The Week Ahead: Yellen's speech the key event; China May data main releases

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US: Yellen's speech more important after weak labour data

The key event this week will be Fed Chair Janet Yellen's speech (6 June) on the economic outlook and monetary policy, which has become even more important after the dismal NFP data for May. Markets will focus on changes to the policy guidance, in light of the weaker jobs data. Any comments on the labour market and how close it is to full employment will be particularly pertinent, in our view. This could indicate the level of labour market rebound required for the Fed to raise rates. A number of FOMC members recently indicated that they expect to see weaker monthly payroll numbers, given the more advanced stage of the economy's recovery. This includes Boston Fed President Eric Rosengren indicating in May that under a full employment scenario, 80-100K added payrolls per month would be acceptable. Nevertheless, the weak May NFP data substantially reduces the chances of a June rate hike. We believe that July is still a possibility if employment growth rebounds in June and the unemployment rate remains low.

China: Credit growth to recover from one-off effects

We expect aggregate financing to recover in May (consensus: RMB950 billion), after a sharp decline in April (RMB751 billion). The May numbers are likely to correct the one-off reduction in liquidity caused by a massive issuance of government bonds in April. Further, we also see upside risk to the consensus money supply growth (M2) forecast of 12.5% y-o-y (12.8% previously) as the tax collection effects, which dampened banking liquidity in April, are likely to be absent. That said, the pace of credit growth in May is likely to remain substantially below that between 2Q2015-1Q2016, reflecting a more prudent monetary policy stance by the PBoC. Meanwhile, May export growth is likely to decline further (consensus: -4.2% y-o-y after -1.8% y-o-y) as preliminary data from Asian countries that import intermediates from China was weaker than expected in May.

India: RBI to remain on hold, IP data to be dragged down by base effects

We expect the RBI to keep its benchmark policy rate on hold at 6.5% (7 June). Stronger than expected GDP growth, the upside surprise in April inflation and uncertainty around the arrival of monsoons are all likely to persuade the RBI to wait before easing further. Moreover, increasing capital inflows and the RBI's targeted liquidity easing measures since April have brought interbank rates down by another 50 bps since February, supporting the monetary transmission of previous rate cuts and weakening the case for further easing. Meanwhile, industrial output is likely to have remained flat, mainly due to base effects and the impact of the jewellers' strike in April. Excluding these effects, output of capital goods, particularly in the infrastructure sector, is likely to have accelerated further, reflecting an increase in government spending in 2Q. This could tentatively point to a resumption in the investment cycle, infrastructure led.

I. Recent Data and Events

A. MENA Economies

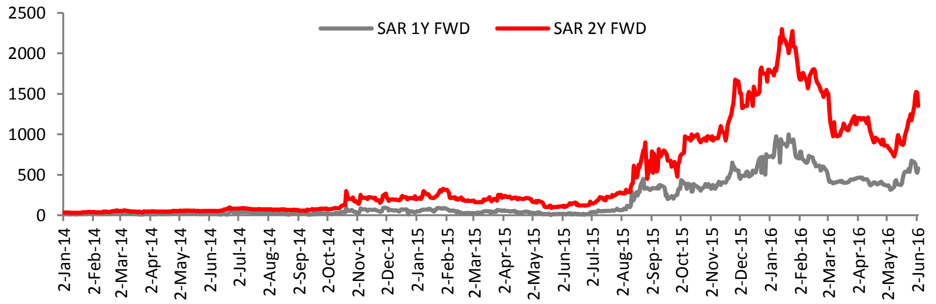
Saudi Arabia: SAMA moves to reduce SAR speculation in forward markets

Move to stem Saudi banks providing liquidity to SAR speculators

Saudi Arabia's central bank, SAMA, sent a circular to banks last week saying it was banning USD:SAR forward structured contracts with immediate effect, according to Bloomberg. Forward transactions backed by actual goods and services will still be allowed. We see this as a further move to stem Saudi banks from providing liquidity to speculators betting on a devaluation of the SAR. Speculation against the peg has again increased on concerns over Saudi Arabia's fiscal position, especially after reports that the government is looking to issue "I owe you" (IOU) notes to contractors to help cover outstanding dues. In January 2016, SAMA instructed Saudi banks to stop trading currency options on SAR forwards.

