The Week Ahead: President Trump's address to Congress and GDP data in focus

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US: President Trump's address to Congress the key event

The upcoming week will be busy for US data and events, with President Donald Trump's address to a joint session of Congress taking centre stage (28 February). Markets will focus on the economic agenda, especially specific details of upcoming fiscal policy. Expectations of fiscal loosening (lowering taxes, increasing investment and support to businesses) have boosted sentiment and driven US stock markets up since the presidential election, despite limited particulars so far. Clues of measures to reduce the fiscal deficit, or offset any easing, will also be closely watched. Meanwhile, a number of FOMC members have speaking engagements this week, including Fed Chair Janet Yellen (3 March). We expect the overall message to continue to highlight that an interest rate rise in the upcoming period will likely be appropriate. However, we do not expect any explicit mention of a March rate hike. We continue to see June as the most likely timing of the next hike.

Global: Important US and Eurozone data week

In the US, key data releases will include 4Q2016 GDP, PCE inflation, ISM manufacturing, durable goods orders and consumer confidence. Consensus expects that 4Q GDP growth (second print) will be revised up to 2.1% SAAR from 1.9% in the first reading. The increase is expected on the back of upward revisions to non-resident construction, though net trade could be a larger drag with stronger imports. Also important will be personal spending and PCE deflator data for January (1 March). Core PCE is expected to remain steady at 1.7% y-o-y in January, despite the monthly rise accelerating to 0.3% m-o-m (December: 0.1% m-o-m). Meanwhile, February inflation data is to be released for the Eurozone. Higher energy prices are likely to have pushed up headline CPI to 1.9% y-o-y (January: 1.8%), though core inflation is likely to remain sticky and muted at 0.9% y-o-y, reflecting the drag from excess capacity and weak wage growth.

EM: India 4Q2016 GDP data and possible Oman bond issuance

India will publish 4Q2016 GDP data on 28 February, which will reveal the impact of demonetisation on the economy. We expect GDP growth to decelerate sharply to 5.8% y-o-y (consensus: 6.1%; 3Q: 7.3%), with weaker y-o-y domestic consumption and capex growth. That said, we see a significant margin of error around our and consensus estimates due to data methodology. Official GDP data extrapolates informal sector economic activity based on trends in the formal sector, which may understate the true impact of the liquidity squeeze in rural areas and the SME sector. Meanwhile, closer to home, Oman could issue a multi-tranche USD denominated sovereign bond. Oman is holding investor meetings (24-28 February) in Asia, the UAE and the UK. Foreign borrowing is vital in funding Oman's fiscal deficit and reducing liquidity tightening pressures in the domestic banking sector. Meanwhile, Oman raised corporate taxation rates to 15% last week (page 2) in a move to strengthen fiscal policy.

I. Recent Events and Data Releases

A. MENA Economies

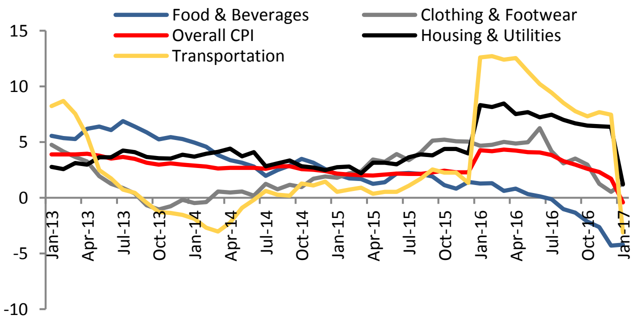
Saudi Arabia: Deflation in January as CPI falls by 0.4% y-o-y

Removal of fuel and utility price hikes from annual data and fall in food prices behind lower CPI

Consumer price index contracted by 0.4% y-o-y in January, driven by a number of factors. Firstly, the price rises in fuel and utilities, implemented at end-2015 and in January 2016, fell out of the annual data. This resulted in the key drivers of inflation in 2016 weakening sharply in annual terms in January. Indeed, housing and utility price rises slowed to 1.2% y-o-y (December: 6.4%), while transportation prices contracted by 3.1% y-o-y (December: +7.5%). However, other factors also contributed, which we believe is reflected in the 0.2% m-o-m fall in consumer prices. These include the strong USD and weak domestic demand backdrop. The strong USD continues to be reflected in the prices of imported goods, including food (January: -4.2% y-o-y and -0.6% m-o-m). There is also price discounting by retailers, including for foodstuffs, given the weak domestic demand backdrop.

