ADCB Asset Management

The Quarterly Investment View

January 2015

بنك أبوظبي التجاري

ADCB

adcb.com

بنك أبوظبي التجاري
ADCB

Index

The oil factor mitigates the incipient global slowdown

Luciano Jannelli, Ph.D., CFA
Head Investment Strategy
luciano.jannelli@adcb.com

Rahmatullah Khan
Economist
Investment Strategy Team
rahmatullah.khan@adcb.com

More than six years after the 2008 Global Financial Crisis (GFC) the global economy has given only little signs of a broad-based and sustained pick-up in aggregate spending. The only large advanced economy that has seen a significant and continuous pick-up in job creation is the US. Yet, even in this lonely so-called "champion of growth", and notwithstanding such protracted employment growth, salary growth and capital spending (except until very recently energy capital spending) have remained subdued, telling us something deeper bout the inherent fragility of its very recovery.

Little wonder if consensus growth forecasts from 2011 to 2014 have been systematically, year over year, revised downward. And little wonder if – come 2015 – with the Eurozone slipping into deflation and China's export growth model increasingly unable to perform in a world of excess capacity, there were many good reasons to expect again a year of less rather than more growth. We were thus approaching 2015 with a sense of heightened concern, also because equity valuations have become increasingly unattractive and a lasting equity correction still has the potential of removing the positive QE-induced wealth effect from the US recovery. From our point of view the increase in equity market volatility has little to do with rate hikes, much more with global growth concerns.

Yet, and in spite of such growth concerns, the sharp oil price correction of the last months seems to us still mostly supply, rather than demand driven. As such, it should have a significantly positive impact on global economic growth. It allows low income households across the globe to stabilize, if not increase, their consumption spending. It makes it easier for many governments to reduce their deficits. It also reduces – at least temporarily - inflationary expectations thereby further dampening yields and making it easier for governments to service their debts without adding fiscal drag.

To be sure, we were sceptical about the consensus forecasts for 2015 and we are certainly not advocating a return to the high growth rates we were used to before the GFC. Yet, whilst we still have serious doubts about the consensus 2015 US growth rate at 3%, we are now more confident a repeat of the 2014 2% performance is possible. China and the Eurozone are still unlikely to reach respectively 7% and 1% growth in 2015, but the former might now be able to avoid a signification reduction towards the 5% level, and the latter might be able to avoid outright recession. No little difference from the viewpoint of financial markets.

Federal Reserve adjusting to the global environment

The US dollar index (the greenback's exchange rate based on the trade weights of the US' main trading partners) is now up 15% versus its average of the last 5 years. Even for a relatively large and closed economy such as the US this should have a tangibly negative impact on growth and an already low level of inflation. If one adds to that the (at least initially) disinflationary impact of the lower oil price, it becomes very hard to see how the Fed could hike rates in 2015 to a significant extent. We have long argued that the upcoming rate hikes will not alter the basic fact that US monetary policy will remain largely accommodative, simply because the end of additional QE does not imply that the Fed will allow its balance sheet to shrink in any meaningful manner. Recently we have been considering to replace our "not so relevant rate hike" scenario with the hypothesis of "no rate hike at all". If anything, some minor rate hikes would be relevant in that they would finally signal a return to normal monetary policy, thereby boosting confidence into the economic system. But even small rate hikes seriously risk exacerbating the appreciation of the US dollar. And that's precisely why the Federal Reserve might ultimately decide to pass in 2015.

Other central banks picking up the baton of QE and Greece unlikely to exit the Euro-zone

Bank of Japan Governor Kuroda has - politically alone – little choice but to pursue his very expansionary monetary policy stance. Given the country's still very strong external credit position, as well as the fact that most debt is domestically held, this is for the moment unlikely to destabilize the Japanese bond market. Now that the ECB's sole mandate of price stability is in concrete peril, President Draghi is likely to cook up some scheme for the acquisition of sovereign, supranational and/or corporate bonds over and on top of the ECB's already existing buy programs. Rumors to the contrary notwithstanding, Germany is unlikely to allow Greece to exit the single currency. Germany, in fact, remains the single largest beneficiary of the monetary union and the benefits that it derives from the euro are significantly larger than all the money put up (and which it still owns) to help bail out the various periphery economies. Why would the ever so prudent German government wish to put such wonderful and advantageous trade-off at an immediate risk by allowing an unprecedented euro exit, which could then be only the first domino to fall in a longer series of such exits?

Yields to remain low, but equities to remain volatile

Sluggish growth will keep yields at bay. Low yields and moderate growth are still positive for equities but volatility is very unlikely to abate. The rise in the US dollar is a headwind for US equities in particular. Amongst advanced markets German, and more in general European export-oriented, equities might be the most attractive in terms of valuation, and in consideration of the fact that the euro has lost a significant part of the gains it had made earlier in the year against the yen. Amongst emerging markets we look favorably to equities and bonds of energy-dependent markets such as India, Turkey and Indonesia. When the oil price will stabilize we expect a consolidation and pick-up of equity markets in the Gulf Cooperation countries.

Past quarter global markets' performance

Index Snapshot (World Indices)

Index	Latest	Quarterly change % (Q4-2014)	Change in 2014 (%)
S&P 500	2,002.6	4.4	11.4
Dow Jones	17,371.6	4.6	7.5
Nasdaq	4,592.7	5.4	13.4
DAX 40	9,586.9	3.5	2.7
Nikkei 225	16,885.3	7.9	7.1
FTSE 100	6,437.9	-0.9	-2.7
Sensex	26,908.8	3.3	29.9
Hang Seng	23681.3	2.9	1.3
Regional Markets (Sunday to Thursday)			
ADX	4424.6	-11.3	5.6
DFM	3600.3	-25.2	12.0
Tadawul	8175.4	-23.2	-2.4
DSM	11898.2	-10.5	18.4
MSM30	6204.12	-15.2	-7.2
BHSE	1425.2	-3.3	14.2
KWSE	6423.2	-14.2	-13.4
MSCI			
MSCI World	1,654.4	0.7	2.9
MSCI EM	934.7	-4.9	-4.6

Global Commodities, Currencies and Rates

Commodity	Latest	Quarterly change % (Q4-2014)	Change in 2014 (%)
ICE Brent USD/bbl	51.5	-39.4	-48.3
Nymex WTI USD/bbl	48.49	-41.6	-45.9
OPEC Basket USD/bbl	46.7	-44.8	-51.8
Gold USD/t. oz	1213.9	-2.0	-1.4
Platinum USD/t oz	1220.0	-7.1	-11.9
Copper USD/MT	276.15	-6.1	-16.8
Aluminium	1762	-5.2	4.1
Currencies			
EURUSD	1.1850	-4.2	-12.0
GBPUSD	1.5138	-3.9	-5.9
USDJPY	119.08	9.2	13.7
USDCHF	1.0135	4.1	11.4
Rates			
USD Libor 3m	0.2536	8.7	3.9
USD Libor 12m	0.6338	8.7	7.8
UAE Eibor 3m	0.6771	-4.8	-16.7
UAE Eibor 12m	1.0157	-2.3	-14.2
US 3m Bills	0.0203	-42.0	-46.2
US 10yr Treasury	1.9729	-12.8	-28.3

.