Fig. 1. Saudi Arabia: Speculation on SAR devaluation increases since May on concerns over the fiscal position

Swap points



Source: Bloomberg

SAMA reiterates support for SAR peg to USD

We do not expect a change in the peg of the SAR to the USD in the short to medium term, as the benefits (including anchoring FX and inflation expectations) outweigh the negatives. Moreover, any potential benefit to government finances from higher oil revenues in SAR terms would be more than outweighed by the associated surge in import costs if the SAR was weakened, in our view. A similar conclusion was provided in a recent study by SAMA titled "Saudi Arabia's Exchange Rate Policy: Its Impact on Historical Economic Performance" (published on 26 April 2016). The paper concluded that the dollar peg has served Saudi Arabia well, and is likely to do so until Saudi Arabia becomes a meaningfully diversified economy. Moreover, SAMA's new Governor Ahmed al-Kholifey also reiterated the commitment to the peg.

GCC: UAE and Saudi PMIs strengthen in May, indicating pickup in non-oil activity

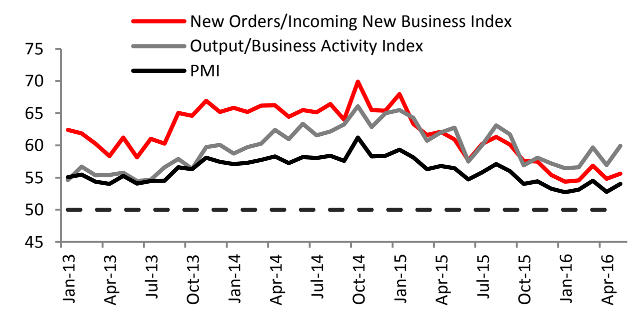
Higher oil price likely supported PMIs – but non-oil activity still weaker than in 2015

Both the UAE and Saudi Arabia's PMIs rose in May from the previous month. The UAE's headline PMI increased more sharply than Saudi Arabia's, to 54 in May from 52.8 in April. The rise was largely driven by the output/business activity index which stood at a healthy

59.9 in May (from 56.9 in April). The new orders component also increased (to 55.8 from 54.6 in the previous month), which we see as pointing to a pickup in domestic demand. In Saudi Arabia, there was just a moderate increase to 54.8 in May (54.2 in April), driven by stronger new orders (to 58.1). Overall, the data indicates a pickup in non-oil activity in May, which we believe was supported by the higher oil price. Nevertheless, overall activity remained below the levels of 2015. We believe that the PMI data likely overestimates the buoyancy of domestic demand in Saudi Arabia.

Fig. 2. UAE: PMI rises in May on stronger business activity and new orders

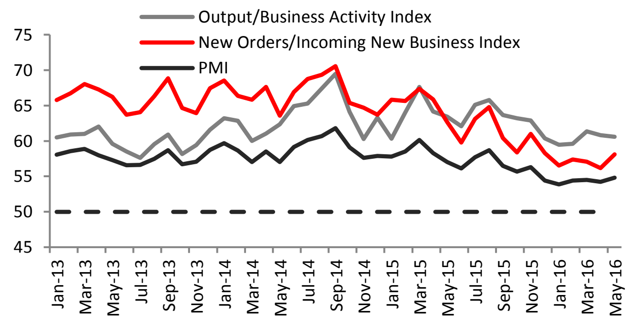
Index, above 50 indicates expansion



Source: Markit Economics

Fig. 3. Saudi Arabia: Rise in May PMI likely supported by higher oil, but domestic demand looks overestimated

