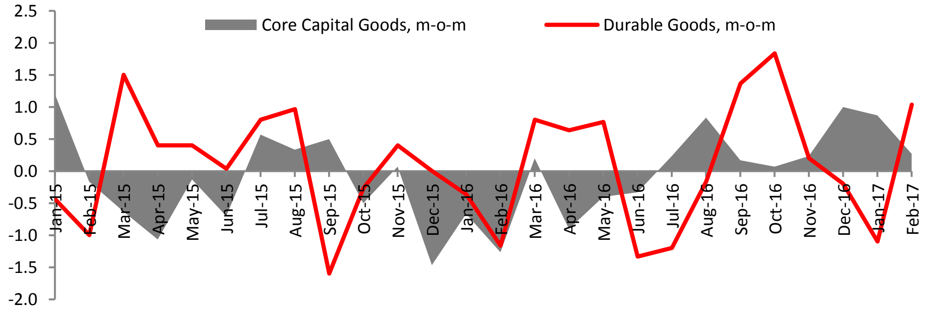
US: Durable goods orders mixed for February, with core disappointing

Core capital goods orders fall in February

Durable goods orders data for February was mixed. On the positive side, headline orders rose 1.7% m-o-m in February, beating consensus expectations of a 1.4% rise. The reading for January was revised up to a robust 2.3% m-o-m, from 2% initially. The rise in headline orders in 2M2017 was largely driven by commercial aircrafts and related parts. However, core capital goods orders contracted by 0.1% m-o-m in February, substantially below market expectations of a 0.5% m-o-m increase. March data will be critical to gauge if the rise in optimism from end-2016 is translating into a sustained rise in manufacturing and investment activity. Core capital goods orders were up 9.1% annualised in the three months ending in February. There has been a build-up in momentum in core capital goods orders from 4Q2016, likely supported by a boost in oil production and improved optimism following the elections.

Fig. 3. US: Softening momentum in core capital goods, after unexpected fall of 0.1% m-o-m in February

% change m-o-m, 3M moving average



Source: US Census Bureau

UK: Inflation picks up strongly in February though BoE expected to remain on hold in 2017

Food and transport prices jumped up sharply, explaining bulk of inflation increase

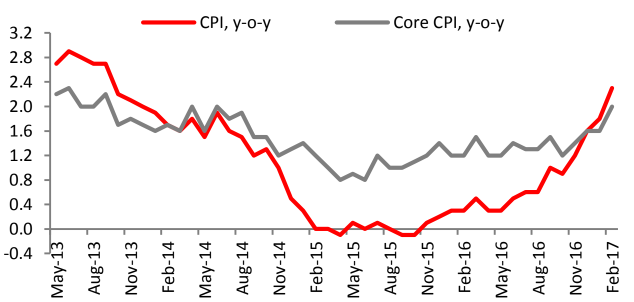
UK inflation accelerated faster than market expectations in February to 2.3% y-o-y (consensus: 2.1%; January: 1.8%), mainly driven by higher transport costs and food prices. Jointly, these two factors added 0.21 pp to the 0.5 pp increase in the y-o-y inflation rate since January. This is in line with the BoE's expectations in its February inflation report where it had highlighted a near-term increase in food and energy prices due to a weaker GBP and relatively higher global oil prices (vis-à-vis February 2016). However, the surprising aspect of the inflation release was an acceleration in core inflation to 2% y-o-y (consensus: 1.7%, January: 1.6%), led by a jump in the prices of recreational activities and household goods. However, we consider this acceleration to be a one-off, and expect any further upside pressure on core inflation to be muted considering the softening in wage growth in recent months.

We still expect BoE to keep rates on hold in 2017

The recent inflation numbers are likely to harden the BoE's monetary policy guidance, with the central bank removing any references to the possibility of additional monetary easing in the near-term. Nevertheless, we still believe that the BoE is likely to keep its benchmark policy rate and quantum of monthly QE purchases intact this year, mainly for two reasons. First, the bank's threshold for an inflation overshoot in 2017 driven by the Brexit vote in its latest inflation report (2.7%) still remains higher than the current headline number. Indeed, we expect some easing in headline CPI in 2Q2017 (but still above 2%) as increases in fuel and vegetable prices drop off. Second, we expect core inflation pressures to remain limited. In our view, the upside risks to core prices from a weaker GBP are likely to be offset by softening consumer spending, as real wage growth slows. Retail sales rebounded by 1.4% m-o-m in February (consensus: 0.4%; January: -0.5%), though this jump was likely a payback for three consecutive declines in retail spending. The momentum in retail sales remains weak, with 3M/3M change in volumes falling by -1.4% (0% in January).

