Economic Research

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The Week Ahead: All eyes on the ECB

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Eurozone: ECB set to loosen, but differences in Council could lead to surprise

The key event this week is the ECB meeting on 10 March, where at the very minimum we expect a -10 bps cut in the deposit rate to -0.4%. There have been some expectations of a possible “tiered” deposit rate system, as in Japan, which would help shield bank profitability from deeper negative deposit rates. However, we believe it could be too soon for this to be introduced. The ECB could also provide new longer-term liquidity for the banking sector, as the targeted longer-term refinancing operations (TLTRO) is due to end in June. Consensus also expects the asset purchase programme to be increased from EUR60 billion per month to EUR70 billion. There has also been market speculation that the programme could be extended by three or six months. However, there are a number of technical constraints to expanding the programme, notably the scarcity of eligible assets, which will need to be addressed. There are also signs of divisions within the ECB’s Governing Council, which adds to the uncertainty ahead of the meeting.

US: Relatively quiet data week; focus on Fed speakers

The upcoming week is rather quiet in US data release terms. The focus will be on Fed speakers, with Vice Chair Stanley Fischer and Governor Lael Brainard speaking on Monday. This is especially the case following the strong labour reports for February and ahead of the 16 March FOMC meeting. The US economy added 242K jobs in February, substantially above the 195K consensus expectation. Meanwhile, the unemployment rate held steady at 4.9%, despite a rise in the participation rate. A monthly fall in wages was the main disappointment of the report. Nevertheless, overall the data was robust, highlighting a continued tightening in the labour market. Despite the strong report, we do not see the Fed moving at its March meeting, given the still fragile global sentiment.

China: Data for February including trade, bank lending and CPI

Elsewhere, the focus will be on the monthly data for February. CPI inflation for China is expected to remain steady at 1.8% y-o-y in February, which should provide further support for interest rate cuts. Aggregate financing is expected to have remained strong, albeit likely down from the unsustainable pace in January. Increased infrastructure investment and signs of a pickup in property sales should be underlying factors supporting bank lending. From March, credit growth should also benefit from the 50 bps RRR cut for all financial institutions, effective from 1 March. Meanwhile, the National People's Congress (NPC) indicated a more supportive fiscal stance to support the growth outlook. The fiscal deficit target has been widened to 3% of GDP for 2016, up from 2.3% of GDP in 2015 and 1.8% in 2014. This will allow both higher government spending and tax cuts for corporates. Earlier in the NPC, China lowered its GDP target to 6.5-7% for 2016 (from 7% in 2015).

I. Recent Events and Data

A. MENA Economies

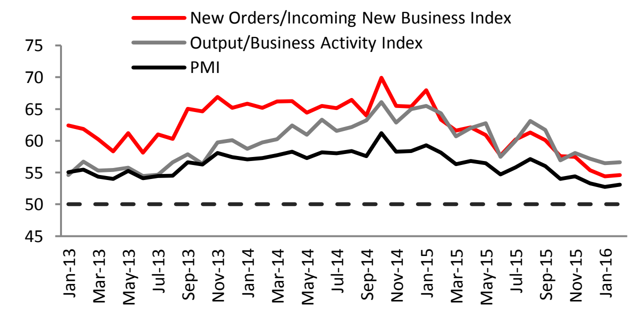
UAE and Saudi PMI: Some improvement in February readings

PMI data still point to overall weakening in private sector growth

Both the UAE and Saudi Arabia's PMI readings rose in February from their multi-year lows in January. We believe that the stabilisation in oil prices and reduction in global market volatility likely improved sentiment. Overall, the data continued to point to a deceleration in private sector activity into 2016, though it remained positive.

