# Economic Research

بنك أبوظبي التجاري
ADCB



## The Week Ahead: Fed turns even more dovish; we expect another cut by CBE

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### US: Fed communication, 4Q GDP and January PCE inflation

A number of Fed speakers, including Vice Chair Richard Clarida, John Williams and Randal Quarles, have speaking engagements this week. Markets will watch for any further information on what triggered the Fed to effectively indicate no rate hikes in 2019 at last week's FOMC meeting (page 3). Following the dovish Fed and weak global data, the yield spread between the US 3-month Treasury bill and the 10-year note inverted for the first time since 2007, raising fears of a recession. We expect the speakers to maintain a cautious tone and highlight increasing global uncertainties, along the lines of Fed Chair Jerome Powell's post-meeting press conference. Our key takeaway from the FOMC meeting is that the Fed has become less confident in the medium-term economic outlook, and has shifted its focus to support growth while inflation remains under control. We see the change in stance from January as intended to prolong the business cycle with an accommodative monetary policy stance. Meanwhile, the US will release the final print of 4Q GDP with consensus expected it to be lowered to 2.3% q-o-q SAAR in 4Q, from 2.6% previously.

### UK: Next two weeks critical for Brexit developments

Brexit-related uncertainty should continue this week, with pressure mounting on Prime Minister Theresa May to find a Brexit solution or a way forward following the options given by the European Council at the end of last week (page 4). It remains unclear whether the government will hold a third meaningful vote on PM May's Brexit deal this week or not. However, the indications are that there is still no majority for the deal despite increasing chances of Brexiters coming together to support the withdrawal agreement. Indeed, we see a strong likelihood that Parliament will look to take greater control of the Brexit proceedings in the upcoming days, with MPs voting on a number of amendments to decide the way forward. We expect political tensions to remain high in the coming two weeks amidst rising public support for a second referendum.

### Egypt: CBE likely to cut rates by another 100 bps

We expect the CBE to cut benchmark interest rates by another 100 bps on 28 March, as at its February meeting. We highlight greater risks to our forecast following the February CPI print, when headline inflation strengthened to 14.4% y-o-y – a three-month high and up from 12.7% in January. However, the rise in inflation was driven by food prices (particularly vegetables) which are volatile and not responsive to monetary policy. The increase in core inflation was more contained, rising to 9.2% y-o-y in February (January: 8.6%) and still within the CBE's new 9% (±3%) target for 4Q2020. We expect the CBE to take advantage of the EGP's strengthening from the end of January, buoyed by solid capital inflows and the dovish stance of the Fed. We believe that the differential yield on government debt securities will still be positive enough to attract further inflows. If the CBE does not move this week, it will probably have to wait until September before it is in a position to cut again, given the outlook for mid-year fuel and utility price reforms and the start of Ramadan.

# I. Recent Events and Data Releases

## A. MENA Economies

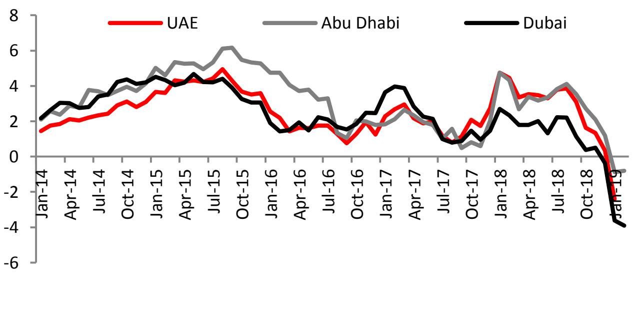
### GCC: UAE and Saudi Arabia see further deflation in February

*Dubai sees greater deflation in February, largely due to transportation subcomponent*

UAE and Saudi Arabia saw deflation for a second consecutive month in February, in line with our expectations. As highlighted in our earlier research, we believe that both countries will see a contraction in annual average inflation in 2019. For both of these countries, key factors have been: i) the fall in residential rental prices; ii) the weak domestic demand backdrop; and iii) the impact of VAT dropping out of the annual data. In the case of the UAE, lower fuel prices are also a contributing factor. In Abu Dhabi, the CPI fell by 0.8% y-o-y in February, broadly in line with the January print (-0.88% unrounded), while in Dubai, there was a stronger contraction of 3.9% from 3.6% in January. The greater fall in Dubai's consumer prices in February was largely due to the transportation component. We do not expect to see any meaningful strengthening in household spending, as the deflation partly reflects structural challenges to the economy – namely the oversupply of housing, which is also feeding into a number of other economic areas. For further details, please see our note – **UAE Economic Update: Consumer price index contracts in January; deflation expected for 2019**, published on 4 March 2019.

