The Week Ahead: Look out for any announcements by ECB or BoE

Economics Team

Monica Malik, Ph.D.
Chief Economist
+971 (0)2 696 8458
Monica.Malik@adcb.com

Shailesh Jha
Economist
+971 (0)2 696 2704
Shailesh.Jha@adcb.com

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Global: Markets have stabilised since Brexit vote

A week after the Brexit vote, the losses in financial markets have been more limited than initially expected. So far, the sell-off has focused on specific assets, suggesting some variance in investors' perceptions of risk in each market. GBP and European banking stocks have fallen sharply, reflecting the concern over the UK's growth outlook and the unquantifiable costs of Brexit for European financial institutions. Surprisingly, conventional risky assets, such as oil and emerging market stocks have recovered quite swiftly from the shock of the vote. We believe this is the result of a coordinated accommodative stance adopted by major central banks and indications of further loosening. The Fed signalled it would hold off from hiking rates in July, the ECB has suggested changes to the pace and composition of its QE programme, and the BoE has given clear hints of monetary easing this summer. Further, fiscal support has come from European governments' recent soft pedalling of their austerity targets. British Chancellor George Osborne joined that group on Saturday, when he announced a suspension of the UK's budget targets until 2020. That said, we expect the above measures to only be cyclically positive. In the medium term, uncertainty around Brexit should push the UK into recession and Europe's growth lower, and continue to hurt asset returns in European financial markets.

Europe: EU leaders promise orderly Brexit

Coordinated action from EU leaders and the ECB limited the fallout from the Brexit vote on European peripheral bond markets, in which yields have now fallen even below pre-Brexit vote levels. The ECB ramped up purchases of corporate bonds under its QE programme and suggested additional monetary accommodation in the coming weeks. Meanwhile, comments by the EU leaders last week allayed immediate fears of contagion across the bloc. They promised a swift and orderly exit for the UK from the EU and emphasised that no negotiations on a future trade deal with the UK would be started unless the country formally invoked the exit clause under the Lisbon Treaty. In another boost to market sentiment, the conservative party of Mariano Rajoy won the parliamentary elections in Spain and is likely to form a coalition government with other pro-EU parties. This week, markets will continue to take their cue more from further developments around the Brexit negotiations than data releases.

US: NFP and June Fed minutes the key events

The key releases this week will be the June NFP data and the minutes of the Fed's June meeting. However, both will be obsolete given the Brexit vote. Consensus expects 175K jobs were created in June, up from just 38K in May. We believe at this pace a September rate hike would have been feasible had the UK chosen to remain in the EU. Nevertheless, the more measured reaction in the global markets to the Brexit vote leaves the door open for a year-end hike by the Fed. Data continues to point to a pickup in economic momentum in 2Q2016.

I. Recent Data and Events

A. MENA Economies

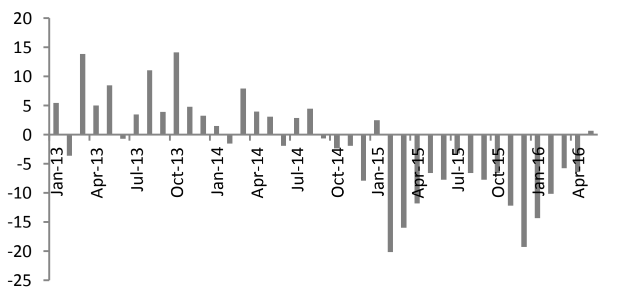
Saudi Arabia: NFAs rise moderately in May

NFAs and government deposits rise with USD10 billion international syndicated loan

SAMA's net foreign assets (NFAs) rose by USD0.7 billion in May, the first monthly rise in 15 months. We attribute the moderate increase to the USD10 billion international syndicated loan raised by the government at the end of April. This was also reflected in the government's deposits with SAMA (the liability side) rising by USD3.5 billion. The increase in FX reserves in May came after NFAs fell by -USD5.7 billion in March and -USD6.6 billion in April. We believe that the rise in government deposits with commercial banks (up USD6.6 billion) also reflects the syndicated loan. We believe that much of the international loan was placed in the banking sector to support domestic liquidity. Nevertheless, data again reflected a large deficit funding requirement, though some support came from the rising oil price in May. This requirement is keeping liquidity tight, and the government's domestic bond issuance continues to rise (up 9.7% m-o-m in May). The government's ability to turn increasingly to external markets to meet a significant part of its funding needs will remain important. We expect both NFAs and government deposits to fall again from June as the one-off support is removed.