Fig. 1. UAE: PMI index rises in February, from 46-month low in January

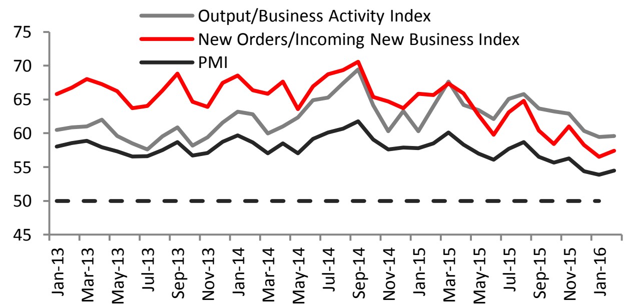
Index; reading above 50 indicates expansion



Source: Markit Economics

Fig. 2. Saudi Arabia; PMI data point to pickup in both external and domestic demand in February

Index; reading above 50 indicates expansion



Source: Markit Economics

UAE PMI rises on employment and export orders

In the UAE, the headline PMI rose to 53.1 in February, up from 52.7 in January (a level above 50 indicates expansion). The two main categories supporting the rise were employment and export orders. We see the rise in export orders as positive given its role in driving key sectors of the economy. The PMI data pointed to a weaker rise in domestic demand. Overall, we continue to see a weaker employment backdrop in 2016 due to the forecast slowdown in growth. In Saudi Arabia, both total and export orders supported the pickup in headline PMI. New export orders rose particularly strongly in February. The headline PMI index rose to 54.4 in February from 53.9 in January, which was its lowest reading since the survey was launched in August 2009.

Bahrain: Sovereign ratings downgraded by Moody's, other GCC countries placed on watch

Bahrain downgraded by one notch – to below investment grade

Moody's Investors Service downgraded Bahrain's long-term issuer rating to Ba1 from Baa3, with a negative outlook, and placed it on review for further downgrade. This follows a two notch downgrade by S&P in February. Both ratings agencies now have Bahrain below investment grade. In line with other recent downgrades, this move was due to the negative impact of the further sharp fall in oil prices, which Moody's expects to remain low for several years. This will affect Bahrain's government finances, balance of payments and economic performance. Moody's estimates that with the lower oil price, Bahrain's fiscal deficit widened to 13.4% of GDP in 2015. We estimate a slightly higher deficit of 14.9% (please see our note **GCC: Adjusting to a low oil price environment**, published on 25 February 2016). Moreover, Moody's estimates that government debt increased to almost 61% of GDP in 2015, from 44% in 2014, and will rise to 80% of GDP in 2016.

Kuwait, Qatar, Saudi Arabia and UAE placed on review

Moody’s also placed the outlooks of 12 other oil exporting countries on review to assess the full impact of the oil price shock. Moody's aims to conclude all rating reviews within two months. Within the GCC this includes Kuwait, Qatar, Saudi Arabia and the UAE. Moody’s already lowered Oman's government long-term issuer rating by two notches to A3 and placed it on review for further downgrade on 26 February 2016 (please see our **Global Data Watch**, published on 29 February 2016). We continue to highlight the better ability of Kuwait, Qatar and the UAE to withstand the lower oil price, notably given their stronger fiscal buffers. Moody’s Brent crude assumptions are USD33 p/b for 2016 and USD38 p/b for 2017, below our forecasts of USD41 p/b and USD50 p/b respectively. We continue to expect the downgrades by S&P and Moody’s to raise the cost of government borrowing, especially external. However, we do expect the debt capital and syndicated loans markets to be open to the GCC.

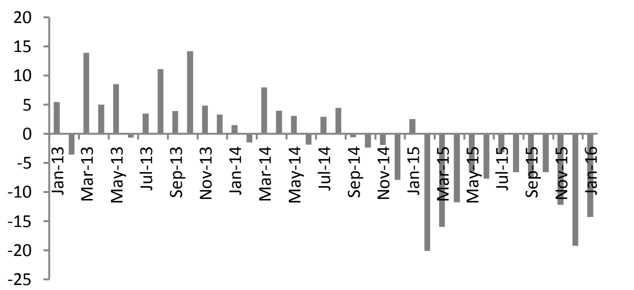
Saudi Arabia: FX reserves post another large decline in January

SAMA’s NFAs fall -USD14.3 billion in January

SAMA’s NFAs fell by -USD14.3 billion m-o-m in January to USD594.6 billion, their lowest level since July 2012. The decline comprised a -USD10.8 billion drop in SAMA’s foreign currency deposits held abroad and a -USD3.5 reduction in its foreign securities holdings. However, the monthly fall in absolute terms, while still large, was milder than the December drop of -USD19.3 billion, which is notable given that oil prices fell further in January. We believe that the more moderate drop in January likely reflected a greater drawdown of government deposits at SAMA and commercial banks. Thus, the data do not point to a pullback in government spending in January despite the contractionary budget announced for the year.