Fig. 1. Saudi Arabia: CPI contracted by 0.4% y-o-y on lower food prices and removal of 2016 utility price increases from annual data

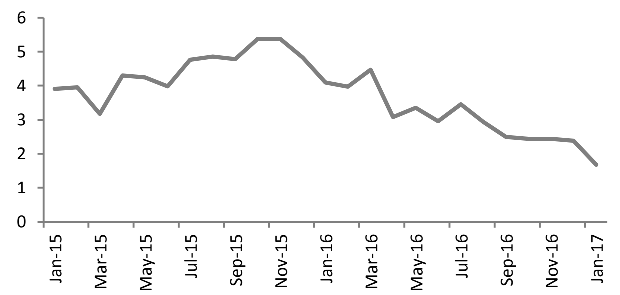
% change y-o-y



Source: General Authority for Statistics

Fig. 2. Saudi Arabia: Markedly lower housing and utility inflation mostly led by utility prices stabilising on y-o-y basis, though rental inflation is also softening

% change y-o-y, rental price



Source: General Authority for Statistics

Inflation expected to pick up in 2H2017 on new fiscal reforms

Lower inflation in 1H2017 could provide weak support to private consumption versus 2016 levels. Nevertheless, we expect any recovery in household spending to be modest given the soft employment and wage backdrop (public and private). Further fiscal reforms, possibly in 2H2017, including a levy on soft drinks and tobacco and further fuel prices increases (retail), could also result in a pick-up in inflation. A possible levelling off in the USD in 2017 and higher global inflation on higher energy prices are also likely to support a pick-up in inflation in 2H2017 given the time lag in global inflation filtering into Saudi prices.

Oman: Increases corporate tax rate to 15%

Corporate tax exemptions for small firms and certain sectors have been removed

Oman has raised its corporate income tax to 15% from 12%. Moreover, previous exemptions for small firms and certain sectors have been removed. Companies with revenues of under OMR300,000 (previously exempt from corporate taxation) will have to pay a flat 3% tax from the beginning of 2017. Also the mining, education (private) and hotel sectors will now have to pay tax under the new regime. Oman is the only GCC country to undertake tax reforms at this point, with most other countries focusing on lowering subsidies and increasing government fees. Please see our recent report, **GCC: Higher oil prices to provide some relief, though growth recovery to be weak**, published on 16 February 2017. However, with the small increase in the tax rate and the low growth environment, we expect the support for government revenue to be limited – likely less than 1% of GDP in 2017. We have already included the increase in corporate tax in our fiscal estimates. We see Oman's fiscal deficit narrowing to 9.7% of GDP in 2017, largely on higher hydrocarbon revenues. Nevertheless, reforms to broaden government revenue are positive, which will be further supported by the GCC-wide introduction of VAT in 2018.

Kuwait: Draft bill looks to rein in fiscal reforms

Draft bill could find strong support in National Assembly

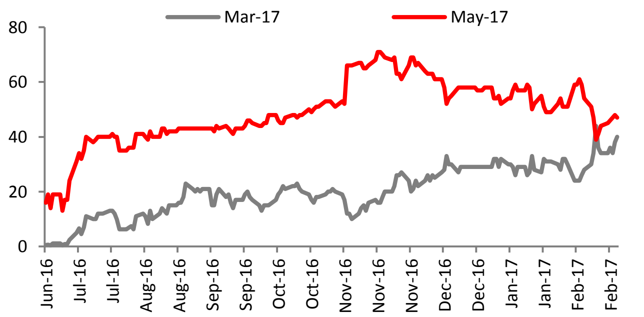
The Kuwaiti parliament's financial and economic affairs committee has approved a draft bill that revokes recent decisions to increase administered prices, according to the state news agency KUNA. The draft bill looks to remove the rises in fuel prices introduced in September 2016 as well as the increase in utility prices scheduled for 2017. Kuwait raised fuel prices in September by 40-73%, depending on the grade of fuel. However, this was already diluted by the move in October to partly compensate nationals by providing a certain amount of free petrol. The draft bill will be put before the National Assembly and could find strong support given the dominance of opposition members, who in many cases campaigned against these fiscal reforms. We believe that Kuwait will find it difficult to progress with fiscal reforms with the current National Assembly. Nevertheless, the fiscal deficit should narrow along with the higher oil prices.