Fig. 1. Saudi Arabia: SAMA's NFAs rise USD0.7 billion in May; fall expected in June

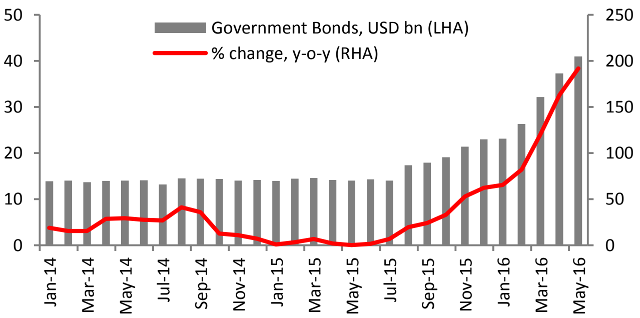
USD billion, change in SAMA's NFAs



Source: SAMA

Fig. 2. Saudi Arabia: Government borrowing from banking sector continues to rise sharply

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



Source: SAMA

Further loosening of banking sector ratios expected in order to provide space for banks to lend

Despite the rise in government deposits with commercial banks, system wide deposits fell by -0.5% m-o-m. Private sector deposits fell by -1% m-o-m. Meanwhile, credit growth remained solid, with government borrowing increasing (constituting 55% of the incremental increase in May). Private sector credit growth also remained strong (up 0.7% m-o-m and 9.4% y-o-y) due to the need for working capital. The L-to-D ratio rose to 90.1% in May, close to its cap. SAMA had already raised the L-to-D limit on commercial banks from 85% to 90% in February, though this excludes long term loans raised by banks (which are included in the banking sector's system wide L-to-D ratio). We expect further easing of regulations (possibly including lowering the RRR) to create headroom for loan growth. Meanwhile, POS transactions jumped in May (up 19.9% m-o-m in value terms), which we believe was supported by increased purchases ahead of Ramadan. Nevertheless, the overall trend suggests weaker spending in 2016 (-3.8% y-o-y in 5M2016) following the subsidy reforms implemented in December and January.

Bahrain: Fitch downgrades sovereign rating to BB+

Bahrain now rated sub-investment grade by all three main agencies

Fitch Ratings has downgraded Bahrain's debt one notch to BB+ with a stable outlook. This brings Fitch's Bahrain rating to sub-investment grade; this was already the case for Moody's and S&P, both of which have even lower ratings for Bahrain. Thus, we do not expect a marked change in Bahrain's ability to raise external funding, though its weaker fiscal position is already reflected in its cost of raising debt. The lower oil price was behind the downgrade. Moreover, Fitch noted the lack of a clear path towards a more sustainable position, though it said there has been some progress with fiscal consolidation. Fitch expects government debt to rise to almost 80% of GDP in 2016 (from around 62% in 2015), substantially above the BBB and BB medians of around 40%. Whilst the government deficit is expected to widen to -15.4% of GDP in 2016 (from -14.8% in 2015), this is based on an average Brent oil price of USD35 p/b, which we consider low.