Fig. 3. Saudi Arabia: SAMA’s NFAs drop sharply again in January (though by less than in December)

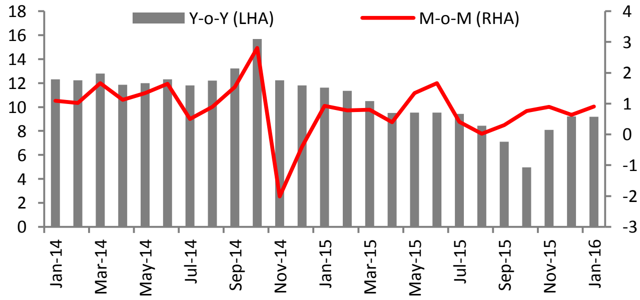
USD billion



Source: Saudi Arabian Monetary Agency

Fig. 4. Saudi Arabia: Private sector credit growth accelerates since November 2015

% change



Source: Saudi Arabian Monetary Agency

Public and private sector loan growth solid

Meanwhile, other monetary data showed liquidity tightened further in January, with total deposits falling -0.5% m-o-m and system-wide credit growing 0.8% m-o-m. Total loan growth remained strong at 10.6% y-o-y, broadly in line with the 10.4% seen in December. Government borrowing from the banking sector rose by 65.4% y-o-y, though it accounted for only 6.3% of total credit. Private sector credit growth also remained solid at 9.2% y-o-y, accelerating from the 5% y-o-y in October, possibly due to delays in government payments. These delays could be resulting in corporates turning to bank credit to bridge financing requirements. Meanwhile, indicators of private consumption, such as POS transactions, point (unsurprisingly) to a fall in spending in January. We attribute this to the subsidy reforms and the January fall in oil prices. The value of sales fell -1.5% m-o-m (versus a 6.4% rise in December), whilst growth in the number of transactions decelerated to 3% m-o-m (from 9% in December).

Limited supply of affordable housing remains a key issue

Loosening of mortgage terms: SAMA announced an affordable mortgage scheme last week, in conjunction with the ministries of housing and finance. Under the scheme, the loan-to-value ratio of mortgages would increase to 85% from the current 70%. However, no indication has been given regarding either timing or eligibility. The funding would be guaranteed by the Ministry of Finance, and likely support developers' desire to progress with low-income housing projects. We see the aim of the move as to increase property ownership amongst Saudis. However, we see two short-term risks: i) the shortage of affordable housing; and ii) the tightening liquidity in the banking sector. Whilst the government is looking to progress with a number of initiatives to increase housing supply, we believe this will take time. Recent measures include taxing undeveloped urban land.

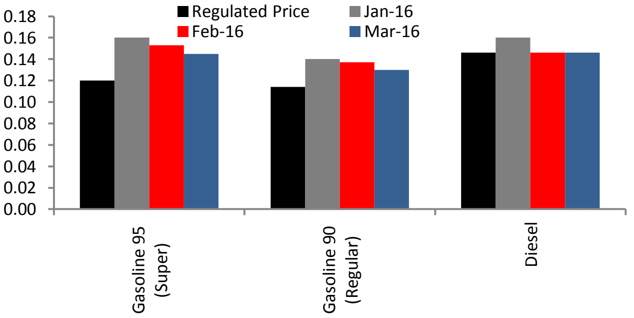
GCC: Oman and UAE reduce fuel prices for March

Reduction in Oman prices indicates they are now market based

Oman and the UAE each announced lower gasoline prices for March, reflecting the weaker global oil price. This was Oman's second adjustment since it liberalised fuel prices on 15 January, with prices having been cut on both occasions. The price reduction for March indicates that the liberalisation lifted prices in line with the market level. Initial comments from Oman suggested that it had not liberalised fuel prices completely. Prices in Oman and the UAE are broadly comparable now. The liberalisation in Oman will strengthen inflation, albeit less than was implied in January due to the subsequent reductions. Oman has indicated that it is looking to raise electricity subsidies for high consumption commercial, industrial and government users. However, we believe that the pass-through to consumers will be relatively limited. We see UAE inflation moderating in 2016 following the August 2015 price deregulation, and expect gasoline prices to be around -20% y-o-y lower in March.