B. G4 Economies

US: FOMC minutes more hawkish, but still no urgency to move

Fig. 3. US: Markets see 40% probability of 25 bps rate hike in March

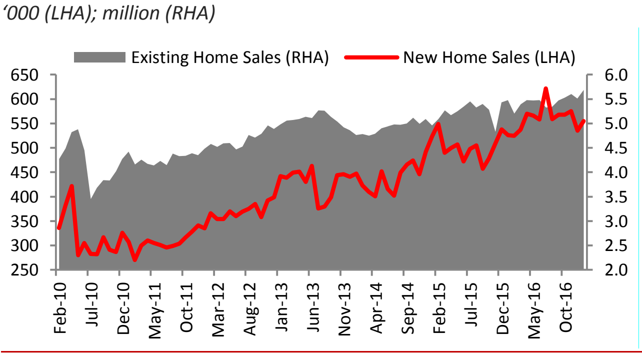
Market expectations of 25 bps rise in FFTR



Source: Bloomberg

Fig. 4. US: Existing home sales robust in January, despite the December rate hike

'000 (LHA); million (RHA)



Source: National Association of Realtors

No urgency to move imminently (March), though likely relatively soon

The minutes of the FOMC (ending 1 February) were more hawkish than the post-meeting statement (broadly neutral) and in line with recent comments by FOMC members. The minutes indicated that a rise in interest rates would be appropriate if inflation and employment data printed in line with expectations or stronger. The minutes suggested that FOMC members preferred to await details of fiscal policy before making any changes to their projections. Moreover, only a few members thought that the unemployment rate was falling to a level that would markedly increase inflationary pressure at this point. These factors imply that the Fed is content with its policy projections and is not looking to increase rates imminently. We believe that if economic data is particularly strong (especially inflation and employment) the probability of a May rate hike increases; we still believe that March is too soon. Our core scenario remains June for the timing of the next rate hike. The minutes also indicated that discussions over the Fed's balance sheet policy are in the very early stages. The Fed should start discussing economic conditions that could warrant changes in the existing balance sheet policy at upcoming meetings.

Changes to Fed communication announced – blackout period extended

Two upcoming changes in Fed communications were also highlighted. Firstly, the Fed will introduce a fan chart from September to indicate its degree of confidence in its economic forecasts. An example of the chart will be published ahead of the FOMC's March (14-15) meeting. Secondly, the blackout period will be extended to the second Saturday before the meeting (previously the prior Tuesday). Thus, Fed Chair Janet Yellen's speech on 3 March will be the last occasion she will be able to guide markets ahead of the next FOMC meeting.

Existing home sales: in January were very strong, rising 3.3% m-o-m (consensus: 1.1%) to 5.69mn SAAR. This was the strongest pace of increase since February 2007 and tentatively indicates that the December interest rate hike is not dampening housing demand.

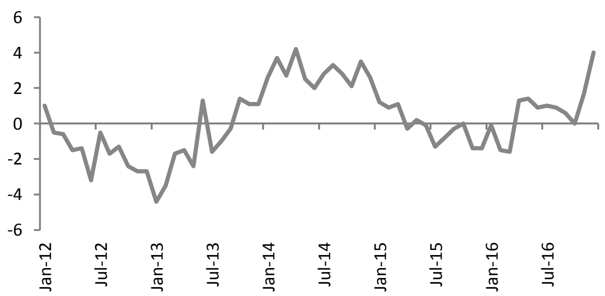
UK: 4Q GDP growth revised upwards on stronger manufacturing output

UK GDP revised up in 4Q following stronger-than-expected manufacturing output

The UK's 4Q GDP growth was revised up to 0.7% q-o-q (consensus: 0.6%; 3Q: 0.6%), following stronger-than-expected output from manufacturing industries (Fig. 5). On a demand basis, exports remained the engine of GDP growth, adding 1.3pp to headline GDP (-1.2pp in 3Q) as a weaker sterling aided shipments of cars and aircrafts in particular (Fig. 6). That said, much of the robustness in exports was offset by a sharp weakening in business investment, which subtracted -1.1 pp from the headline figure (1.2pp in 3Q). Household consumption remained a stable source of growth, adding 0.4pp, albeit softening somewhat versus previous quarters (0.5pp in 3Q). Annual growth in 2016 came in at 1.8%, significantly below the BoE's estimate of 2.2%.