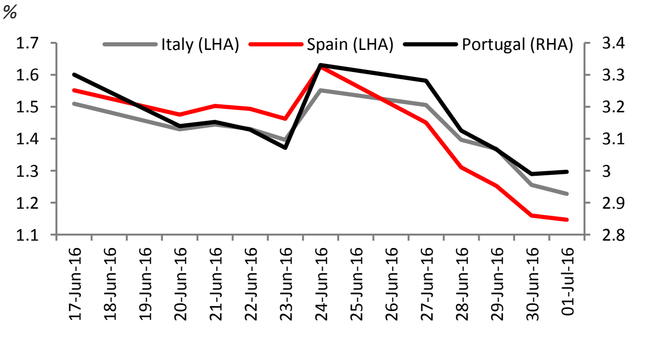
B. G4 Economies

Europe: Bond markets calm after Brexit shock

ECB increases corporate bond purchases following Brexit vote

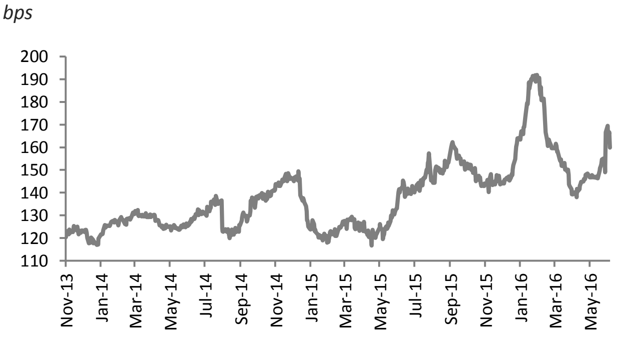
European peripheral bond yields fell below their pre-Brexit vote levels last week, supported by comments from European political leaders and ECB officials. The ECB played down the impact of Brexit on the economy, and emphasised that the bank was ready to intervene as required. It also ramped up its corporate bond purchases last week to EUR2.65 billion (from EUR1.9 billion the previous week) to ease market liquidity concerns. We do not expect the ECB to expand the pace of its asset purchases in July given the recent market stability. However, we believe that the spillover from any UK recession following the Brexit vote would likely have an adverse impact on the ECB's medium term inflation targets; we would expect this in turn to persuade it to increase its QE programme, possibly before the end of 2016. Indeed, the continued muted inflation data for the first three weeks of June (+0.1% y-o-y after -0.1% in May), i.e. before the EU referendum, support our expectation of a further deterioration in inflation dynamics as Brexit uncertainties cause firms to cut investment spending across the continent.

Fig. 3. Eurozone: Peripheral bond yields have fallen below pre-Brexit vote levels, following ECB comments



Source: Bloomberg

Fig. 4. UK: Sovereign credit rating downgrade is being reflected in widening credit spreads



Source: Bloomberg

UK: Fitch and S&P downgrade sovereign ratings

Financing of current account deficit highlighted as key reason for downgrade

S&P and Fitch each downgraded the UK's sovereign credit ratings by one notch to AA last week. They highlighted the risk of further downgrades in the near future, citing uncertainties around the financing of the country's wide current account deficit (-7% of GDP in 1Q2016) and the growing support for a second Scottish referendum. We see these downgrades as another headwind to medium-term economic growth, as they increase sovereign risk premia. Further, given the British government's decision last week to suspend its budget targets until 2020, we believe that the medium-term risk of a credit rating downgrade has increased further, chiefly due to the elevated level of public debt. We expect the UK economy to fall into recession in 2H2016, led by weaker investment spending.

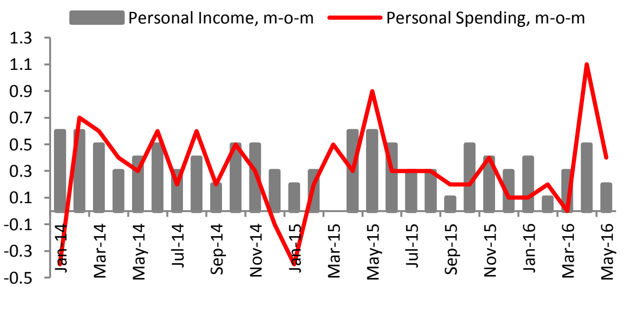
US: Personal spending remains solid, weak buildup in price pressure

Rise in core PCE deflator remains moderate

Consumer confidence and expenditure data remained strong, continuing to point to a rebound in 2Q. Personal spending rose by 0.4% m-o-m in May, in line with market expectations, supported by sales of autos and other durable manufactured goods. The continued expansion in May was particularly notable given the robust growth in April, which was revised up to 1.1% m-o-m (from 1% initially). However, the core PCE price index (the Fed's preferred measure of inflation) rose by a moderate 0.2% m-o-m, as it had in April. The core PCE rate in annual terms also remained stable at 1.6% y-o-y (rounded).