Fig. 5. Oman: Reduces prices in March, for second consecutive month

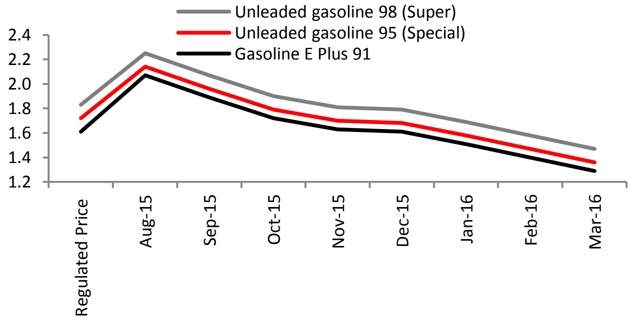
OMR per litre



Source: Oman Ministry of Oil and Gas

Fig. 6. UAE: Gasoline prices around -20% y-o-y lower in March

AED per litre



Source: UAE Ministry of Energy

B. G4 Economies

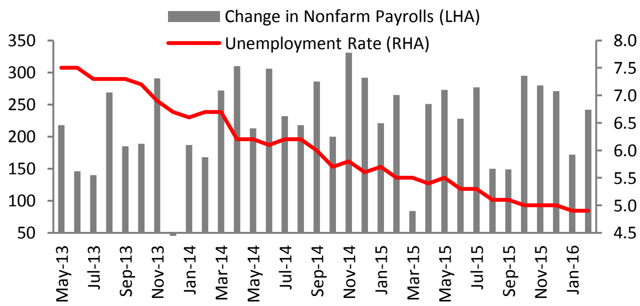
US: Adds robust 242K jobs in February, though wages retreat

The US economy added 242K jobs in February, substantially above the 195K consensus expectation. Overall the data continue to highlight the strength of the labour market, though wage growth fell in monthly terms. Service sectors were largely behind the strong growth, led by education & health services. Retail trade and leisure & hospitality also saw solid gains. Meanwhile, the manufacturing sector contracted by -16K. In another positive development, the previous estimates for December and January were revised up by a net 30K. This, alongside the strong February print, resulted in a robust three-month average of 228K. The unemployment rate held steady at 4.9%, despite the participation rate rising to 62.9% in February from 62.7% the previous month.

Strong job creation in the service sector – net upward revisions for December and January

Fig. 7. US: Three-month average job creation stood at 228K between December and February

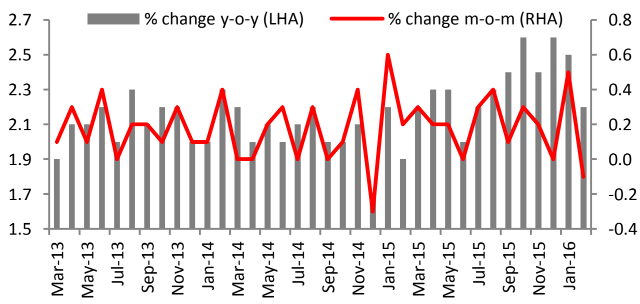
'000(LHA); % (RHA)



Source: Bloomberg

Fig. 8. US: Wage growth falls in monthly terms, after strong growth in January

% change



Source: Bloomberg

The key negative of the labour report was the -0.1% m-o-m fall in average hourly earnings. This was likely some pullback from the 0.5% m-o-m rise in January. Wage growth in y-o-y terms decelerated to 2.2% in February, from 2.5% the previous month. However, the fall in wage growth was concentrated in a number of sectors including mining and financial activity. Removing the volatility of one month's data, the labour market continues to show a solid and sustained recovery. This should continue to drive personal consumption and residential investment, alongside inflation in service sectors. We do not expect jobs growth to remain above 200K as the labour market recovery matures. Nevertheless, jobs growth in the mid-100K region should still be sufficient for an ongoing tightening. This supports our outlook for two rate hikes in June and December. Despite the strong jobs creation in February, we do not see the Fed moving at the March meeting, given the still fragile global sentiment.