Index, above 50 indicates expansion



Source: Markit Economics

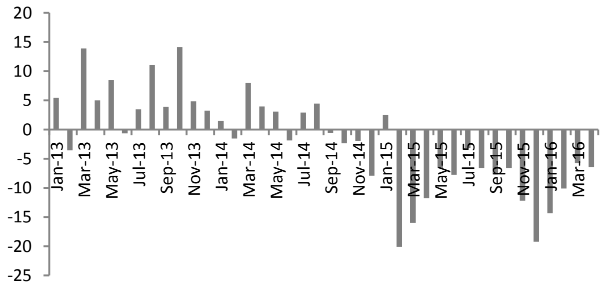
Saudi Arabia: NFAs continued to fall at solid pace in April with further tightening in banking sector liquidity

NFAs fell by USD6 billion in April – implying that the USD10 billion syndicated loan was not disbursed

Central bank data for April continued to reflect the tight liquidity conditions in the banking sector as well as the fiscal strain. SAMA's net foreign assets (NFAs) continued to fall at a sharp pace, down USD6.4 billion in April (-1.1% m-o-m and -15.7% y-o-y) to USD572.2 billion, steeper than March's USD5.8 billion decline. The pace of the April decline was surprising given the rise in the oil price and the USD10 billion of international syndicated loans raised by the government at the end of the month. The data suggests that the loan was not disbursed in April or that the deficit funding requirements were considerably higher than in previous months (if dispersed). Government deposits in the banking sector (where funds could also have been allocated) remained virtually steady in April, reinforcing our view that the loan was likely not disbursed.

Fig. 4. Saudi Arabia: SAMA NFAs down by 6.4 billion in April to USD572.2 billion

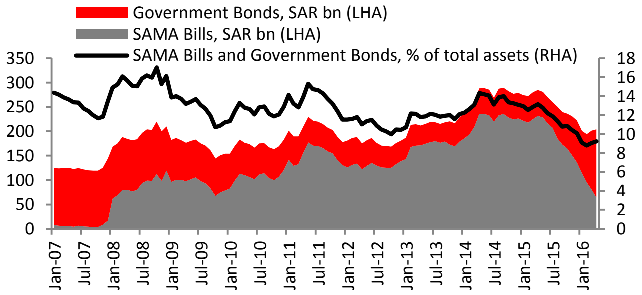
USD change in SAMA's NFAs



Source: SAMA

Fig. 5. Saudi Arabia: Bank holdings of government debt increase sharply since February

SAR billion (LHA),



Source: SAMA

Government borrowing drives credit growth in April

Liquidity in the banking sector tightened further in April, with system-wide deposits falling by -0.7% m-o-m whilst credit growth expanded by 1.9%. The contraction in deposits was largely led by government entities (-3.9% m-o-m), whilst private sector deposits dropped by a more modest -0.1%. Credit growth was driven by the public sector (c.60% of incremental lending). Government borrowing increased by 16% m-o-m – the third consecutive month of double-digit growth. Demand for the debt has been supported by the government's issuance of floating rate bonds since February 2016. Meanwhile, private sector credit growth decelerated to 0.4% m-o-m in April, down from 0.8% the previous month. This could be partly due to the government starting to pay its arrears to the contracting sector; these late payments were a key factor in the private sector's strong credit growth in 1Q2016. The tightening in banking sector liquidity could see some respite once Saudi Arabia turns to the debt market. Saudi Arabia is reportedly considering selling USD10-15 billion of multi-tranche bonds in 2016, possibly after Ramadan. A bond issue would also help to slow the pace of FX drawdowns.