Fig. 5. UK: Manufacturing output in December was stronger than initial estimate; 4Q GDP was thus revised up

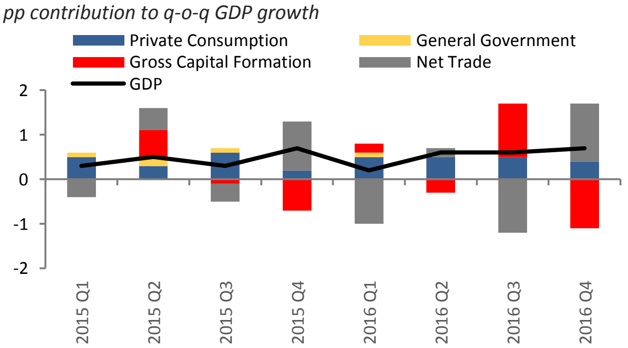
% change y-o-y



Source: Office for National Statistics, UK

Fig. 6. UK: Net trade was the driver of 4Q growth; business investment pulled back sharply

pp contribution to q-o-q GDP growth



Source: Office for National Statistics, UK

Looking ahead, we expect GDP growth to slow further to 1.5% in 2017. This is likely to be driven by a deceleration in consumption growth. Rising inflation and the slowing pace of wage growth in recent months are likely to dampen consumer spending, particularly on discretionary services such as dining and retail. Business investment growth is also likely to remain subdued as corporates hold back capex until clarity around a new EU-UK trade deal emerges. Exports are likely to cushion growth, benefitting from an uptick in global trade demand and a weaker GBP. In this scenario, we do not see any significant demand push to drive up core inflation, though headline inflation is likely to remain above the BoE's target of 2%. We expect the central bank to maintain an accommodative monetary stance until end-2018.

We expect GDP growth to slow to 1.5% as consumption softens

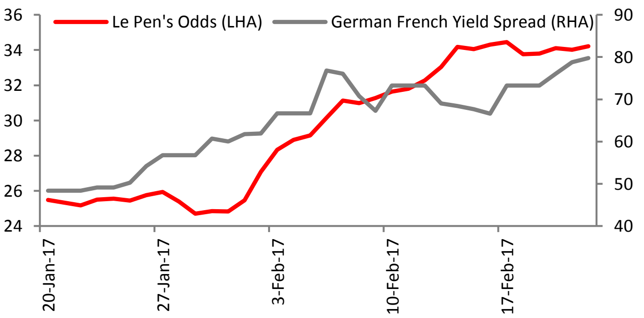
France: Sovereign yields climb as Le Pen gains in opinion polls

Political risks re-asserted themselves in the Eurozone last week, and the spread between French and German sovereign yields widened to 80 bps, its highest level since November 2012. The markets took their cue from the rising support for Front National candidate Marine Le Pen in the presidential election scheduled for April-May (Fig. 7). Le Pen's pledges include a referendum on France's membership of the EU and the introduction of a new French franc in parallel with the EUR. Opinion polls still have Socialist Party candidate Emmanuel Macron leading Le Pen by a slim margin. However, given the inaccuracy of polls in predicting the results of the Brexit vote and US presidential election last year, we remain cautious over their predictions. Even so, any potential Le Pen government would find it difficult to take France out of the EU given that support for the union remains high among voters (64%). Political uncertainties are already having an adverse impact on France's public borrowing costs in early 2017. Lower sovereign yields have helped the French government maintain an accommodative fiscal policy since 2H2015, which has added close to 0.1pp q-o-q to headline GDP.