Hourly wage growth falls -0.1% m-o-m in February

Eurozone: Deflation returns in February, raising pressure on ECB

The flash reading of February inflation surprised markedly to the downside at -0.2% y-o-y, versus the consensus forecast of 0% y-o-y. Alongside the expected drag from energy prices (down -8% y-o-y), core inflation moderated to 0.7% y-o-y in February (from 1% in January), its lowest reading since April 2015. The deceleration was broad-based, including in services and industrial goods. The strong EUR likely

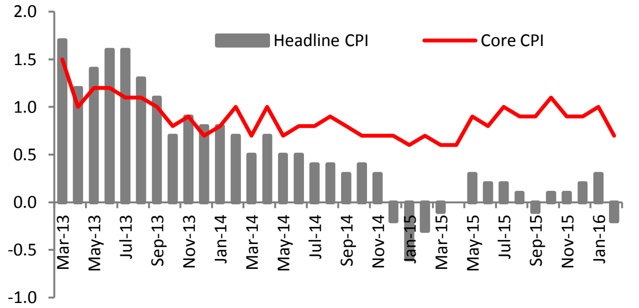
Broad-based deceleration in subcomponents of core inflation contributed to the softening in non-energy goods prices. Meanwhile, domestic inflationary pressures remained muted due to the persistently large output gap.

Divisions within Governing Council could limit policy response

The weak inflation has increased pressure on the ECB to provide a strong policy response on 10 March. However, divisions within the Governing Council may result in a more muted stance. Some members are looking to act decisively in response to signs of the low inflation environment becoming entrenched in wage expectations (the reduction in unemployment has not resulted in upward pressure on prices). Meanwhile, others argue that inflation will eventually pick up with the recovery in GDP growth. Moreover, recent comments have indicated growing concerns over the impact of negative interest rates on the banking sector. A number of technical constraints will also need to be addressed before significant changes can be made to the ECB's asset purchase programme.

Fig. 9. Eurozone: CPI falls back into deflation in February, raising expectations of bold ECB action

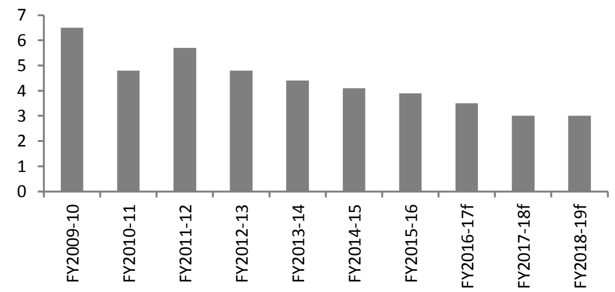
% change y-o-y



Source: Bloomberg

Fig. 10. India: Fiscal consolidation continuing, with fiscal deficit expected to reach 3% of GDP in FY2017-18

Fiscal deficit, % of GDP



Source: India budget statements; CEIC

C. Emerging Market Economies

India: FY2016-17 budget maintains consolidation path, though still growth-supportive

Government's GDP growth and revenue assumptions look largely achievable

We see a number of positives in India's FY2016-17 (April-March) fiscal budget, notably fiscal consolidation being balanced with growth. The budget remained consolidatory, sticking to the fiscal deficit target of 3.5% of GDP. This was down from a target of -3.9% for FY2015-16. The outlook was for further consolidation, with the deficit target of -3% of GDP in FY2017-18 also being retained. The underlying GDP growth and revenue assumptions for FY2016-17 largely look realistic. The budget is based on nominal GDP growth of 11% y-o-y, whilst gross tax revenues are slated to increase 11.7% y-o-y. However, one area of risk is the ambitious disinvestment target, which could be impacted by capital market sentiment.