**Fig. 1. UAE: Fall in fuel and housing prices largely behind 2019 deflation**

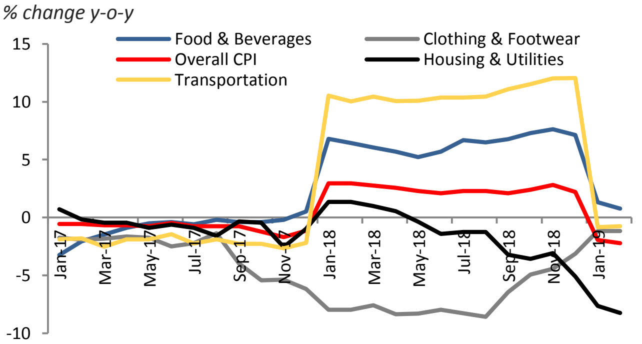
*% change y-o-y*




Source: Federal Competitiveness and Statistics Authority, Statistics Centre of Abu Dhabi, Dubai Statistics Centre, ADCB calculations

**Fig. 2. Saudi Arabia: Decline of expatriate population resulting in fall in housing inflation**

*% change y-o-y*




Source: General Authority for Statistics, ADCB calculations

*Recovery in UAE and Saudi private consumption expected to be weak due to ongoing structural challenges*

In the case of Saudi Arabia, the CPI fell at a faster pace of 2.2% y-o-y in February, from a contraction of 1.9% in January. On a monthly basis, prices fell by 0.2% – the seventh consecutive month of price decline. The deflation continued to be led by the housing subcomponent, which saw a further weakening in February. We continue to foresee private consumption remaining weak in 2019 due to ongoing job losses in the expatriate population – albeit at a weaker pace than in 2018 – and a further rise in dependents fees. Changes to spending patterns over the last few years due to the fiscal consolidation should also limit the recovery in private consumption, alongside the high national unemployment level. However, the forecast rise in government wages and no new major fiscal measures should support a gradual pick-up in household spending. For further details, please see our note – **Saudi Arabia Economic Update: Return to deflation**, published on 19 February 2019.

# B. G4 Economies

## US: Fed delivers dovish surprise, signalling no rate hikes in 2019

*Fed reiterates its patient approach with wait-and-see stance*

The Fed kept interest rates on hold at its 19-20 March meeting, but delivered a dovish surprise once again. The highlights of the FOMC meeting were: i) that the median dots now indicate no further rate hikes in 2019 and only one 25bps hike in 2020; and ii) the balance sheet reduction will slow from May and will be completed by the end of September. Moreover, the changes made to the policy statement, revisions to economic projections, and the tone of the post-meeting conference all had a dovish tilt, further reinforcing the Fed's already bearish stance. Fed communication continues to indicate that it will remain patient for a longer period than envisaged at the January meeting. Fed Chair Jerome Powell underlined that the Fed is yet to achieve its inflation target in a symmetrical way, suggesting that it would like to see inflation above 2% for a considerable period before it takes any further action. On dot plot projections, 11 of the 17 FOMC members now forecast no rate hike in 2019, as compared to the two rate hikes projected in December 2018. Overall, the dot plot is indicating just one further 25bps rate hike in the current hiking cycle. On the economy, the Fed now expects GDP growth to expand at a slower pace of 2.1% in 2019 (December: 2.3%) and 1.9% in 2020 (down from 2% previously). Despite the downward GDP growth revisions, the 2019 forecast was still higher than the longer-run estimate of 1.9%.