Executive Summary

- Federal Reserve will remain very accommodative even after starting to gradually hike rates, ECB to become increasingly supportive through 2015, BoJ likely to continue quantitative easing.
- US growth to remain steady and moderate, likely to pull Europe and Emerging markets
- Advanced economies equities have still some upside given accommodative monetary policies
- China's reform, and growth, problems will remain with us for a longer period
- Commodity exporting emerging markets such as Brazil, Russia and South Africa will suffer
- Emerging markets which are not exposed to commodity prices and where the reform process seems to be more promising, such as India, are more likely to take advantage of the decline in commodity and energy prices
- Selectively emerging markets hard currency bonds offer good value, whereas local currency bonds remain subject to a scenario of continuing exchange rate volatility
- Energy prices are expected to stabilize, and at some point recover from current lows
- Industrial metals have still more downside given the ongoing transformation of China's economy
- Precious metals upside to be capped by continuing global disinflation, as well as the permanent shrinkage of emerging markets trade surpluses.

Market Outlook and Portfolio Positioning

Fixed Income

Duration	Avoid the intermediate section of the yield curve	Federal Reserve will only very gradually start hiking rates in 2015. Long-term yields remains capped by secular disinflation.
Advanced economy corporate bonds	Underweight	Credit spreads have widened again towards the end of the last year. Widening has come on the back of lower grade corp yield moving up while high grade corp yield has largely trended downward.
EM bonds	Selectively overweight	Among Emerging Markets we differentiate between commodity exporters and importers, favoring the latter. Commodity exports not only face growth issues but they seem to be prone to currency volatility. In commodity importer country's bonds, we still prefer USD bonds rather than local currency bonds primarily of continuing currency volatility.

Equity Markets

US	Moderately overweight	We have so far been confirmed in our call for more accommodative monetary policy for longer and the recommendation to stay overweight in US equities. As growth and policy will remain accommodative, we stay moderately overweight, yet we now expect less upside because of increasingly stretched valuations.
Eurozone	Moderately overweight	Periphery equities' valuation-based catch-up has now petered out. Growth will pick-up moderately as the ECB enhances support and exports to the US increase. In real terms Eurozone equities are expected to perform in line with US equities.

Japan	Moderately overweight	US recovery and very accommodative monetary policy is still supportive to our constructive view on Japanese equities. However, gains are likely to be limited as compared to the last two years primarily due to disappointing growth and inflation performance.
Emerging Markets	Selectively overweight	Emerging equity markets remain a mixed bag. We are overweight those emerging markets that are more reform prone and less dependent on commodities, such as India and some Eastern European and Asian economies, such as Turkey and Indonesia.

Energy and Commodity Prices

Energy	Neutral	The recent sharp decline in prices seem to have undershot. Yet, volatility is to remain high as long as the direction of US production remains unclear. For the moment we expect as sideward price movement.
Industrial Metals	Underweight	The full implications of the China transformation story will determine a further reduction in the commodity- intensity of its economy. There may be some recurring technical rebounds in specific metal prices, but globally deflationary downward pressures are likely to continue in this commodity space.
Precious Metals	Underweight	As most advanced economies maintain their deleveraging course, the USD and Euro in particular are likely to remain strong versus emerging market currencies. Thus the risks of investing in precious metals remain quite elevated.

Currencies

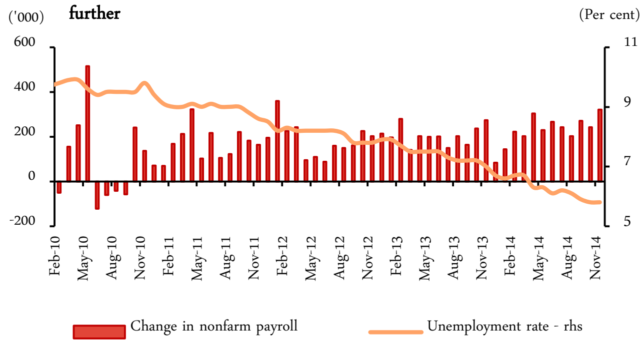
EUR	Down	A diverging monetary cycle in the two economic regions supports further US dollar strengthening in coming quarters. A more dovish Fed might to some extent mitigate this development, yet not alter its basic thrust.
GBP	Down	Weakening growth momentum in the UK and anaemic economic environment in the neighbouring Eurozone has negatively affected cable in recent months. We expect this to continue in coming quarters. However, we expect only a marginal depreciation of the pound sterling versus the US dollar as both Fed and BoE rate hikes are expected to be muted.
JPY	Down	Japanese yen is expected to remain in depreciating trend as the BoJ will continue to inject large amount of money into the system. But the yen being a carry trade currency, it should see temporary rebounds during global risk aversion phases.

United States: Fed to remain prudent amidst global growth concerns

US recovery to remain modest

Whilst it is true that the economic recovery in the US has broadened its base, it remains inherently fragile as can be observed from the fact that wage growth is stalling in spite of continuing job creation. Normally, at this stage of the cycle, the declining slack in the labor market should already have boosted workers' earnings growth, thereby further enhancing consumption growth. There is one silver lining in that the lower oil price raises households' real income. As such, it should provide – together with improved household balance sheets - structural support to continuing consumption growth. However, even if we expect US real growth to remain decent (say around 2% annual real GDP growth), we do not expect a major break-out away from the lower growth rates that have emerged since the 2008 Global Financial Crisis. A lot of this has to do with the simple fact that overall household and government debt stocks remain at historically high levels, and that the rest of the world continues to struggle to shake of very strong deflationary pressures.