B. G4 Economies

US: Exceptionally weak NFP data for May sharply reduces expectations of June rate hike

Only 38K jobs were created in May, weakest level since 2010

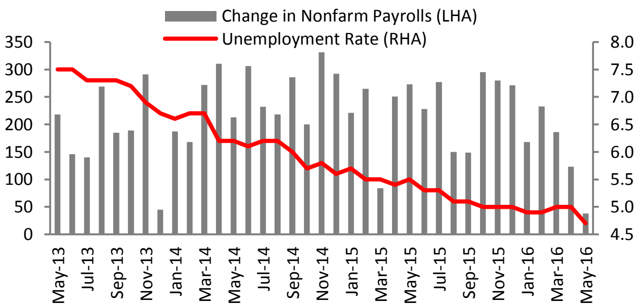
The US economy created only 38K jobs in May, the lowest level in over five years[ED1] and sharply below the consensus expectation of 160K. Even accounting for the Verizon strike (35K striking workers according to the Bureau of Labor Statistics), the print was dismal. Moreover, data for March and April was revised down by a net -59K. The data likely reflects some adjustment after the strong jobs growth at the beginning of the year, with the mild weather supporting earlier seasonal hiring, and the lagged response to the slower growth in 1Q. The pullback in seasonal hiring could have been reflected in the softness in the construction, leisure and hospitality sectors in April and May. However, the data raises some questions, as the ADP employment report stated that private sector employment rose by 173K in May. With the weak jobs growth, the three-month moving average fell to 116K, not far off the Fed's suggested "breakeven" pace of job growth. On a six-month basis it stood at a still healthy 170K.

Unemployment falls to 4.7% in May, but due to drop in labour participation

There were few positive developments in other areas of the May jobs report. Only wage growth was in line with consensus at 0.2% m-o-m, which kept the annual rate at 2.5%. The gradual acceleration in wage growth reflects a tightening in the labour market, albeit with slack remaining. The unemployment rate fell unexpectedly to 4.7% in May (consensus: 4.9%) from 5% in April. However, the fall in unemployment was due to people leaving the workforce, reflected in the participation rate falling to 62.6% (from 62.8% in April).

Fig. 6. US: Only 38K jobs added in May; unemployment rate falls to 4.7% but on lower labour force participation

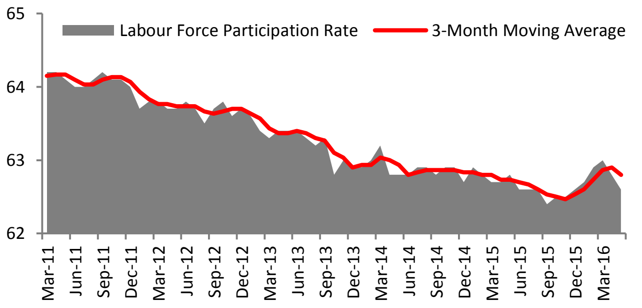
'000 (LHA); % (RHA)



Source: Bloomberg

Fig. 7. US: May labour force participation falls to 62.6%, the same level as in December 2015

%



Source: Bloomberg

June rate hike looks off the table, with Brexit risk also higher following latest poll

The weak May NFP data substantially reduces the chances of a June rate hike. We believe that July is still a possibility if employment growth rebounds for June and the unemployment rate remains low. A number of Fed speakers expect lower payroll growth numbers in 2016 than in previous years, given the advanced stage of recovery of the US economy. Last week Dallas Fed President Robert Kaplan highlighted that he thought 100K to 150K was the "breakeven" level of monthly payroll growth. Earlier indications by FOMC suggested that the breakeven level was around 100K. However, if employment growth remains lacklustre, the FOMC could remain on hold for longer than we expect and only look to raise in September. Under a September rate rise scenario, we see the likelihood of just one increase in 2016 of 25 bps.

April nominal personal spending highest in over six years

Personal spending and PCE inflation: Personal income and spending data for April was strong and in line with the rebound in retail spending. However, we believe this will not be sufficient to outweigh the May labour data. Personal spending rose by a solid 1% m-o-m, beating the consensus expectation of 0.7%. This was the fastest pace of expansion in more than six years. The areas of spending growth were broad-based, including goods and services. Meanwhile the core PCE deflator (the Fed's preferred gauge of inflation) rose by 0.2% m-o-m in April, keeping the y-o-y rate steady at 1.6%.