*We believe that Fed's ultra-dovish stance could be premature*

Our key takeaway was that the Fed has become less confident in the medium-term economic outlook (global and domestic), with the focus shifting to support growth while inflation remains under control. We see this shift in stance as intended to prolong the business cycle with an accommodative monetary policy stance. The Fed's ultra-dovish stance at this point could be premature, especially given the still healthy economic expansion, close to target inflation and tight labour market conditions. We also highlight the possibility of the Fed reversing its stance on its interest rate outlook if the incoming data surprises to the upside in the near term, especially after witnessing a number of U-turns from the central bank in this hiking cycle. Hence, we retain our core scenario of one 25bps rate hike in 2019, but underline increasing downside risks to our view. The FOMC continues to highlight its data dependence, thus keeping the door open for a change in stance.

**Fig. 3. US: Summary of FOMC's median economic projections, %**

| | 2019 | 2020 | 2021 | Longer run |
|---|---|---|---|---|
| **Real GDP growth, 4Q y-o-y** | | | | |
| March | 2.1 | 1.9 | 1.8 | 1.9 |
| December | 2.3 | 2 | 1.8 | 1.9 |
| **Unemployment rate, 4Q average** | | | | |
| March | 3.7 | 3.8 | 3.9 | 4.3 |
| December | 3.5 | 3.6 | 3.8 | 4.4 |
| **PCE inflation, 4Q y-o-y** | | | | |
| March | 1.8 | 2 | 2 | 2 |
| December | 1.9 | 2.1 | 2.1 | 2 |
| **Core PCE inflation, 4Q y-o-y** | | | | |
| March | 2 | 2 | 2 | - |
| December | 2 | 2 | 2 | - |
| **Median FFTR, year end** | | | | |
| March | 2.375 | 2.625 | 2.625 | 2.75 |
| December | 2.875 | 3.125 | 3.125 | 2.75 |

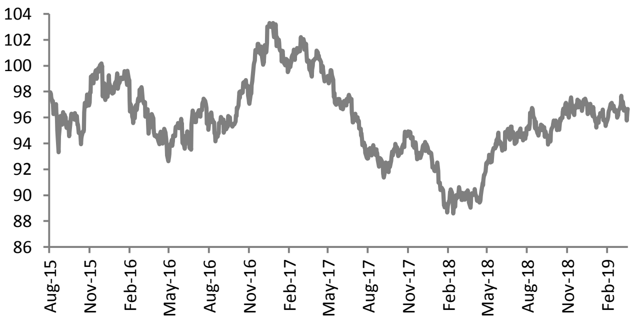
Source: Federal Reserve

*Balance sheet reduction to slow in May and end in September*

On the balance sheet, the Fed announced that the reduction would slow from May and be completed by the end of September. During May to September, the FOMC will reduce the run-off of its Treasury security holdings to USD15 billion, from the current USD30 billion. However, the Fed will continue to allow its holdings of agency debt and mortgage-backed securities (MBS) to decline, with an objective of holding only treasury securities in the longer run. Starting from October, the Fed will reinvest maturing MBS across the UST curve, capping MBS redemptions at USD20 billion per month. Chair Powell noted that the Fed will reinvest maturing MBS securities across the treasury curve for now, but highlighted the possibility of shifting to shorter maturities at a later date.