A solid improvement in labor market to support consumption further

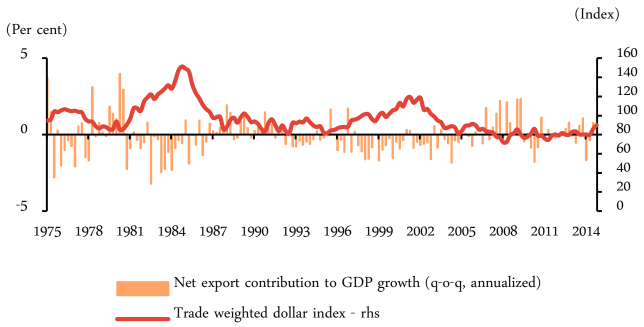


Source: Bloomberg

The US economy is not an island

The US economy, in fact, is not immune of the struggling Eurozone, recessionary Japan and slowing emerging economies. This can be very easily observed from below chart which shows that periods of stronger dollar coincide with net export dragging GDP growth lower.

Fed is likely to be mindful of dollar strength that affects net export contribution to the GDP growth



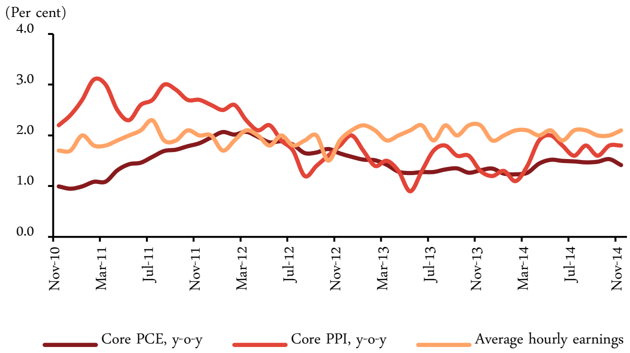
Source: Bloomberg

We believe that there remains room for further appreciation of the US dollar and – as such – an additional drag on US growth.

Federal Reserve to remain very prudent

The strength of the US dollar has not only a negative impact on growth, it also has a disinflationary impact on the economy to an equivalent extent as the rise in interest rates (through the reduction of prices of imported goods). This reinforces the economy's disinflationary trend which is already very strong in view of still significant deleveraging, very well contained wage pressures, the continuous slide in commodity prices and – recently – the sharp drop in energy prices.

Inflationary pressure remains subdued



Source: Bloomberg

The short- versus long term implications of the oil price drop and the Federal Reserve's patience

First and foremost it is important to note that the overall stance of US monetary policy will remain accommodative through 2015 because the Federal Reserve – whilst not adding additional liquidity in the system – will not reduce the size of its balance sheet either. Thus the largely accommodative stance will not be altered by what we have long expected to be a moderate increase of the Federal Reserve Funds rate in 2015. The Federal Reserve has now an additional motive to be prudent since in the short-term the drop in the oil price is not only deflationary, but possibly also recessionary because for sure it will reduce energy capital expenditures (which are the bulk of US capital expenditures). Over the longer period the drop in oil prices is reflationary since it increases consumers' real income by liberating resources for the acquisition of discretionary items, thereby also promoting capital expenditure in other sectors of the economy. As these second order effects need time to work out, and given also the strong US dollar, the Federal Reserve will want to err on the side of prudence and raise rates only moderately, in the order of say 50 basis points, in 2015. A no rate hike at all scenario is becoming more likely. The overall yield curve should thus remain contained which is good for US equities.

Eurozone: the old issues are still there, the euro is still too strong

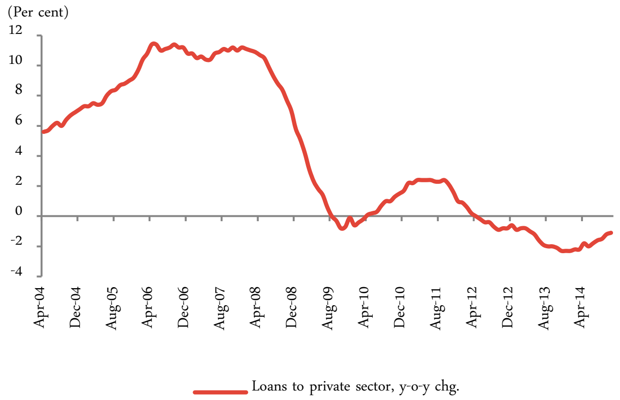
Draghi's balance sheet battle

It is probably important to stress that even if Mr. Draghi succeeds in increasing the ECB's balance sheet from 2tn to 3tn euros, overall annual real GDP growth in the Eurozone will remain subdued at the 1% level. Thus the "mere" purpose of the expansion of the ECB's balance sheet is to prevent the monetary union to slide into a deflationary recession across all its member-states. In order to bring the balance sheet as quickly as possible at the desired level – or more importantly convince the markets immediately that the 3tn euro size is feasible by the end of 2015 – Mr. Draghi will most likely have to add the acquisition of approximately 500bn corporate, supranational (EIB) and sovereign bonds to existing buy and lending programs.

Euro deprecation as the key QE reflation lever

Critically the further compression of Euro-zone bond yields as well as the reduction of periphery spreads will take stress of the banks' balance sheets and thereby facilitate lending. Yet, given the lack of credit demand, and the entrenchment of the credit crunch in periphery economies, one should not expect miracles when it comes to increasing lending.

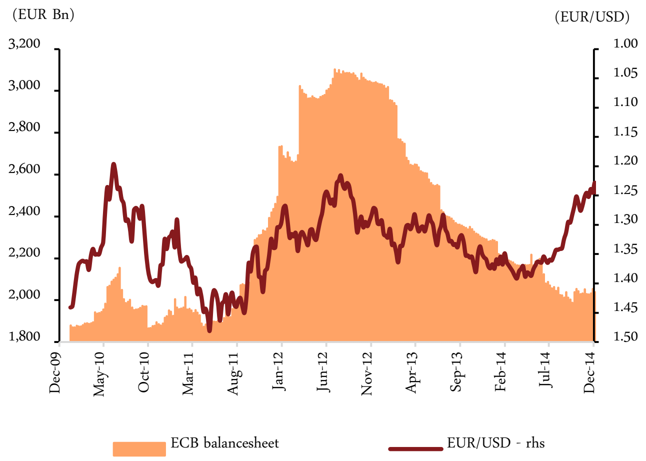
Lending to remain modest in euro



Source: Thomson Reuters

Thus the most effective way by which QE can directly reflate the Eurozone's economy is by promoting a further devaluation of the euro which promotes exports, and makes the Eurozone' assets cheaper for foreigners.