Government spending focus to support private consumption

Total spending is set to rise 10.8% y-o-y, driven largely by current expenditure. This will include expenditure associated with the Seventh Pay Commission hike, which includes increases in basic pay and pension contributions, estimated to increase 18% y-o-y. However, the proposed increases in allowances have been postponed. The wage growth, along with the lower oil prices, should be positive for private consumption, which we expect to be the main GDP growth driver in 2016. We see the outlook for investment spending as being weaker than for current spending; capital expenditure in the budget remained broadly unchanged and we continue to see implementation risks.

Moreover, if government revenues disappoint, then we believe that any pullback in spending would likely be made on the investment front.

Budget leaves space for 25 bps rate cut at April meeting

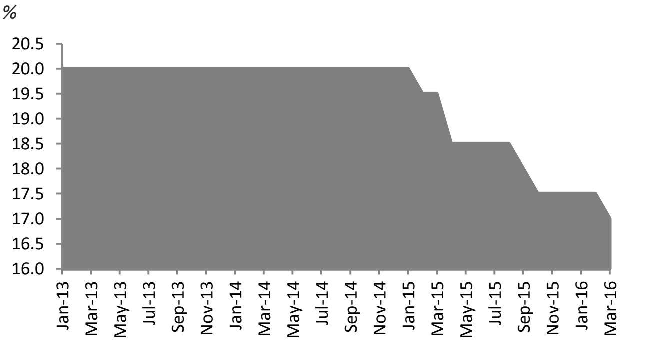
The other key focus of the budget was rural development, following two years of drought. This includes investment irrigation facilities, grants for villages and reductions in farmers' debt burdens. The measures to support rural development should result in more balanced growth and be positive for consumption. Agriculture and related sectors account for about half of India's employment. Moreover, improvement in the agricultural sector's performance would also ease the government's food subsidy burden and reduce food inflation. With the budget remaining fiscally consolidatory, we expect the RBI to cut rates by 25 bps at its 5 April meeting. This expectation is supported by CPI inflation having printed at 5.7% y-o-y in January, i.e. below the RBI's January 2016 target of 6%.

China: Reduces RRR, pumps liquidity into banking sector

RRR lowered by 50 bps – fifth reduction since early 2015

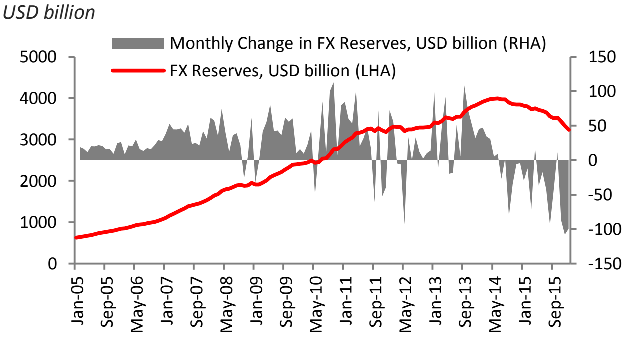
China added to its monetary stimulus measures last week by cutting the RRR and injecting around USD100 billion long-term cash into the economy. The PBoC lowered the RRR by 50 bps for all financial institutions, effective from 1 March, releasing about RMB600-700 billion liquidity into the banking system. This was the fifth RRR cut since February 2015, and was made amidst signs of a further economic slowdown and weak inflation drivers. The increased liquidity should bolster credit growth, including meeting corporate financing needs and supporting infrastructure investments by GREs. We see these measures as signalling an ongoing loosening bias in order to bolster private and market confidence. The RRR cut indicates that the PBoC is more confident regarding the impact of the capital outflows on FX stability. In January, the bank indicated that it was reluctant to lower the RRR due to concerns that capital outflows would weaken the currency. Notably, the large capital outflows themselves necessitate further RRR cuts to offset any liquidity tightening.