**Fig. 4. US: Dollar index still broadly steady last week despite dovish Fed communication**

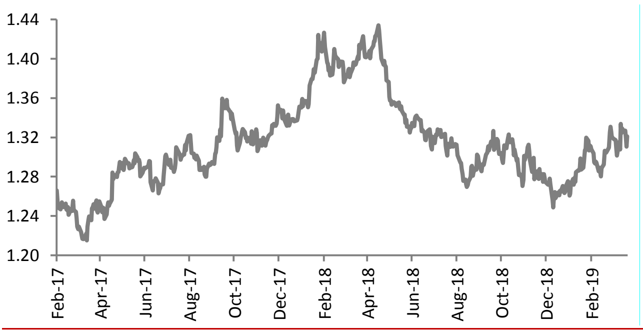
*DXY index*




Source: Bloomberg

**Fig. 5. UK: GBP still supported against USD with markets pricing in eventual soft Brexit outcome**

*GBP:USD*




Source: Bloomberg

## UK: EU extends Article 50 beyond 29 March, albeit with conditions

*EU extends Article 50 deadline by at least two weeks*

The European Council (EC) extended the 29 March deadline for the UK leaving the EU to 12 April, giving the UK around two additional weeks to pass the Brexit deal or agree a way forward. EC President Donald Tusk provided four main options for the UK. These are: i) PM May's deal; ii) a no-deal exit; iii) a long extension; and iv) revocation of Article 50 – with the latter two scenarios requiring the UK to hold European parliamentary elections. The EC plan stipulates that if the UK parliament passes PM Theresa May's Brexit deal, the Article 50 extension will be pushed back to 22 May, providing time to pass the necessary legislation. However, the 12 April deadline remains if the withdrawal agreement is not approved by Parliament, before which the UK will have to "indicate a way forward", i.e. choose an option from ii-iv outlined above. The prospects of European parliamentary elections are likely to be opposed vehemently by the Brexiters. PM May also stated that her government has no intention of taking part in the European Parliamentary elections, but acknowledged that she would need to work with Parliament if her deal fails again for the third time. Moreover, the EC highlighted that the withdrawal agreement cannot be reopened at this point.

*We expect political tensions to remain high over coming two weeks*

Looking ahead, the UK Parliament is expected to vote on PM May's deal again this week (no clear date set), although the indications are that it is unlikely to get a majority. However, the recent demonstrations calling for a second referendum may bring Brexiters together to vote for the PM's deal, resulting in the final vote being much closer than the previous two meaningful votes. The failure to get the Brexit deal passed or the government's inability to table another meaningful vote could lead Parliament to start with indicative votes on a number of options including: i) revocation of Article 50 and a cancellation of Brexit; ii) another Brexit referendum; iii) the PM's deal plus a customs union; iv) the PM's deal plus both a customs union and single market access; v) a Canadastyle free trade agreement; and vi) withdrawal from the EU without a deal. The indicative votes may start as early as Wednesday 27 March. Meanwhile, the Labour Party could also bring in a no-confidence vote against the PM, citing her failure to get her deal passed, which in turn increases the likelihood of a general election. We continue to highlight that political tensions will remain high in the coming two weeks, keeping many options open.

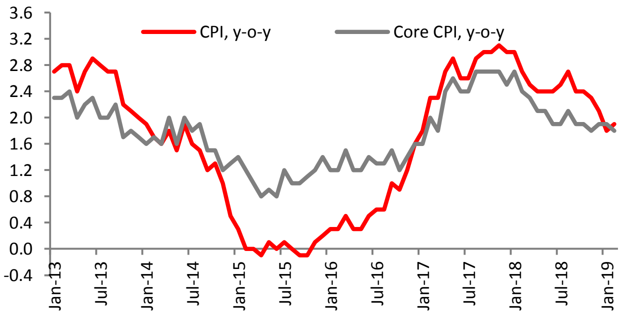
## UK: BoE stays put, citing Brexit-related uncertainty

*Overall communication remains cautious and we expect BoE to remain on hold in 2019*

The BoE voted unanimously to keep its benchmark policy rate unchanged at 0.75% at its 21 March meeting, in line with our and consensus expectations. The MPC continued to highlight Brexit-related uncertainties and their negative impact on short-term economic activity, especially on business investment. The committee reiterated that the direction of monetary policy will depend on the UK's future relationship with the EU and the BoE's policy response could be in either direction. The BoE also stated that incoming economic data has been mixed since the February policy meeting and it expects economic growth to remain relatively weak in the near term. On inflation, the BoE expects headline inflation to remain close to its 2% target over the coming months, though with domestically generated price pressures expected to remain modest. In total, the BoE communication continues to strike a cautious tone and this is unlikely to change until there is further clarity on the future relationship with the EU. We continue to believe that the BoE will remain on hold throughout 2019.