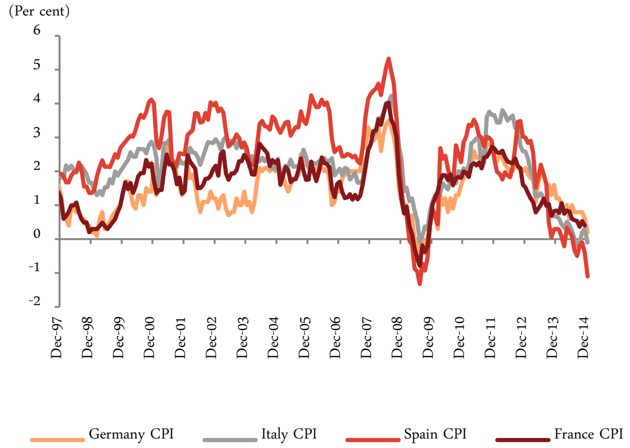
ECB balancesheet needs to expand in order to devalue Euro



Source: Bloomberg

A depreciation of the euro will also (through an increase in the price of imported goods) determine the necessary increase in inflation, thereby preventing the credit crunch from morphing into an outright aggregate demand crunch.

Inflation is down in all Eurozone countries



Source: Bloomberg

Deflation entrenchment and Greece are the key risks

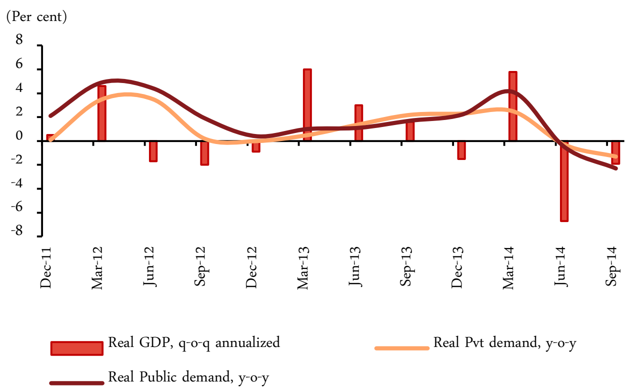
Whilst we believe that Mr. Draghi will succeed in his 2015 balance sheet target, we are not convinced that that will be sufficient to defuse the entrenchment of deflationary expectations over the next six months, especially if the euro does not depreciate further in a significant manner (in this respect we note that deflation continues to plague Japan in spite of the significant expansion of the Bank of Japan's balance sheet). Uncertainties are compounded by the risk of Greece having an anti-euro government by January 25 which would demand a renegotiation of its outstanding debt, as well as the austerity policies.

Japan: concerns over success of “Abenomics” creeping in

Growth disappoints, again

The economic recovery has remained elusive following the April sales tax hike as the economy went into a recession with declining real GDP in two consecutive quarters. As economic indicators – both industrial production and the Tankan producers confidence index – have disappointed in October and November, there is now a concrete risk that fourth quarter growth could even disappoint the modest expectation of 2.8% (QoQ annualized) from the already low third quarter base. Market consensus expects real GDP growth to be modest at 1% in 2015 on the back of an estimated meagre growth of 0.3% in 2014.

Both private demand as well as public demand are weak

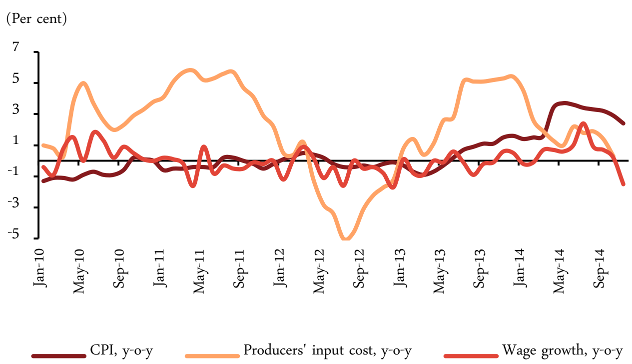


Source: Bloomberg

Abenomics fails?

While growth is disappointing, the recent downward trend in inflation is questioning the very success of “Abenomics”, a policy that is entirely centered on the idea of creating inflation through quantitative easing so as to induce wage growth that in turn would sustain domestic demand. In fact, the tax-induced inflation created early this year seems to be petering out and the decline in wages in November (year-over-year basis) confirms how serious the policy failure risk is.

After a brief jump in inflation downward trend resumed



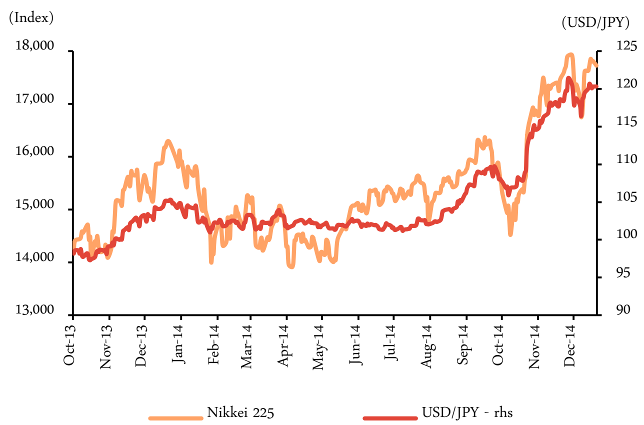
Source: Bloomberg

Authorities increasing “Abenomics” measures

Realising the weakness in growth momentum and the anaemic internal price dynamics, the Bank of Japan (BoJ) announced a slew of additional quantitative easing measures in October to support the equity market and further depreciate the Japanese yen. Whilst, these new measures have effectively boosted equity prices and depreciated the currency further, it is not clear yet that they will have the desired impact on inflation and real growth.

Prime Minister Abe’s recently announced fiscal stimulus worth of JPY 3.5tn (c.USD 29bn) is for sure unlikely to have any meaningful impact on economic activity. Moreover, more significant fiscal stimulus is not an option for the government as the deficit is already running above 8% of GDP and public debt is in excess of 225% of GDP.