Fig. 4. UK: Inflation accelerated in February; we believe that the pick-up in core prices was a one-off

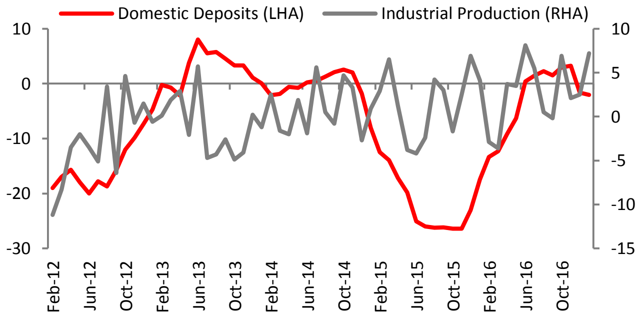
% change y-o-y



Source: Office for National Statistics

Fig. 5. Greece: Deposit growth showing signs of bailout-related uncertainty; economic activity may suffer too

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



Source: Eurostat

Greece: EU summit proves inconclusive on bailout payments

Uncertainty around IMF's participation in bailout will weigh on Greek economy

Eurozone finance ministers failed to reach an agreement over the next tranche of payments to the Greek bailout programme at the EU summit last week. Specifically, dates could not be finalised for two key preconditions of the deal that would bring the IMF on board as a contributor to the Greek bailout package – i) a review of austerity measures undertaken by the Greek government; and ii) the easing of fiscal deficit targets beyond

2018. Participation by the IMF in the bailout package has been set as a necessary condition by Germany for future payments to Greece. We still see ample time for a bailout to be agreed before Greece's debts become due in July, though the ongoing uncertainty about the IMF's participation in the programme is likely to weigh on Greece's economic growth in 1H2017.

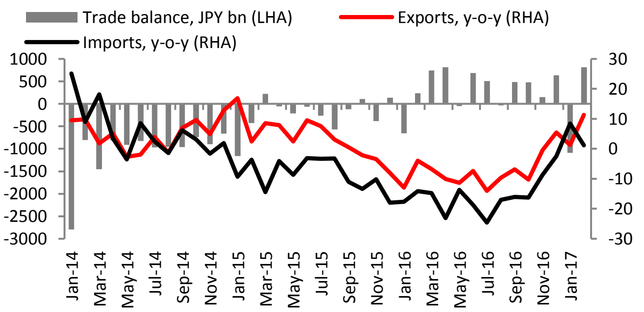
Japan: Exports surge in February with broad recovery in global demand

Export growth partly helped by positive base effects from Chinese New Year

Exports in February grew at their fastest pace since January 2015, rising by 11.3% y-o-y (consensus: 10.1%; January: 1.3%). Part of this rise was due to a rebound in exports to China (25.1% after 3.1%) driven by favourable Lunar New Year base effects, in line with our expectations. Even so, there was a broad recovery in exports across the world, with volumes to the US (2.2% after -5.1% in January) and the EU (4.9% after -2.7%) also rising, driven by improved orders for cars, auto parts and heavy engineering goods. Another encouraging aspect was the pick-up in exports to Asia-Pacific (16% after 4.2%), particularly to South Korea and ASEAN countries. This bodes well for future exports as these destinations, as intermediate producers, are closely linked to Chinese and US manufacturing supply chains.

Fig. 6. Japan: Relatively weak and less volatile JPY has supported exports since 4Q2016

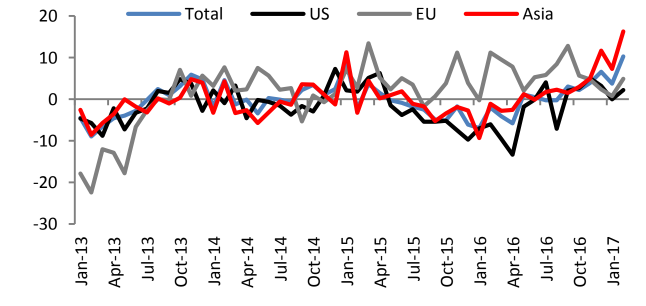
JPY billion (LHA), % change y-o-y (RHA)



Source: Ministry of Finance, Japan

Fig. 7. Japan: Exports increased across regions in February and were particularly strong in Asia

% change y-o-y



Source: Economic and Social Research Institute, Japan

We expect boost from net exports to GDP to strengthen in 2017

We expect exports to add 0.5-0.7 pp to headline GDP growth in Japan in 2017, up from 0.3 pp in 2016. We see three key factors underpinning exports this year: i) the relatively weaker JPY; ii) low FX volatility; and iii) a recovery in global demand. We expect the USD:JPY to be range-bound between 110-115 this year with a weakening bias, influenced primarily by the monetary policy divergence between the Fed (tightening) and the BoJ (accommodative). Furthermore, the prospect of political risks easing in the Eurozone following the Dutch elections and the declining likelihood of a Marine Le Pen presidency in France should also limit the volatility of the JPY (safe haven status), easing business risks for exporters. Finally, we also expect solid demand for infrastructure goods from China as it maintains its strong pace of capital expenditure. The only caveat to our constructive outlook on Japanese exports in the near term is the possibility of steep import tariffs being imposed by the US on Japanese exports. However, US President Donald Trump's rhetoric seems to have softened regarding Japan since his meeting with Prime Minister Shinzo Abe in February.