Eurozone: ECB retains neutral stance; provides details of asset purchase programmes announced in March

ECB to start buying corporate debt on 8 June – likely preferring smaller firms

The ECB made no changes to its monetary policy stance at its meeting last week, in line with our and market expectations. The tone was neutral, emphasising that it remains in a "wait-and-see" mode. However, the ECB revealed important details about implementation of the programmes included in the QE package announced in March – including the critical Corporate Sector Purchase Programme (CSPP). Under CSPP, the ECB will directly buy investment grade corporate bonds from Eurozone non-financial companies beginning on 8 June, with an aim to reduce their borrowing costs. We believe the ECB will prefer smaller firms hitherto dependent on bank lending – facilitating cost-effective first-time access to corporate bond markets.

Meanwhile, the ECB made an upward revision to its inflation forecast for 2016 (0.2% y-o-y from 0.1%), factoring in the surge in energy prices since its March forecast review. It also pushed up its growth forecast to 1.6% y-o-y (1.4% y-o-y previously), reflecting a stronger than expected 1Q2016 result. That said, the ECB's near-term economic outlook remained cautious, with the central bank expecting lower growth in 2Q due to a weaker contribution from net exports. Even regarding inflation, the ECB remained concerned, suggesting that apart from favourable base effects in 2H2016 (energy price related), other near-term drivers of inflation (particularly wages) remained muted. This assessment strengthens our conviction that the ECB will extend its asset purchase programme beyond March 2017 to at least until September 2017. We believe that inflation will undershoot the ECB's current trajectory in early 2017; core inflation is likely to remain below 1% y-o-y until 1H2017, given the weaker than expected annual wage increases in Germany and substantial labour market slack in Italy and Spain.

We still see scope for the ECB to extend its asset purchase programme, with weak inflation drivers

Japan: Second round increase in consumption tax delayed

Prime Minister Shinzo Abe announced last week the postponement of the second consumption tax hike (to 10% from 8%). This was due to take place in April 2017 but will now be introduced in October 2019. This is the second time the hike has been postponed, having initially been slated for October 2015. The move was widely expected by the market and was justified by external factors, most notably concerns over Chinese growth. We believe postponement is the correct move as, given the weak consumption activity; an increase in tax revenue would likely have been muted, notwithstanding the undue pressure it would also have exerted on the already lacklustre domestic demand. We recall that the rise in the tax rate from 5% to 8% in April 2014 pushed the Japanese economy back into recession.

Positive move given weak private demand backdrop

Despite this, we still see a need for wider structural reform to bolster economic activity, alongside further fiscal stimulus. Abe also promised that a second, larger supplementary package will be introduced in the autumn, although no details in terms of size have yet been disclosed. This lack of information disappointed the market though further details could emerge ahead of the upper house election on 10 July. We do not see the deferral of the consumption tax hike impacting the BoJ's upcoming monetary policy decisions, with the BoJ needing to address the weak inflation outlook and strong JPY. We believe that the BoJ will introduce further monetary loosening at its 16 June meeting.

Second supplementary fiscal package expected in autumn this year

C. Emerging Market Economies

India: 1Q GDP surprises consensus but might limit future monetary easing

India's 1Q GDP data significantly surprised consensus to the upside, printing at 7.9% y-o-y (7.5% expected) and showing a marked acceleration in economic growth (7.2% y-o-y in 4Q15). Nevertheless, the underlying trend was broadly in line with our expectations, with consumption remaining resilient and net exports boosting GDP. On the other hand, capital spending in the manufacturing sector remained weak, falling -1.9% y-o-y versus growth of 4.5% in 4Q; this was primarily due to rising balance sheet stress among private companies. The fiscal stance remained steady, with government spending growth largely unchanged at 2.9% y-o-y compared to 3% y-o-y in 4Q.