Currency depreciation and rally in stock market do not seem to be adequate for sustainable economic recovery



Source: Bloomberg

Continuous policy failure warrants caution

If “Abenomics” would fail in promoting economic growth, it would inevitably raise questions about the sustainability of the countries’ growth in public debt. Not surprisingly, foreign inflows in the equity market were “only” around USD 7.5bn in 2014, down by 94% as compared to 2013.

Thus even if the BoJ measures would continue to support gains in the equity market as the currency depreciation boosts the earnings for Japanese companies, those gains are likely to be limited as compared to the last two years. Finally, any further fiscal stimulus that would shoot the sovereign debt significantly up could at some point become negative for sovereign bonds.

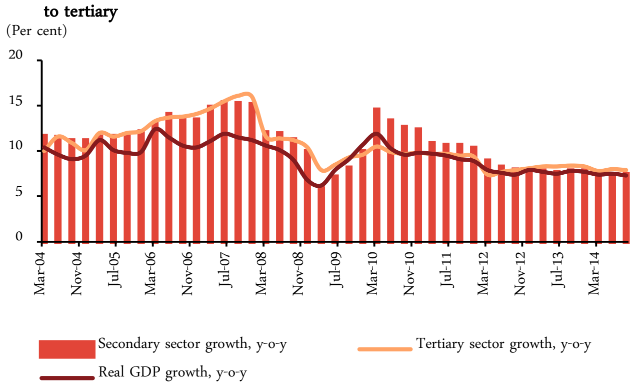
China: central bank turns more dovish as manufacturing slowdown accelerates

Growth slowdown continuing

The ongoing economic transition in China from investment led growth, which heavily relied on infrastructure spending and exports, to domestic consumption driven growth is likely to continue to weigh on the economic outlook. The sluggish global economic conditions have weighed on exports while the curtailment of investments has slowed down manufacturing, and inevitably also consumption.

The chart below shows how both the secondary (industrial) sector (which is almost half of GDP) and the tertiary (services) sector have not managed to keep up with the growth rates before the 2008 Global Financial Crisis (GFC).

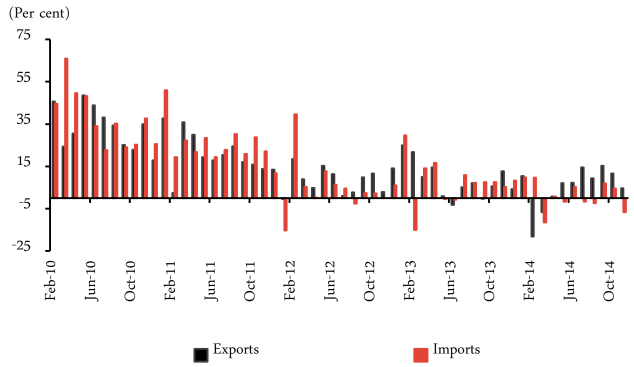
Growth slowdown coming from transition process from secondary to tertiary



Source: Bloomberg

Likewise, the external sector is no longer the support it once provided to the Chinese economy. Also because of the Renminbi's peg to the US dollar, exports are unlikely to repeat their 2010-11 or pre-GFC performance.

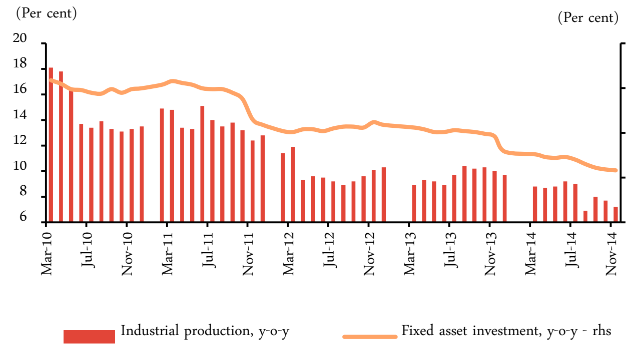
Foreign trade clearly in a lower trajectory



Source: Bloomberg

On the domestic side, the recent trend in economic releases - especially related to the manufacturing sector - confirm the growth going even further down. All in all the probability of sub-7% growth in 2015 has risen.

Industrial side of the economy to continue to trend down

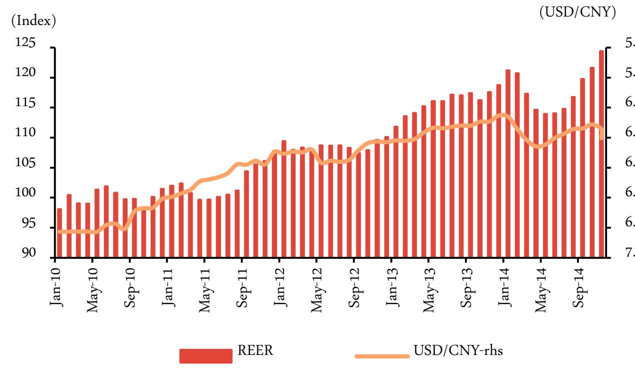


Source: Bloomberg

People's Bank of China more dovish, for now

Slower growth has pushed the People's Bank of China (PBoC) to act by reducing, after more than two years, the one year deposit rate by 40 bps to 5.6%. The market is now expecting another rate cut in 2015. Another policy consideration for the central bank would be a lower exchange rate as the renminbi is scaling new highs in real terms (REER basis) due to its soft peg with the US dollar. Therefore, we believe that the central bank could well take easing action through currency depreciation and liquidity injection.

On REER basis CNY continues to touch new highs in recent years



Source: Bloomberg

Careful with Chinese equities

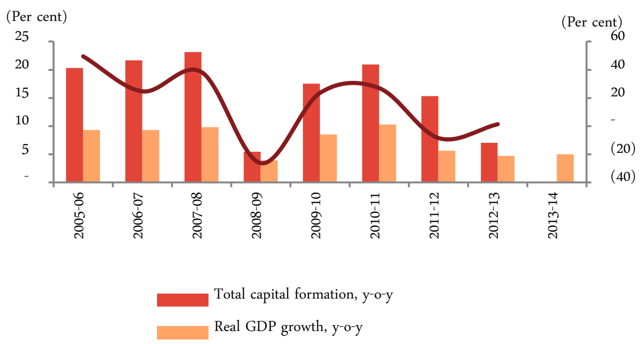
The local equity market rallied significantly over the last two months. A most important factor for the sharp rally was likely the undervaluation of the market, as well as the reform linking the Shanghai and Honk Kong exchanges. This created optimism among investors for a further opening up the financial market. Sentiment got an additional boost from the surprise rate cut by the PBoC. Going forward further upside seems to be largely based upon speculation of the further opening of what remains a very opaque market.