French-German yield spread close to four-year high

Fig. 7. France: Rising probability of Marine Le Pen victory reflected in widening French-German yield spreads

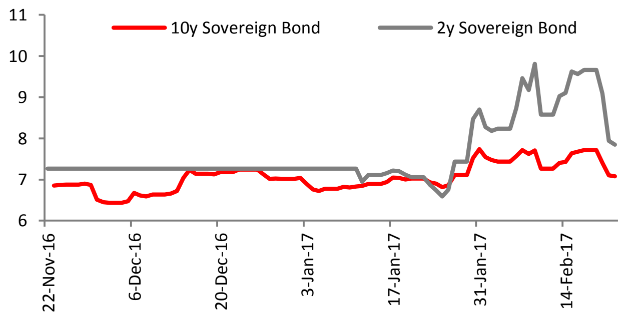
% probability of victory (LHA), spread in bps (RHA)



Source: Bloomberg, Oddscheckers

Fig. 8. Greece: Bond yields fall sharply on hint of possible compromise between EU and IMF

%



Source: Bloomberg

Greece: Partial breakthrough between EU and IMF over bailout deal

Greek bond markets rallied last week on signs of a partial breakthrough over its bailout deal (Fig. 8). In a statement following the Eurogroup meeting last week, President Jeroen Dijsselbloem said that bailout teams from the EU and IMF will visit Athens to jointly resume bailout talks with the Greek government. The Greek government, in return, agreed to introduce legislation for structural fiscal reforms this spring. In particular, it will seek to lower income tax exemption thresholds, reduce pension spending and increase

IMF and EU agree to hold joint talks with Greece on fiscal reform the ability of firms to hire and lay off workers. These reforms were suggested by the IMF in its report on Greek debt sustainability released earlier this month. However, IMF officials have not yet confirmed their financial support for the Greek bailout programme.

EU members more willing to lower Greece's austerity targets

Nevertheless, the comments from EU officials suggested that there could be some compromise with the IMF on Greece's fiscal and debt targets, allowing the Fund to come on board the bailout deal. Notably, President Dijsselbloem said that the focus of the proposed talks in Athens will shift from "austerity" to "deep reform" and that the EU would want to support economic sentiment and growth. In our view, this suggests some willingness by EU members to soften Greece's fiscal and debt targets, perhaps closer to the Greek government's debt repayment deadline in July.

II. Economic Calendar

Fig. 9. Upcoming events and data releases

Time*	Country	Event	Period	Prior	Consensus
	UAE	Dubai Airport Cargo Volume, y-o-y	Jan	5.4%	--
	Saudi Arabia	M2 Money Supply, y-o-y	Jan	3.5%	--
	Saudi Arabia	SAMA Net Foreign Assets, SAR	Jan	1982.4B	--
	Saudi Arabia	Non-Oil Exports, y-o-y	Dec	-9.1%	--
	Kuwait	CPI, y-o-y	Jan	3.5%	--
Monday, 27 Feb					
13:00	Eurozone	M3 Money Supply, y-o-y	Jan	5%	4.8%
17:30	US	Durable Goods Orders, m-o-m	Jan P	-0.5%	2%
17:30	US	Durables ex-Transportation, m-o-m	Jan P	0.5%	0.4%
20:00	US	Fed's Kaplan Speaks in Oklahoma			
Tuesday, 28 Feb					
3:50	Japan	Industrial Production, m-o-m	Jan P	0.7%	0.4%
3:50	Japan	Industrial Production, y-o-y	Jan P	3.2%	4.4%
3:50	Japan	Retail Trade, y-o-y	Jan	0.7%	1%
14:00	Eurozone	CPI Estimate, y-o-y	Feb	1.8%	1.9%
14:00	Eurozone	CPI Core, y-o-y	Feb A	0.9%	0.9%
16:00	India	GDP, y-o-y	4Q	7.3%	6.1%
17:30	US	GDP Annualized, q-o-q	4Q S	1.9%	2.1%
17:30	US	Personal Consumption, q-o-q	4Q S	2.5%	2.5%
17:30	US	Core PCE, q-o-q	4Q S	1.3%	1.3%
19:00	US	Conf. Board Consumer Confidence	Feb	111.8	111
Wednesday, 1 Mar					
0:30	US	Fed's Williams Speaks in Santa Cruz			
3:50	US	Fed's Bullard Speaks in Washington			
4:30	Japan	Nikkei Japan PMI Mfg	Feb F	53.5	--
5:00	China	Non-manufacturing PMI	Feb	54.6	--
5:00	China	Manufacturing PMI	Feb	51.3	51.2
6:00	US	President Donald Trump addresses Joint Congress			
9:00	India	Nikkei India PMI Mfg	Feb	50.4	--
17:30	US	Personal Spending	Jan	0.5%	0.3%
17:30	US	Real Personal Spending	Jan	0.3%	0%
17:30	US	PCE Deflator, y-o-y	Jan	1.6%	2%
17:30	US	PCE Core, y-o-y	Jan	1.7%	1.7%
19:00	US	ISM Manufacturing	Feb	56	56
22:00	US	Fed's Kaplan Speaks in Dallas			
23:00	US	US Federal Reserve Releases Beige Book			
Thursday, 2 Mar					
14:00	Eurozone	Unemployment Rate	Jan	9.6%	9.6%
Friday, 3 Mar					
3:30	Japan	Jobless Rate	Jan	3.1%	3%
3:30	Japan	Natl CPI, y-o-y	Jan	0.3%	0.4%
3:30	Japan	Natl CPI, ex-Fresh Food, y-o-y	Jan	-0.2%	0%
3:30	Japan	Natl CPI, ex-Fresh Food, Energy, y-o-y	Jan	0.1%	0.2%
4:00	US	Fed's Mester Speaks on Leadership in New York			
11:00	Turkey	CPI, y-o-y	Feb	9.2%	9.7%
14:00	Eurozone	Retail Sales, y-o-y	Jan	1.1%	1.5%
19:00	US	ISM Non-Manf. Composite	Feb	56.5	56.5
19:15	US	Fed's Evans and Lacker Speak on Panel in New York			
21:00	US	Fed Vice Chair Fischer Speaks in New York			
22:00	US	Fed Chair Yellen Speaks in Chicago			