Growth positively surprised expectations but trends broadly in line with our view

The big difference between our estimates and the actual numbers was the "statistical errors and discrepancy" component, which added 3.7 pp to GDP (average contribution was 1.8-2 pp in FY2015-16). This component cannot be reliably categorised into either

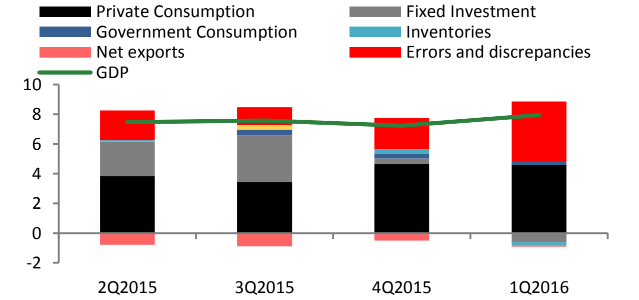
GDP data underestimated consumption strength, mainly in rural areas domestic consumption or corporate inventory. We believe that much of the increase in the error component was simply due to rural consumption being underestimated. The high frequency indicators that we track show steady growth in income in the agriculture and services sectors with a sizeable presence in rural areas (retail trading, transportation). Much of this increase in income could have been translated into gold purchases – a popular physical saving asset in rural areas. Indeed, the data on gold imports and jewellery output also showed a marked pick-up in 1Q, supporting our hypothesis.

The current policy mix indicates RBI could be extremely cautious in easing beyond 3Q16

This mix of GDP growth implies a gradual build-up in inflationary pressures towards 4Q2016-1Q2017, which could limit the RBI's easing cycle. We believe that consumption growth will continue to accelerate towards double digits by end-2016, supported by planned public sector pay hikes and a favourable monsoon season. This should add to the pick-up in core CPI momentum seen in April, likely pushing inflation close to the RBI's upper limit of 6% y-o-y. Though we still expect a 25 bps rate cut by the RBI at its August meeting, mainly to ease liquidity conditions for banks undergoing restructuring, we believe that policy guidance following that meeting is likely to indicate a long pause in monetary easing.

Fig. 8. India: Private consumption remains main driver of real GDP growth

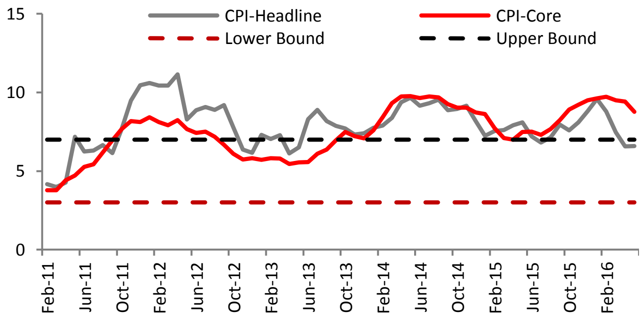
PP contribution to real GDP growth



Source: Central Statistical Organisation

Fig. 9. Turkey: Core inflation showed surprise drop in May, import driven

% change y-o-y



Source: Bloomberg

Turkey: Stronger than expected decline in core inflation

Core inflation decelerates in May, supported by TRY stability

Headline inflation remained unchanged in May at 6.6% y-o-y, though core inflation moderated to 8.8% y-o-y (9.5% y-o-y previously). The numbers support our expectation of another 50 bps rate cut by the CBRT at its meeting in June before an extended pause in 2H2016. The recent stabilisation in TRY depreciation was the main factor behind the decline, as prices of discretionary items and clothing, with significant import shares, grew at a more modest pace. That said, inflation in the services segment, particularly rents, continued to rise. Looking ahead, the pass-through effects of TRY stabilisation since 4Q2015 and an increase in domestic food supply stocks are likely to keep inflation on a downward trajectory, though still above 7% y-o-y (the upper bound of the CBRT's inflation target). However, the degree of rate cuts so far in 2016 and greater external risks to the TRY make us believe that the CBRT will remain on hold in 2H2016.