C. Emerging Market Economies

India: Goods and Services Tax (GST) on track for timely roll-out

GST implementation bills likely to be passed by parliament this week

India's Union Cabinet last week passed the bills required for the implementation of a Goods and Services Tax (GST), paving the way for their approval by parliament this week. We expect parliament to approve the bill given the majority enjoyed by Prime Minister Modi's coalition in the Lower House and the bipartisan support for such reform. This will give the government and firms around three months to set up the infrastructure needed for tax collection before the intended roll-out of the tax in July 2017.

Long-term GST impact to be positive though we expect near-term upside risks to inflation and fiscal accounts

We expect the GST to significantly impact inflation in India and the government's fiscal accounts in FY18 (April 2017-March 2018). First, the GST is likely to tax consumption of most services at 18% (14% under the current regime), which should feed into core inflation measures. This is likely to add 0.7-0.8 pp to headline inflation, pushing it further away from the RBI's medium-term inflation target of 4%. Inflation currently stands at 3.7% y-o-y (February data). Consequently, we do not expect any monetary easing by the central bank in 2017, even though underlying core inflation dynamics (ex-GST effects) remain benign. Second, we estimate INR220 billion (0.12% of GDP) in additional payments by the central government to states to compensate them for the revenue foregone due to the implementation of the GST. In our view, the intended increase in the number of tax-paying firms due to the simplicity of the GST regime will materialise only over the next two to three years. Until then, the states will need to be compensated for revenues lost due to lower tax rates. However, we continue to see the GST reform as a long-term positive. The convergence of multiple state and central levies into four basic tax rates will improve compliance. Furthermore, a single tax rate across the country for a particular product will discourage tax arbitrage, encouraging efficient allocation of resources and economies of scale. We forecast the cumulative long-run positive impact of GST on GDP growth at 0.8-1 pp, which should be visible from 2019 onwards. We see the positive support to GDP growth stemming from i) likely higher government spending supported by increased GST related revenues; and ii) increased corporate productivity as less time is spent on tax compliance.

II. Economic Calendar

Fig. 8. The week ahead

Time	Country	Event	Period	Prior	Consensus
MENA Data					
	UAE	CPI, y-o-y	Feb	2.3%	--
	Saudi Arabia	GDP Constant Prices, q-o-q	4Q	0%	--
	Saudi Arabia	SAMA Net Foreign Assets SAR	Feb	1937.5B	--
	Qatar	GDP Constant Prices, y-o-y	4Q	3.7%	--
	Kuwait	CPI, y-o-y	Feb	3.3%	--
	Oman	CPI, y-o-y	Feb	1.8%	--
	Bahrain	M2 Money Supply, y-o-y	Jan	3.2%	--
	Bahrain	GDP Constant Prices, y-o-y	4Q	3.9%	--
Monday, 27 Mar					
3:50	Japan	BOJ Summary of Opinions at March 15-16 Meeting			
12:00	Eurozone	M3 Money Supply, y-o-y	Feb	4.9%	4.9%
12:00	Germany	IFO Business Climate	Mar	111	111.1
21:15	US	Fed's Evans Speaks on Economy and Policy in Madrid			
Tuesday, 28 Mar					
2:30	US	Fed's Kaplan Speaks in College Station, Texas			
18:00	US	Conf. Board Consumer Confidence	Mar	114.8	114
20:45	US	Fed's George Speaks in Midwest City, OK			
21:00	US	Fed's Kaplan Speaks in Dallas			
Wednesday, 29 Mar					
17:20	US	Fed's Evans Speaks on Economy and Policy in Frankfurt			
19:30	US	Fed's Rosengren Speaks at Economic Club of Boston			
21:15	US	Fed's Williams Speaks to Forecaster's Club of New York			
Thursday, 30 Mar					
	Egypt	GDP Constant, q-o-q	4Q	3.9%	--
	Egypt	Deposit Rate	30-Mar	14.75%	--
	Egypt	Lending Rate	30-Mar	15.75%	--
16:30	US	GDP Annualized, q-o-q SAAR	4Q T	1.9%	2%
16:30	US	Personal Consumption, q-o-q SAAR	4Q T	3%	3%
16:30	US	GDP Price Index, q-o-q SAAR	4Q T	2%	2%
16:30	US	Core PCE, q-o-q SAAR	4Q T	1.2%	1.2%
16:30	US	Initial Jobless Claims	25-Mar	261K	--
17:45	US	Fed's Mester Speaks in Chicago on Payment System Improvement			
19:00	US	Dallas Fed's Kaplan Speaks in Washington			
19:15	US	Fed's Williams Speaks at Learning Community Event in New York			
Friday, 31 Mar					
3:30	Japan	Jobless Rate	Feb	3%	3%
3:30	Japan	CPI, y-o-y	Feb	0.4%	0.3%
3:30	Japan	CPI, ex-Fresh Food & Energy, y-o-y	Feb	0.2%	0.1%
3:50	Japan	Industrial Production, y-o-y	Feb P	3.7%	3.9%
11:00	Turkey	GDP, y-o-y	4Q		
12:30	UK	GDP, q-o-q	4Q F	0.7%	0.7%
13:00	Eurozone	CPI Estimate, y-o-y	Mar	2%	1.8%
13:00	Eurozone	CPI Core, y-o-y	Mar A	0.9%	0.8%
16:30	US	Personal Income, m-o-m	Feb	0.4%	0.4%
16:30	US	Personal Spending, m-o-m	Feb	0.2%	0.2%
16:30	US	PCE Deflator, y-o-y	Feb	1.9%	2.1%
16:30	US	PCE Core, y-o-y	Feb	1.7%	1.7%
18:00	US	Fed's Kashkari Answers Questions at Banking Conference			
18:00	US	U. of Mich. Sentiment	Mar F	97.6	97.6