**Fig. 6. UK: Both headline and core inflation broadly steady in February**

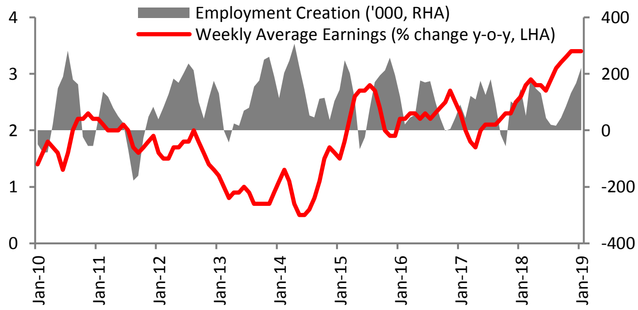
*% change y-o-y*




Source: UK Office for National Statistics

**Fig. 7. UK: Wage growth remains solid at 3.4% y-o-y in January, reflecting tight labour market conditions**

*% change y-o-y (LHA); '000 (RHA)*




Source: UK Office for National Statistics

## UK: Solid job creation in January leads to fall in unemployment rate

*Unemployment rate falls to 44-year low of 3.9% in January, from 4% in December*

The February inflation report was mixed, with core inflation surprising to the downside, but with the headline print coming in higher than the consensus estimate. The headline CPI rate accelerated to 1.9% y-o-y in February (January and consensus: 1.8%), driven by strengthening food, and recreation and culture components. However, core inflation decelerated to 1.8% y-o-y, from 1.9% in January, largely due to further contraction of the clothing and footwear segment. We believe that the February inflation report does not indicate any clear signs of a potential pick-up in inflation in the near term, despite strong labour market conditions. The labour market report released last week showed that wage growth (ex-bonus) remained strong at 3.4% 3M/y-o-y in January – the joint highest print since late 2008. Moreover, the UK economy added 222K jobs in the three months to January, from 167K in December, resulting in the unemployment rate falling to a 44-

year low of 3.9% in January, from 4% in December. We believe that this solid labour market report is unlikely to change the BoE's wait-and-see approach until there is more clarity on the UK's future relationship with the EU.