II. Economic Calendar

Fig. 10. Upcoming events and releases

Time*	Country	Data point	Period	Prior	Consensus
Expected this week					
	UAE	Dubai Airport Cargo Volume, y-o-y	Apr	--	0.1%
	UAE	May Dubai, Abu Dhabi Home Prices by Cluttons			
	Saudi Arabia	Non-Oil Exports, y-o-y	Apr	--	--
	Saudi Arabia	May Cement Output, YTD y-o-y			
	Qatar	CPI, y-o-y	May		3.4%
	Egypt	CPI, y-o-y	May	10.3%	--
	India	BoP Current Account Balance	1Q	`-$7.1B	$4B
	China	Foreign Reserves	May	$3200B	$3219.7B
	China	Trade Balance, USD bn	May	$45.6B	$55.6B
	China	Exports, y-o-y	May	-1.8%	-4.2%
	China	Imports, y-o-y	May	-10.9%	-6.8%
	China	Aggregate Financing CNY	May	751B	950B
	China	New Yuan Loans CNY	May	555.6B	750B
	China	Money Supply M2, y-o-y	May	12.8%	12.5%
Monday 6 June					
10:00	US	Fed's Rosengren Gives Keynote at Helsinki Central Banking Conf			
20:30	US	Fed Chair Yellen to Speak in Philadelphia			
Tuesday 7 June					
09:30	India	RBI benchmark policy rate	7-Jun	6.5%	6.5%
11:30	UK	Halifax House Prices, m-o-m	May	-0.8%	0.3%
13:00	Eurozone	GDP SA, q-o-q	1Q F	0.5%	0.5%
13:00	Eurozone	GDP SA, y-o-y	1Q F	1.5%	1.5%
23:00	US	Consumer Credit	Apr	$29.67B	$18B
Wednesday 8 June					
03:50	Japan	BoP Current Account Balance	Apr	¥2980.4B	¥2307.9B
03:50	Japan	Trade Balance BoP Basis	Apr	¥927.2B	¥920B
03:50	Japan	GDP SA, q-o-q	1Q F	0.4%	0.5%
03:50	Japan	GDP Annualized SA, q-o-q	1Q F	1.7%	2%
03:50	Japan	GDP Deflator, y-o-y	1Q F	0.9%	0.9%
12:30	UK	Industrial Production, m-o-m	Apr	0.3%	0%
12:30	UK	Industrial Production, y-o-y	Apr	-0.2%	-0.4%
15:00	US	MBA Mortgage Applications	3-Jun	-4.1%	--
18:00	US	JOLTS Job Openings	Apr	5757	5650
Thursday 9 June					
03:50	Japan	Machine Orders, m-o-m	Apr	5.5%	-3%
03:50	Japan	Money Stock M2, y-o-y	May	3.3%	3.3%
05:30	China	CPI, y-o-y	May	2.3%	2.3%
05:30	China	PPI, y-o-y	May	-3.4%	-3.1%
11:00	Eurozone	ECB's Draghi Speaks at Economic Forum in Brussels			
16:30	US	Initial Jobless Claims	4-Jun	--	--
18:00	US	Wholesale Inventories, m-o-m	Apr	0.1%	0.1%
Friday 10 June					
03:50	Japan	PPI, y-o-y	May	-4.2%	-4.2%
08:30	Japan	Tertiary Industry Index, m-o-m	Apr	-0.7%	0.7%
16:00	India	Industrial Production, y-o-y	Apr	0.1%	--
18:00	US	U. of Mich. Sentiment	Jun P	94.7	94