Fig. 11. China: Lowers banks' RRR by 50 bps effective 1 March, which should support credit growth



Source: Bloomberg

Fig. 12. China: Strong capital outflows necessitate lowering RRR to offset any liquidity tightening



Source: Bloomberg

Greater fiscal loosening also needed to support growth

We continue to foresee a further 100-150 bps RRR cut in 2016, alongside a 50 bps benchmark rate cut. We believe that the focus will remain on spurring domestic demand. At the G20 meeting, PBoC Governor Zhou Xiaochuan highlighted that monetary easing remains effective and should be combined with fiscal expansion and structural reforms. We also expect greater exchange rate flexibility and an overall weakening of the CNY against the USD. However, we believe that the near-term focus will be on CNY stability.

II. Economic Calendar

Fig. 13. Upcoming events and data releases

Time*	Country	Data point	Period	Prior	Consensus
Expected this week					
	Qatar	CPI, y-o-y	Feb	2.8%	--
	Saudi Arabia	CPI, y-o-y	Feb	4.3%	--
	China	Foreign Direct Investment CNY, y-o-y	Feb	3.2%	--
	China	Aggregate Financing CNY	Feb	3417.3B	1790B
Monday 7 Mar					
7:40	Japan	BOJ Kuroda Speaks in Tokyo			
21:00	US	Fed's Brainard Speaks at International Banking Conference			
21:30	US	Fed's Fischer Speaks at Annual NABE Conference in Washington			
	China	Foreign Reserves	Feb	$3230.9B	$3190B
Tuesday 8 Mar					
3:50	Japan	GDP SA, q-o-q	4Q F	-0.4%	-0.4%
3:50	Japan	GDP Annualized SA, q-o-q	4Q F	-1.4%	-1.6%
3:50	Japan	GDP Private Consumption, q-o-q	4Q F	-0.8%	-0.8%
3:50	Japan	GDP Business Spending, q-o-q	4Q F	1.4%	1.2%
9:00	Japan	Consumer Confidence Index	Feb	42.5	42.2
12:00	Eurozone	EU Finance Ministers Meet in Brussels			
14:00	Eurozone	GDP SA, q-o-q	4Q P	0.3%	0.3%
14:00	Eurozone	GDP SA, y-o-y	4Q P	1.5%	1.5%
	China	Trade Balance	Feb	$63.3B	$50.8B
	China	Exports, y-o-y	Feb	-11.2%	-15%
	China	Imports, y-o-y	Feb	-18.8%	-10.2%
Wednesday 9 Mar					
9:15	UAE	Dubai Economy Tracker SA	Feb	50.7	--
10:00	Japan	Machine Tool Orders, y-o-y	Feb P	-17.2%	--
13:30	UK	Industrial Production, m-o-m	Jan	-1.1%	0.4%
13:30	UK	Industrial Production, y-o-y	Jan	-0.4%	0%
16:00	US	MBA Mortgage Applications	4-Mar	-4.8%	--
Thursday 10 Mar					
3:50	Japan	PPI, m-o-m	Feb	-0.9%	-0.3%
3:50	Japan	PPI, y-o-y YoY	Feb	-3.1%	-3.4%
4:01	UK	RICS House Price Balance	Feb	49%	50%
5:30	China	CPI, y-o-y	Feb	1.8%	1.8%
5:30	China	PPI, y-o-y	Feb	-5.3%	-4.9%
16:45	Eurozone	ECB Main Refinancing Rate	10-Mar	0.05%	0.05%
16:45	Eurozone	ECB Deposit Facility Rate	10-Mar	-0.3%	-0.4%
16:45	Eurozone	ECB Marginal Lending Facility	10-Mar	0.3%	0.3%
	Eurozone	Draghi Gives Press Conference after ECB Rate Decision			
17:30	US	Initial Jobless Claims	5-Mar	278K	275K
	Egypt	Urban CPI, y-o-y	Feb	10.1%	--
	Egypt	Urban CPI, m-o-m	Feb	0.1%	--
	Egypt	CPI Core, y-o-y	Feb	7.7%	--
Friday 11 Mar					
13:30	UK	Trade Balance	Jan	-£2709	-£3000
16:00	India	Industrial Production, y-o-y	Jan	-1.3%	--
17:30	US	Import Price Index, m-o-m	Feb	-1.1%	-0.8%
17:30	US	Import Price Index, y-o-y	Feb	-6.2%	-6.6%