# II. Economic Calendar

**Fig. 8. The week ahead**

| Time* | Country | Event | Period | Prior | Consensus |
|---|---|---|---|---|---|
| **Expected this week** | | | | | |
| | UAE | M3 Money Supply, m-o-m | Feb | 0.1% | |
| | UAE | CPI, y-o-y | Feb | -2.4% | |
| | UAE | Dubai Airport Cargo Volume, y-o-y | Jan | 2.3% | |
| | Saudi Arabia | GDP Constant Prices, y-o-y | 4Q | 2.5% | |
| | Saudi Arabia | M2 Money Supply, y-o-y | Feb | 1.1% | |
| | Saudi Arabia | SAMA Net Foreign Assets SAR | Feb | 1810.8B | |
| | Bahrain | GDP Constant Prices, y-o-y | 4Q | 1.6% | |
| | Bahrain | CPI, y-o-y | Feb | 1.4% | |
| | Kuwait | CPI, y-o-y | Feb | 0.4% | |
| | Qatar | GDP Constant Prices, y-o-y | 4Q | 2.2% | |
| **Monday, 25 March** | | | | | |
| 8:30 | Japan | All Industry Activity Index, m-o-m | Jan | -0.4% | -0.4% |
| 10:30 | Japan | BOJ Harada makes a speech at conference held by DIR | | | |
| 13:00 | Germany | IFO Business Climate | Mar | 98.5 | 98.5 |
| 13:30 | Eurozone | ECB's Coeure Speaks in Lisbon | | | |
| 14:00 | US | Fed's Harker Speaks in London on Economic Outlook | | | |
| **Tuesday, 26 March** | | | | | |
| 11:00 | Germany | GfK Consumer Confidence | Apr | 10.8 | 10.8 |
| 16:30 | US | Housing Starts | Feb | 1230K | 1215K |
| 18:00 | US | Conference Board Consumer Confidence | Mar | 131.4 | 132.1 |
| 23:00 | US | Fed's Daly to Discuss Managing Inflation in Current Climate | | | |
| **Wednesday, 27 March** | | | | | |
| 12:00 | Eurozone | ECB President Mario Draghi Speaks in Frankfurt | | | |
| 12:45 | Eurozone | ECB Chief Economist Praet Speaks in Frankfurt | | | |
| 14:45 | Eurozone | ECB Vice President de Guindos Speaks in Frankfurt | | | |
| 16:30 | US | Trade Balance | Jan | -$59.8B | -$57B |
| 17:30 | Eurozone | ECB Executive Board member Mersch Speaks in Frankfurt | | | |
| 18:00 | US | Current Account Balance | 4Q | -$124.8B | -$130B |
| 21:30 | Eurozone | ECB's Villeroy de Galhau Speaks in Geneva | | | |
| **Thursday, 28 March** | | | | | |
| 13:00 | Eurozone | M3 Money Supply, y-o-y | Feb | 3.8% | 3.9% |
| 15:15 | US | Fed's Quarles Speaks at ECB Conference in Frankfurt | | | |
| 16:30 | US | GDP Annualized, q-o-q | 4Q T | 2.6% | 2.3% |
| 16:30 | US | Personal Consumption | 4Q T | 2.8% | 2.6% |
| 17:00 | Germany | CPI EU Harmonized, y-o-y | Mar P | 1.7% | 1.6% |
| 17:30 | US | Fed's Clarida Speaks at Bank of France Conference in Paris | | | |
| 18:00 | US | Pending Home Sales, m-o-m | Feb | 4.6% | -0.3% |
| | Egypt | Lending Rate | 28-Mar | 16.75% | |
| | Egypt | Deposit Rate | 28-Mar | 15.75% | |
| **Friday, 29 March** | | | | | |
| 3:30 | Japan | Jobless Rate | Feb | 2.5% | 2.5% |
| 3:50 | Japan | Industrial Production, y-o-y | Feb P | 0.3% | -1.2% |
| 3:50 | Japan | Retail Trade, y-o-y | Feb | 0.6% | 0.9% |
| 11:00 | Turkey | Trade Balance | Feb | -2.5B | -2.2B |
| 13:30 | UK | GDP, q-o-q | 4Q F | 0.2% | 0.2% |
| 13:30 | UK | GDP, y-o-y | 4Q F | 1.3% | 1.3% |
| 16:30 | US | Personal Income | Feb | -0.1% | 0.3% |
| 16:30 | US | Personal Spending | Feb | -0.5% | 0.3% |
| 16:30 | US | PCE Deflator, y-o-y | Jan | 1.7% | 1.4% |
| 16:30 | US | PCE Core, y-o-y | Jan | 1.9% | 1.9% |
| 18:00 | US | New Home Sales | Feb | 607K | 619K |