Fig. 5. US: Personal spending continues to expand in May after robust growth in April

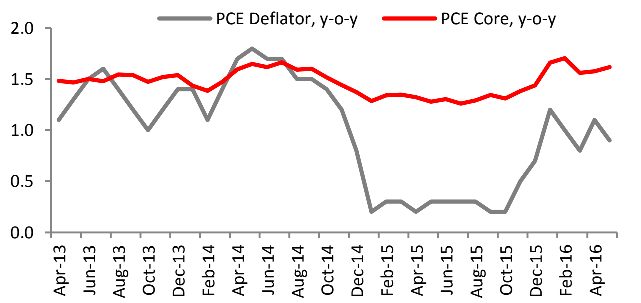
% change m-o-m



Source: Bloomberg

Fig. 6. US: Core PCE deflator remains broadly steady in May, giving Fed time to gauge Brexit vote impact

% change y-o-y



Source: Bloomberg

Consumer confidence rises in June

Consumer confidence rose to 98 in June, beating the consensus (93.4) and May's figure of 92.4. There were improvements in both consumers' assessment of their current conditions and forward-looking expectations. The overall trend remains broadly in line with the elevated levels seen in 2015. Despite the data looking solid, we expect the Fed to remain on hold until December given the greater global uncertainties following the Brexit vote. The Fed will look to gauge the impact of the vote on consumer confidence and spending trends.

Momentum at beginning of year stronger than initially implied by data

1Q GDP: Real GDP growth was revised up to 1.1% q-o-q SAAR in 1Q2016 in its third and final reading, up from 0.8% in the second and 0.5% in the initial reading. The upward revision came on the back of private non-residential investment (increased to -4.5% from -6.2% previously) and net exports (to 0.3% from -2.0%). These improvements more than compensated for the downward revision to private consumption (to 1.5% from 1.9%). The consensus is for GDP growth to rebound to around 2.7% q-o-q SAAR in 2Q2016, led by the marked improvement in consumer confidence. There have been some moderate downward revisions to 2016 GDP growth forecasts (to 1.9%, consensus from 2.1% earlier) following the Brexit vote, expected mainly though the financial channels in 2H2016.

Japan: 2Q2016 data further highlight urgency of monetary easing

Deeper contraction in inflation in June supports our easing call in July

Economic data for June and 2Q2016 were broadly disappointing, with inflation falling to a three-year low and capex sentiment deteriorating further. Inflation fell by -0.4% y-o-y in June (-0.3% in May), as a strong JPY and deferment of a VAT tax hike weighed on prices. Meanwhile, the Tankan index of non-manufacturers' sentiment moderated to +19 in 2Q (+22 previously), as firms stated the strong currency was the main drag on their outlook, particularly in the tourism and retail sectors. We believe that investment spending and business sentiment are likely to weaken further in the coming quarters, as the 2Q surveys do not account for the spike in uncertainty and further JPY strengthening post the Brexit vote. In line with the actions of other major central banks, we expect the BoJ to respond with further monetary easing, perhaps as soon as July.

C. Emerging Market Economies

India: One-off pay hike for public sector employees approved

Pay hikes of 23% to boost consumption growth

The Indian government last week approved a 23% salary hike for 10 million government employees, backdated to be effective from January 2016 (the arrears are to be paid in July). State governments are likely to announce similar hikes for their employees over the next six months. Though the quantum of pay raises in the current cycle is lower than the last one (30%, in 2009), we expect it to boost consumption more significantly this time. Firstly, lower inflation in 2016 (currently around 5-6% y-o-y, compared to 10% y-o-y in 2009) will translate into a stronger boost to real incomes. Secondly, the private sector is currently better placed to hike wages than it was in 2009 (a year stymied by the global recession). Furthermore, the belated but plentiful monsoon is likely to boost rural wages in tandem with urban salary hikes. We now expect private consumption to grow by around 9% y-o-y in 2Q2016-1Q2017 as a result of these factors, up from our previous forecast of 8.1%.