* UAE time

Source: Bloomberg

Fig. 9. Last week's data

Time	Country	Event	Period	Prior	Consensus	Actual
MENA Data						
	UAE	M2 Money Supply, y-o-y	Feb	0.4%	--	1.1%
	UAE	Central Bank Foreign Assets	Feb	290.8B	--	307.9B
	Saudi Arabia	CPI, y-o-y	Feb	-0.4%	--	-0.1%
	Bahrain	CPI, y-o-y	Feb	0.8%	--	0.4%
	India	BoP Current Account Balance	4Q	-$3.4B	-$12B	-$7.9B
	Egypt	Trade Balance	Jan	-$2379M	--	-$2334M
Tuesday, 21 Mar						
13:30	UK	CPIH, y-o-y	Feb	1.9%	2.2%	2.3%
13:30	UK	CPI, m-o-m	Feb	-0.5%	0.5%	0.7%
13:30	UK	CPI, y-o-y	Feb	1.8%	2.1%	2.3%
13:30	UK	CPI Core, y-o-y	Feb	1.6%	1.7%	2%
13:30	UK	PPI Input, y-o-y	Feb	20.1%	20.1%	19.5%
13:30	UK	PPI Output, y-o-y	Feb	3.6%	3.7%	3.7%
Wednesday, 22 Mar						
3:50	Japan	BOJ Minutes of Jan. 30-31 Meeting				
3:50	Japan	Trade Balance Adjusted	Feb	¥204B	¥550.8B	¥680.3B
3:50	Japan	Exports, y-o-y	Feb	1.3%	10.1%	11.3%
8:30	Japan	All Industry Activity Index, m-o-m	Jan	-0.2%	0%	0.1%
18:00	US	Existing Home Sales	Feb	5.69M	5.55M	5.48M
Thursday, 23 Mar						
13:30	UK	Retail Sales, ex-Auto Fuel, m-o-m	Feb	-0.3%	0.3%	1.3%
13:30	UK	Retail Sales, ex-Auto Fuel, y-o-y	Feb	2.1%	3.2%	4.1%
16:30	US	Initial Jobless Claims	18-Mar	246K	240K	261K
18:00	US	New Home Sales	Feb	558K	565K	592K
19:00	Eurozone	Consumer Confidence	Mar A	-6.2	-5.9	-5
Friday, 24 Mar						
4:30	Japan	Nikkei Japan PMI Manufacturing	Mar P	53.3	--	52.6
13:00	Eurozone	Markit Eurozone Manufacturing PMI	Mar P	55.4	55.3	56.2
13:00	Eurozone	Markit Eurozone Services PMI	Mar P	55.5	55.3	56.5
16:30	US	Durable Goods Orders, m-o-m	Feb P	2.3%	1.4%	1.7%
16:30	US	Core Capital Goods, m-o-m	Feb P	0.1%	0.5%	-0.1%

* UAE time
Source: Bloomberg

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