* UAE time
Source: Bloomberg

Fig. 14. Last week's data

Time*	Country	Data point	Period	Prior	Consensus	Actual
Monday 29 Feb						
3:50	Japan	Industrial Production, y-o-y	Jan P	-1.9%	-3.8%	-3.8%
3:50	Japan	Retail Trade, y-o-y	Jan	-1.1%	0.1%	-0.1%
3:50	Japan	Retail Sales, m-o-m	Jan	-0.3%	0.1%	-1.1%
13:30	UK	Mortgage Approvals	Jan	71.3K	74K	74.6K
14:00	Eurozone	CPI Estimate, y-o-y	Feb	0.3%	0%	-0.2%
14:00	Eurozone	CPI Core, y-o-y	Feb A	1%	0.9%	0.7%
19:00	US	Pending Home Sales, m-o-m	Jan	0.9%	0.5%	-2.5%
19:00	US	Pending Home Sales NSA, y-o-y	Jan	3.1%	3.8%	-0.9%
Tuesday 1 Mar						
5:45	China	Caixin China PMI Mfg	Feb	48.4	48.4	48
6:00	Japan	Nikkei Japan PMI Mfg	Feb F	50.2	--	50.1
9:00	India	Nikkei India PMI Mfg	Feb	51.1	--	51.1
13:00	Eurozone	Markit Eurozone Manufacturing PMI	Feb F	51	51	51.2
13:30	UK	Markit UK PMI Manufacturing SA	Feb	52.9	52.3	50.8
14:00	Eurozone	Unemployment Rate	Jan	10.4%	10.4%	10.3%
19:00	US	ISM New Orders	Feb	51.5	--	51.5
19:00	US	ISM Manufacturing	Feb	48.2	48.5	49.5
Wednesday 2 Mar						
16:00	US	MBA Mortgage Applications	26-Feb	-4.3%	--	-4.8%
17:15	US	ADP Employment Change	Feb	193K	190K	214K
Thursday 3 Mar						
5:45	China	Caixin China PMI Composite	Feb	50.1	--	49.4
6:00	Japan	Nikkei Japan PMI Composite	Feb	52.6	--	51
9:00	India	Nikkei India PMI Composite	Feb	53.3	--	51.2
9:30	Saudi Arabia	Saudi Arabia PMI	Feb	53.9	--	54.4
9:30	Egypt	Egypt PMI	Feb	48	--	48.1
9:30	UAE	UAE PMI	Feb	52.7	--	53.1
12:30	UK	Halifax House Prices, m-o-m	Feb	1.7%	0%	-1.4%
12:30	UK	Halifax House Price, 3Mths/Year	Feb	9.7%	10.4%	9.7%
13:00	Eurozone	Markit Eurozone Composite PMI	Feb F	52.7	52.7	53
14:00	Eurozone	Retail Sales, m-o-m	Jan	0.6%	0.1%	0.4%
14:00	Eurozone	Retail Sales, y-o-y	Jan	2.1%	1.3%	2%
17:30	US	Initial Jobless Claims	27-Feb	272K	270K	278K
19:00	US	Factory Orders	Jan	-2.9%	2.1%	1.6%
19:00	US	Factory Orders, ex-Trans	Jan	-0.9%	--	-0.2%
Friday 4 Mar						
17:30	US	Trade Balance	Jan	-$44.7B	-$44B	-$45.7B
17:30	US	Change in Nonfarm Payrolls	Feb	172K	195K	242K
17:30	US	Unemployment Rate	Feb	4.9%	4.9%	4.9%
17:30	US	Average Hourly Earnings, m-o-m	Feb	0.5%	0.2%	-0.1%
17:30	US	Average Hourly Earnings, y-o-y	Feb	2.5%	2.5%	2.2%
17:30	US	Labor Force Participation Rate	Feb	62.7%	62.8%	62.9%

* UAE time
Source: Bloomberg

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