Higher wage spending should result in some fiscal cuts to capex

However, these pay increases could come at the cost of a tighter fiscal and monetary stance. The net fiscal burden of recent pay raises (0.55% of GDP) is slightly higher than the budgeted number (0.45%). This could imply cuts in capital expenditure by the government to meet its fiscal target of 3.9% of GDP. Similarly, we could see pressure on core inflation as consumption spending on discretionary goods and services increases towards the end of 2016. Thus, we do not expect the RBI to cut rates in 4Q2016 or 2017.

II. Economic Calendar

Fig. 7. Upcoming events and releases

Time*	Country	Data point	Period	Prior	Survey
Expected this week					
	Qatar	GDP Constant Prices, y-o-y	1Q	4%	--
	Qatar	GDP Constant Prices, q-o-q	1Q	-0.5%	--
	Kuwait	GDP Current Prices, y-o-y			
	Kuwait	M2 Money Supply, y-o-y	Apr	4.1%	--
	Egypt	Gross Official Reserves	Jun	17.5B	--
	Egypt	GDP Constant Prices, q-o-q	1Q	-3.2%	--
Monday 4 July					
03:50	Japan	Monetary Base, y-o-y	Jun	25.5%	--
Tuesday 5 July					
05:45	China	Caixin China PMI Services	Jun	51.2	--
06:00	Japan	Nikkei Japan PMI Composite	Jun	49.2	--
09:00	India	Nikkei India PMI Services	Jun	51	--
12:00	Eurozone	Markit Eurozone Services PMI	Jun F	52.4	52.4
12:30	UK	Markit/CIPS UK Services PMI	Jun	53.5	52.8
13:00	Eurozone	Retail Sales, m-o-m	May	0%	0.4%
13:30	UK	Carney Publishes BOE Financial Stability Report			
18:00	US	Factory Orders, m-o-m	May	1.9%	-0.8%
22:30	US	Fed's Dudley Speaks on Local Economy in Binghamton, NY			
Wednesday 6 July					
10:00	Germany	Factory Orders, m-o-m	May	-2%	1%
15:00	US	MBA Mortgage Applications	1-Jul	-2.6%	--
16:30	US	Trade Balance	May	-$37.4B	-$40B
18:00	US	ISM Non-Manf. Composite	Jun	52.9	53.3
22:00	US	FOMC Meeting Minutes	15-Jun	--	--
Thursday 7 July					
	China	Foreign Reserves	Jun	$3191.7B	$3160B
10:00	Germany	Industrial Production SA, m-o-m	May	0.8%	0%
11:30	UK	Halifax House Prices, m-o-m	Jun	0.6%	0.3%
12:30	UK	Industrial Production, m-o-m	May	2%	-1%
12:30	UK	Manufacturing Production, m-o-m	May	2.3%	-1.2%
15:30	Eurozone	ECB account of the monetary policy meeting			
16:15	US	ADP Employment Change ('000)	Jun	173K	160K
16:30	US	Initial Jobless Claims	2-Jul	268K	267K
Friday 8 July					
03:50	Japan	BoP Current Account Balance	May	¥1878.5B	¥1742.3B
16:30	US	Change in Nonfarm Payrolls ('000)	Jun	38K	175K
16:30	US	Unemployment Rate	Jun	4.7%	4.8%
16:30	US	Average Hourly Earnings, m-o-m	Jun	0.2%	0.2%
16:30	US	Average Hourly Earnings, y-o-y	Jun	2.5%	2.7%
16:30	US	Average Weekly Hours All Employees	Jun	34.4	34.4
16:30	US	Labor Force Participation Rate	Jun	62.6%	--
16:30	US	Underemployment Rate	Jun	9.7%	--
23:00	US	Consumer Credit	May	$13.4B	$17B