* UAE time
Source: Bloomberg

Fig. 10. Last week's data

Time*	Country	Event	Period	Prior	Consensus	Actual
GCC Data						
	Saudi Arabia	CPI, y-o-y	Jan	1.7%	--	-0.4%
	Bahrain	CPI, y-o-y	Jan	2.3%	--	0.8%
Monday, 20 Feb						
3:50	Japan	Trade Balance	Jan	¥640.4B	-¥625.9B	-¥1086.9B
3:50	Japan	Exports, y-o-y	Jan	5.4%	5%	1.3%
4:01	UK	Rightmove House Prices, y-o-y	Feb	3.2%	2.8%	2.3%
19:00	Eurozone	Consumer Confidence	Feb A	-4.8	-4.9	-6.2
Tuesday, 21 Feb						
4:30	Japan	Nikkei Japan PMI Mfg	Feb P	52.7	--	53.5
8:30	Japan	All Industry Activity Index, m-o-m	Dec	0.4%	-0.2%	-0.3%
13:00	Eurozone	Markit Eurozone Manufacturing PMI	Feb P	55.2	55	55.5
13:00	Eurozone	Markit Eurozone Services PMI	Feb P	53.7	53.7	55.6
18:45	US	Markit US Manufacturing PMI	Feb P	55	54.6	56
Wednesday, 22 Feb						
13:00	Germany	IFO Business Climate	Feb	109.9	109.6	111
13:30	UK	GDP, q-o-q	4Q P	0.6%	0.6%	0.7%
13:30	UK	GDP, y-o-y	4Q P	2.2%	2.2%	2%
13:30	UK	Private Consumption, q-o-q	4Q P	0.7%	0.6%	0.7%
13:30	UK	Government Spending, q-o-q	4Q P	0%	0.1%	0.2%
13:30	UK	Gross Fixed Capital Formation, q-o-q	4Q P	0.9%	0.2%	0%
13:30	UK	Exports, q-o-q	4Q P	-2.6%	2%	4.1%
13:30	UK	Imports, q-o-q	4Q P	1.3%	0.3%	-0.4%
14:00	Eurozone	CPI, y-o-y	Jan F	1.1%	1.8%	1.8%
14:00	Eurozone	CPI Core, y-o-y	Jan F	0.9%	0.9%	0.9%
16:00	US	MBA Mortgage Applications	17-Feb	-3.7%	--	2%
19:00	US	Existing Home Sales	Jan	5.51M	5.54M	5.69M
23:00	US	FOMC Meeting Minutes	1-Feb	--	--	
Thursday, 23 Feb						
17:30	US	Initial Jobless Claims	18-Feb	238K	240K	244K
Friday, 24 Feb						
19:00	US	New Home Sales	Jan	535K	571K	555K
19:00	US	U. of Mich. Sentiment	Feb F	95.7	96	96.3

* UAE time
Source: Bloomberg

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