India: reform path progresses but capex cycle needs revival for growth to accelerate

Capital spending must recover

The upswing in consumer and business sentiments is yet to be followed by an effective improvement in real economic data. It is worth noting that the significant downturn in corporate capital spending – a decline of 8.5% in 2011-12 and a tepid revival of 1.3% in the succeeding year – had been caused by the combination of domestic policy paralysis and anemic global growth. Thus the prospect of more incisive policy action bodes well for at least some structural pick-up in capital spending, even if global growth would not accelerate. Also the main cause of low household capital spending – i.e. a high inflationary environment which ultimately resulted in a crash in household capital spending growth from 38.6% in 2011-12 to 5.1% in 2012-13 – seems now likely to have vanished.

Investment cycle to pick up for growth to accelerate

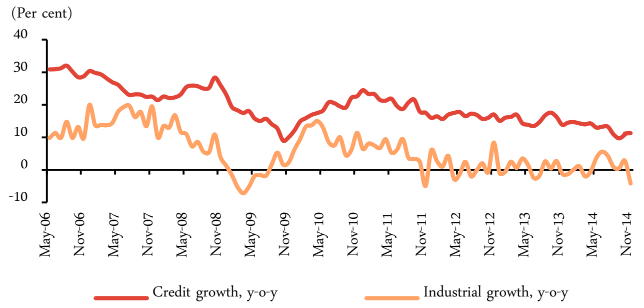


Source: CSO

Policy measures must lead the way

The recent liberalization of the Land Acquisition Bill and the increase of the FDI limit in the insurance sector from 26% to 49% confirm the government's intention to expedite the reform process and attract investments. However, one needs to be cautious as these ordinances have yet to pass through both houses of parliament where the ruling coalition does not have a majority in the upper house. To look for a revival in the corporate capex cycle, we are amongst others closely monitoring credit growth. The downtrend in credit growth; however, has yet to reverse. A significant pick-up in credit off-take is usually a precursor for a turnaround in the capex cycle and industrial growth.

Industrial production and credit growth yet to show turnaround

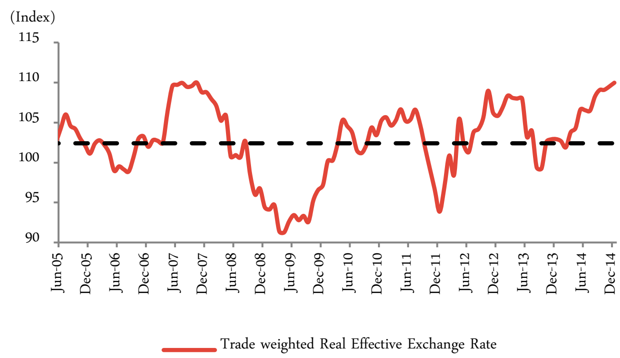


Source: Bloomberg

But fundamental economic factors have already improved

Whilst growth has not yet picked up sufficiently, very important structural factors, such as the high current account deficit, the high fiscal deficit and persistently high inflation have improved remarkably over the last months and quarters. The current account deficit has declined as low as 1.1% of GDP in the second quarter of 2014 and the government remains credibly committed to the targeted fiscal deficit of 4.2% of GDP in the fiscal year 2014-15, helped also by the recent slump in oil prices. The decline in commodity prices has also significantly helped in cooling off inflation. Indeed, inflation is expected to undershoot the Reserve Bank of India target of 6% in March, inducing the central bank's Governor, Raghuram Rajan, to adopt a more dovish stance. Many market participants expect a rate cut as early as in January. However, the governor could wait for fiscal budget announcements before he takes a call on the policy rate. In this respect it is worth noting that the high level of inflation over the last few years has had its toll on the real effective exchange rate, and thus the country's competitiveness. This warrants some more depreciation which – however – is inflationary in nature.

Rupee remains over valued on REER basis



Source: Bloomberg

Moderately positive on equities

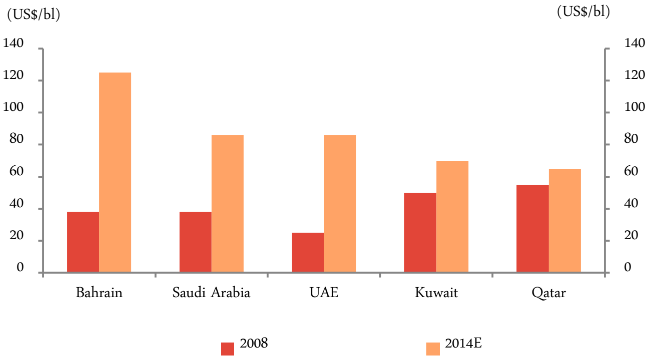
The still very good growth prospects warrant a positive stance on equities which is somehow mitigated in the short term by the stretched implicit earnings expectations.

GCC: low debt and high reserve levels allow to mitigate growth impact of oil price drop

Sound fiscal management allows GCC to rationalize government spending so as to mitigate growth impact

Since government spending is still the main driver of economic growth in the Gulf Cooperation Council countries, the recent sharp decline in oil prices has created concerns about its sustainability in the medium term. It is worthwhile to note that government spending had risen sharply since 2008-09 as governments in the region undertook a countercyclical fiscal policy in the wake of Global Financial Crisis, embarking on rapid infrastructure development. This has significantly increased the fiscal break-even oil price for countries in the region.