* UAE time
Source: Bloomberg

Fig. 8. Last week's data

Time*	Country	Data point	Period	Prior	Survey	Actual
MENA Data						
	Saudi Arabia	GDP Constant Prices, y-o-y	1Q	1.8%	--	1.5%
	Saudi Arabia	GDP Constant Prices, q-o-q	1Q	1.5%	--	0.7%
	Saudi Arabia	M2 Money Supply, y-o-y	May	-2.8%	--	-3.8%
	UAE	Dubai Airport Cargo Volume, y-o-y	May	4.8%	--	4.7%
	Qatar	M2 Money Supply, y-o-y	May	-1.6%		-4.4%
	Kuwait	CPI, y-o-y	May	2.9%		2.8%
	Bahrain	GDP Constant Prices, y-o-y	1Q	2.8%	--	4.5%
	Bahrain	GDP Constant Prices, q-o-q	1Q	0%	--	0.9%
Monday 27 June						
12:00	Eurozone	M3 Money Supply, y-o-y	May	4.6%	4.8%	4.9%
17:45	US	Markit US Services PMI	Jun P	51.3	52	51.3
17:45	US	Markit US Composite PMI	Jun P	50.9	--	51.2
Tuesday 28 June						
16:30	US	GDP Annualized, q-o-q	1Q T	0.8%	1%	1.1%
16:30	US	Personal Consumption, q-o-q	1Q T	1.9%	2%	1.5%
17:00	US	S&P/CaseShiller 20-City Index NSA	Apr	184.8	186.7	186.6
18:00	US	Consumer Confidence Index	Jun	92.4	93.5	98
Wednesday 29 June						
03:50	Japan	Retail Trade, y-o-y	May	-0.9%	-1.6%	-1.9%
10:00	UK	Nationwide House Prices, m-o-m	Jun	0.2%	0%	0.2%
10:00	UK	Nationwide House Prices NSA, y-o-y	Jun	4.7%	4.9%	5.1%
12:30	UK	Mortgage Approvals	May	66.2K	65K	67K
13:00	Eurozone	Consumer Confidence	Jun F	-7.3	-7.3	-7.3
15:00	US	MBA Mortgage Applications, w-o-w	24-Jun	2.9%	--	-2.6%
16:30	US	Personal Income, m-o-m	May	0.5%	0.3%	0.2%
16:30	US	Personal Spending, m-o-m	May	1.1%	0.4%	0.4%
16:30	US	PCE Core, m-o-m	May	0.2%	0.2%	0.2%
16:30	US	PCE Core, y-o-y	May	1.6%	1.6%	1.6%
18:00	US	Pending Home Sales, m-o-m	May	3.9%	-1.1%	-3.7%
Thursday 30 June						
03:50	Japan	Industrial Production, m-o-m	May P	0.5%	-0.2%	-2.3%
03:50	Japan	Industrial Production, y-o-y	May P	-3.3%	1.9%	-0.1%
12:30	UK	GDP, q-o-q	1Q F	0.4%	0.4%	0.4%
12:30	UK	GDP, y-o-y	1Q F	2%	2%	2%
13:00	Eurozone	CPI Estimate, y-o-y	Jun	-0.1%	0%	0.1%
13:00	Eurozone	CPI Core, y-o-y	Jun A	0.8%	0.8%	0.9%
16:30	US	Initial Jobless Claims	25-Jun	258K	267K	268K
Friday 1 July						
03:30	Japan	Jobless Rate	May	3.2%	3.2%	3.2%
03:30	Japan	Job-To-Applicant Ratio	May	1.3	1.4	1.4
03:30	Japan	Natl CPI, y-o-y	May	-0.3%	-0.5%	-0.4%
03:30	Japan	Natl CPI ex-Fresh Food, y-o-y	May	-0.3%	-0.4%	-0.4%
03:30	Japan	Tokyo CPI, y-o-y	Jun	-0.5%	-0.4%	-0.4%
03:50	Japan	Tankan Large Mfg Index	2Q	6	4	6
03:50	Japan	Tankan Large Non-Mfg Index	2Q	22	19	19
03:50	Japan	Tankan Large All Industry Capex	2Q	-0.9%	5.3%	6.2%
05:00	China	Manufacturing PMI	Jun	50.1	50	50
09:00	India	Nikkei India PMI Mfg	Jun	50.7	--	51.7
12:30	UK	Markit UK PMI Manufacturing SA	Jun	50.4	50.1	52.1
13:00	Eurozone	Unemployment Rate	May	10.2%	10.1%	10.1%
18:00	US	ISM Manufacturing	Jun	51.3	53.2	51.7

* UAE time
Source: Bloomberg

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