* UAE time
Source: Bloomberg

Fig. 11. Last week's data

Time*	Country	Data point	Period	Prior	Consensus	Actual
MENA data						
	Saudi Arabia	M2 Money Supply, y-o-y	Apr	-2.2%	--	-2.8%
	Saudi Arabia	SAMA Net Foreign Assets SAR	Apr	2170B	--	2145.9B
	Qatar	M2 Money Supply, y-o-y	Apr	-0.4%	--	-1.6%
	Egypt	Gross Official Reserves	May	17B	--	17.5B
Monday 30 May						
03:50	Japan	Retail Sales, m-o-m	Apr	1.5%	-0.6%	0%
Tuesday 31 May						
03:30	Japan	Jobless Rate	Apr	3.2%	3.2%	3.2%
03:50	Japan	Industrial Production, m-o-m	Apr P	3.8%	-1.5%	0.3%
03:50	Japan	Industrial Production, y-o-y	Apr P	0.2%	-5%	-3.5%
12:00	Eurozone	M3 Money Supply, y-o-y	Apr	5%	5%	4.6%
13:00	Eurozone	Unemployment Rate	Apr	10.2%	10.2%	10.2%
13:00	Eurozone	CPI flash estimate, y-o-y	May	-0.2%	-0.1%	-0.1%
13:00	Eurozone	CPI Core, y-o-y	May A	0.7%	0.8%	0.8%
16:00	India	GDP, y-o-y	1Q	7.2%	7.5%	7.9%
16:00	India	GDP Annual Estimate, y-o-y	1Q P	7.6%	7.5%	7.6%
16:30	US	Personal Income, m-o-m	Apr	0.4%	0.4%	0.4%
16:30	US	Personal Spending, m-o-m	Apr	0%	0.7%	1%
16:30	US	PCE Deflator, m-o-m	Apr	0.1%	0.3%	0.3%
16:30	US	PCE Deflator, y-o-y	Apr	0.8%	1.1%	1.1%
16:30	US	PCE Core, m-o-m	Apr	0.1%	0.2%	0.2%
16:30	US	PCE Core, y-o-y	Apr	1.6%	1.6%	1.6%
18:00	US	Consumer Confidence Index	May	94.7	96.1	92.6
Wednesday 1 June						
03:50	Japan	Capital Spending, y-o-y	1Q	8.5%	2.4%	4.2%
05:00	China	Manufacturing PMI	May	50.1	50	50.1
09:00	India	Nikkei India PMI Mfg	May	50.5	--	50.7
12:30	UK	Mortgage Approvals	Apr	70.3K	67.9K	66.3K
12:30	UK	Markit UK PMI Manufacturing SA	May	49.4	49.6	50.1
15:00	US	MBA Mortgage Applications	27-May	2.3%	--	-4.1%
18:00	US	ISM Manufacturing	May	50.8	50.3	51.3
Thursday 2 June						
15:45	Eurozone	ECB Main Refinancing Rate	2-Jun	0%	0%	0%
15:45	Eurozone	ECB Deposit Facility Rate	2-Jun	-0.4%	-0.4%	-0.4%
15:45	Eurozone	ECB Marginal Lending Facility	2-Jun	0.25%	0.25%	0.25%
15:45	Eurozone	ECB Asset Purchase Target	Jun	EU80b	EU80b	EU80b
16:15	US	ADP Employment Change	May	166K	173K	173K
16:30	US	Initial Jobless Claims	28-May	268K	270K	267K
Friday 3 June						
16:30	US	Trade Balance	Apr	-$35.5B	-$41B	-$37.4B
16:30	US	Change in Nonfarm Payrolls	May	123K	160K	38K
16:30	US	Change in Private Payrolls	May	130K	150K	25K
16:30	US	Unemployment Rate	May	5%	4.9%	4.7%
16:30	US	Average Hourly Earnings, m-o-m	May	0.4%	0.2%	0.2%
16:30	US	Average Hourly Earnings, y-o-y	May	2.5%	2.5%	2.5%
18:00	US	ISM Non-Manf. Composite	May	55.7	55.3	52.9
18:00	US	Factory Orders, m-o-m	Apr	1.7%	1.9%	1.9%
Sunday 5 June						
09:30	Saudi Arabia	Saudi Arabia PMI	May	54.2	--	54.8
09:30	Egypt	Egypt PMI	May	46.9	--	47.6
09:30	UAE	UAE PMI	May	52.8	--	54

UAE time
Source: Bloomberg

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