Fiscal break-even oil prices have shotup over the last few years



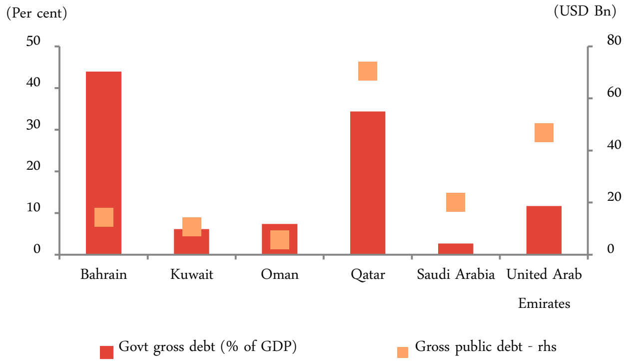
Source: CEIC, Thomson Reuters Datastream, IMF

The current oil price is lower than the fiscal break-even price for almost all countries in the GCC. This means that if the average oil price remains around the same level in the coming quarters, each member country will have a fiscal deficit. As a result, many market participants expect cuts in government spending which will have a negative impact on the growth outlook in the region. We believe that the impact of current lower prices would not be significant in the medium term primarily for the following reasons.

First, the oil prices might well have undershot which could determine a rebound later in the year as the supply outlook gets clearer and demand gets support from the recent lower prices.

Second, member economies except Bahrain enjoy a strong fiscal environment as reflected by an extremely low level of public debt and high levels of reserve assets. Gross public debt in Saudi Arabia (which alone constitutes roughly half of the GCC countries' economic size) is less than 2% of GDP while it is less than 12% of GDP in the UAE.

Low level of public debt can sustain fiscal deficit in the medium term



Source: IMF, October 2014

Saudi Arabia in its budget for 2015 has indicated that the current low level of oil prices will not affect its spending plans in the medium term. Even after an estimated deficit of USD 14.4bn in 2014, it announced a budget with an intention of increasing spending, though modestly, in 2015. A budgeted deficit of USD 39bn or higher actual deficit could be easily managed by the government having around USD 427bn deposits with the central bank and around USD 750bn as foreign reserve assets. Oman increased its spending plan by 4.5% to USD 36.6bn for 2015 despite a widening of the deficit. The country expects to manage this from state reserves, previous years' surpluses and international grants & loans. Dubai also revealed an increase in its expenditure plans by 9%. Despite the rise in planned expenditures, the Emirate expects the budget to be balanced this year on an expected rise in revenues. This reflects confidence that Dubai's economy, largely driven by trade and tourism, will be unaffected.

Given our belief that the recent dip in oil prices should not have in 2015 a very strong impact on government spending, the growth outlook, especially for the non-oil sector remains stable. Stable or slightly lower crude production could have some moderating impact on headline GDP growth numbers for 2015. Moreover, lower oil prices will result into lower nominal GDP.

Moderately cautious on equities

We are cautiously positive on local equity markets, as participants will realize that overall economic growth should remain stable. We do see downside risks to our expectations as long as the oil price does not fully stabilize. Equity markets could also be affected by the potential rate hikes by the Fed, which regional central banks will have to follow due to the currency peg.

Appendix

GDP forecast	2014 Estimates	2015 Consensus	2015 ADCB	2016 Consensus	2016 ADCB
US	2.30%	3.0%	↘	2.8%	=
Eurozone	0.80%	1.1%	↘	1.5%	=
Japan	0.20%	1.0%	=	1.4%	=
China	7.40%	7.0%	↘	6.7%	↘
India	5.20%	5.5%	↗	6.3%	=

Source: Bloomberg

CPI forecast YoY	2014 Estimates	2015 Consensus	2015 ADCB	2016 Consensus	2016 ADCB
US	1.70%	1.5%	=	2.2%	↘
Eurozone	0.44%	0.6%	=	1.3%	=
Japan	2.80%	1.5%	=	1.5%	↗
China	2.10%	2.0%	=	2.5%	=
India	6.40%	6.7%	↘	6.1%	↘