* UAE time

Source: Bloomberg

**Fig. 9. Last week's data**

| Time* | Country | Event | Period | Prior | Consensus | Actual |
|---|---|---|---|---|---|---|
| **GCC Economies** | | | | | | |
| | Saudi Arabia | CPI, y-o-y | Feb | -1.9% | | -2.2% |
| | Kuwait | M2 Money Supply, y-o-y | Jan | 4% | | 5.2% |
| | Qatar | CPI, y-o-y | Feb | -1.6% | | -1.6% |
| **Monday, 18 March** | | | | | | |
| 3:50 | Japan | Trade Balance | Feb | -¥1415.2B | ¥305.1B | ¥339B |
| 8:30 | Japan | Industrial Production, m-o-m | Jan F | -3.7% | | -3.4% |
| 8:30 | Japan | Industrial Production, y-o-y | Jan F | 0% | | 0.3% |
| **Tuesday, 19 March** | | | | | | |
| 13:30 | UK | Claimant Count Rate | Feb | 2.8% | | 2.9% |
| 13:30 | UK | Jobless Claims Change | Feb | 15.7K | | 27K |
| 13:30 | UK | Average Weekly Earnings, 3M/y-o-y | Jan | 3.5% | 3.2% | 3.4% |
| 13:30 | UK | Weekly Earnings, ex-Bonus, 3M/y-o-y | Jan | 3.4% | 3.4% | 3.4% |
| 13:30 | UK | ILO Unemployment Rate, 3M | Jan | 4% | 4% | 3.9% |
| 14:00 | Germany | ZEW Survey Expectations | Mar | -13.4 | -11 | -3.6 |
| 18:00 | US | Factory Orders | Jan | 0.1% | 0.3% | 0.1% |
| 18:00 | US | Durable Goods Orders | Jan F | 0.4% | 0.4% | 0.3% |
| 18:00 | US | Durables, ex-Transportation | Jan F | -0.1% | -0.1% | -0.2% |
| 18:00 | US | Cap Goods Shipments, Non-defence, ex-Air | Jan F | 0.8% | 0.8% | 0.8% |
| **Wednesday, 20 March** | | | | | | |
| 10:00 | Japan | Machine Tool Orders, y-o-y | Feb F | -29.3% | | -29.3% |
| 13:30 | UK | CPI, m-o-m | Feb | -0.8% | 0.4% | 0.5% |
| 13:30 | UK | CPI, y-o-y | Feb | 1.8% | 1.8% | 1.9% |
| 13:30 | UK | CPI Core, y-o-y | Feb | 1.9% | 1.9% | 1.8% |
| 22:00 | US | FOMC Rate Decision (Upper Bound) | 20-Mar | 2.5% | 2.5% | 2.5% |
| 22:00 | US | FOMC Rate Decision (Lower Bound) | 20-Mar | 2.25% | 2.25% | 2.25% |
| 22:00 | US | Interest Rate on Excess Reserves | 21-Mar | 2.4% | 2.4% | 2.4% |
| **Thursday, 21 March** | | | | | | |
| 13:30 | UK | PSNB, ex-Banking Groups | Feb | -13.3B | 0.7B | 0.2B |
| 13:30 | UK | Retail Sales, inc-Auto Fuel, m-o-m | Feb | 0.9% | -0.4% | 0.4% |
| 13:30 | UK | Retail Sales, inc-Auto Fuel, y-o-y | Feb | 4.1% | 3.3% | 4% |
| 16:00 | UK | Bank of England Bank Rate | 21-Mar | 0.75% | 0.75% | 0.75% |
| 16:00 | UK | BOE Corporate Bond Target | Mar | 10B | 10B | 10B |
| 16:00 | UK | BOE Asset Purchase Target | Mar | 435B | 435B | 435B |
| 16:30 | US | Philadelphia Fed Business Outlook | Mar | -4.1 | 4.8 | 13.7 |
| 18:00 | US | Leading Index | Feb | -0.1% | 0.1% | 0.2% |
| 19:00 | Eurozone | Consumer Confidence | Mar A | -7.4 | -7.1 | -7.2 |
| **Friday, 22 March** | | | | | | |
| 3:30 | Japan | National CPI, y-o-y | Feb | 0.2% | 0.3% | 0.2% |
| 3:30 | Japan | National CPI, ex-Fresh Food, y-o-y | Feb | 0.8% | 0.8% | 0.7% |
| 3:30 | Japan | National CPI, ex-Fresh Food, Energy, y-o-y | Feb | 0.4% | 0.4% | 0.4% |
| 4:30 | Japan | Nikkei Japan PMI Manufacturing | Mar P | 48.9 | | 48.9 |
| 12:30 | Germany | Germany Manufacturing PMI | Mar P | 47.6 | 48 | 44.7 |
| 13:00 | Eurozone | Markit Eurozone Manufacturing PMI | Mar P | 49.3 | 49.5 | 47.6 |
| 17:45 | US | Markit US Manufacturing PMI | Mar P | 53 | 53.5 | 52.5 |
| 18:00 | US | Wholesale Inventories, m-o-m | Jan | 1.1% | 0.1% | 1.2% |
| 18:00 | US | Existing Home Sales | Feb | 4.9M | 5.1M | 5.5M |
| 22:00 | US | Monthly Budget Statement | Feb | $8.7B | -$227B | -$234B |

* UAE time
Source: Bloomberg

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