Source: Bloomberg

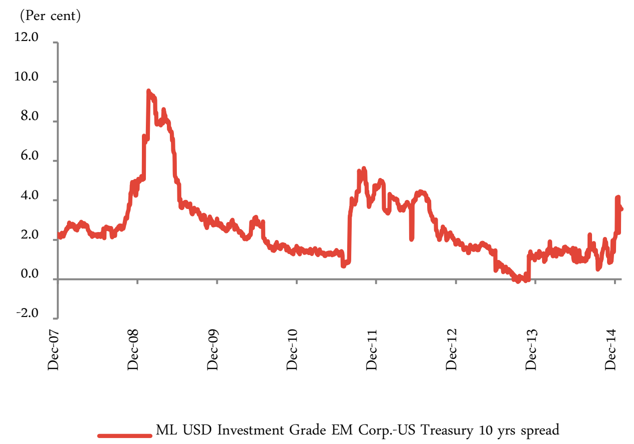
= in agreement

↘ expect moderately less | ↗ expect moderately more

⇘ expect significantly less | ⇗ expect significantly more

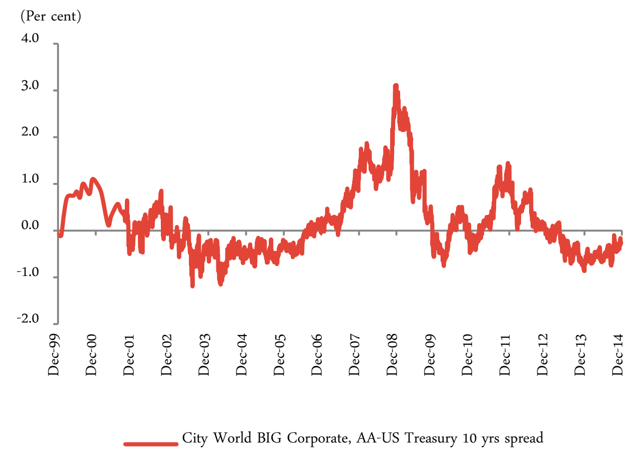
Bond Market Spreads

EM IG corporates v/s US Treasury 10yrs



Source: Thomson Reuters

World large corporates v/s US Treasury 10yrs

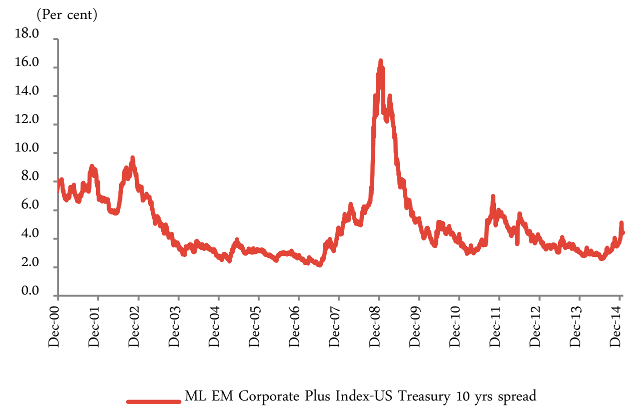


Source: Thomson Reuters

ML Global HY corporates v/s US Treasury 10yrs

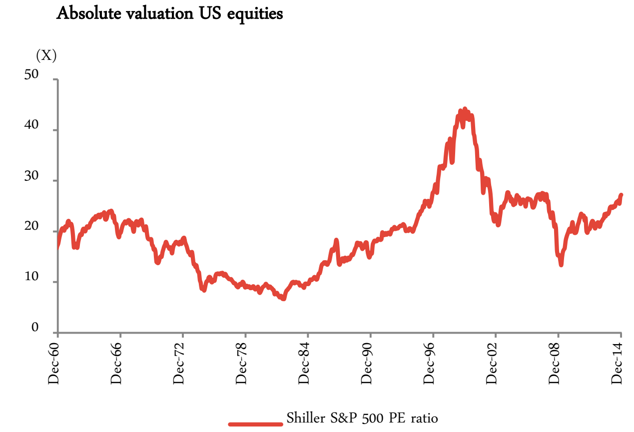
Source: Thomson Reuters

ML EM corporate plus index v/s US 10yr Treasury

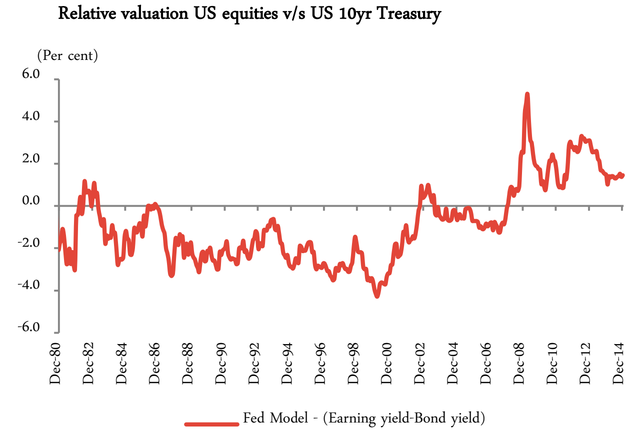


Source: Thomson Reuters

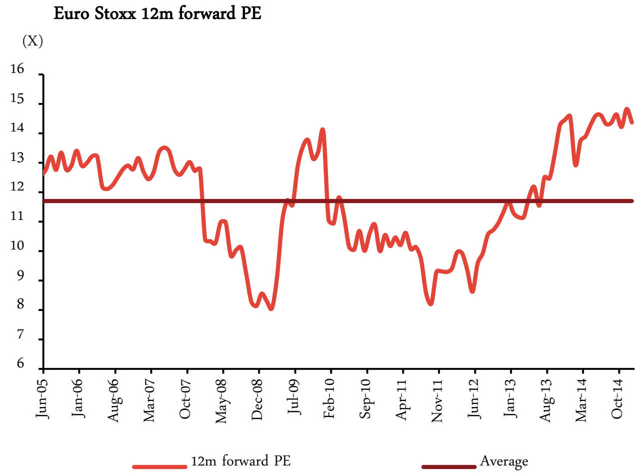
Equity Market Valuations



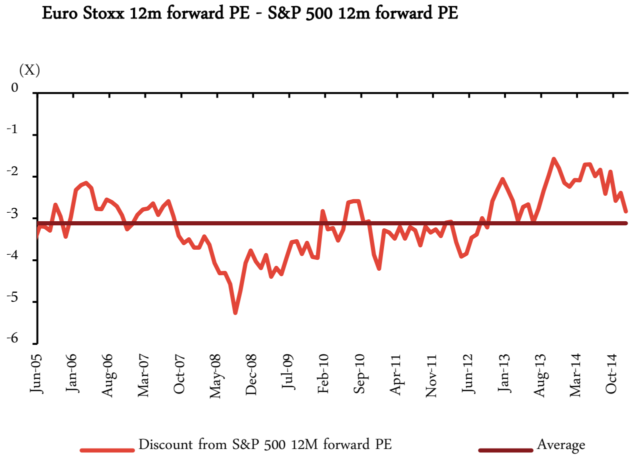
Source: multpl.com



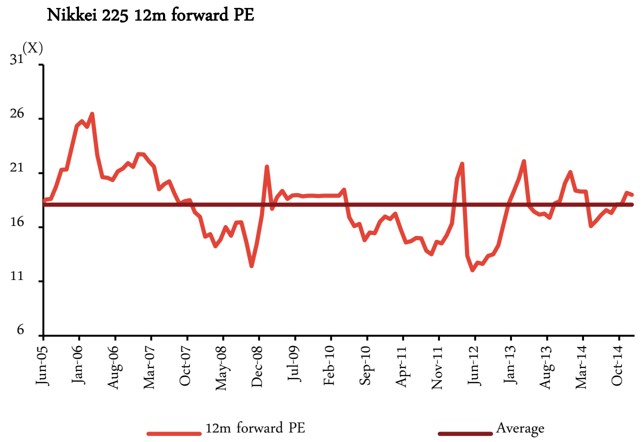
Source: Thomson Reuters, multpl.com



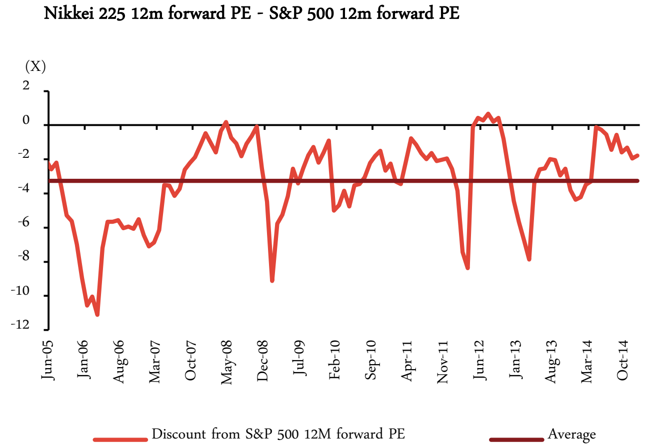
Source: Bloomberg



Source: Bloomberg

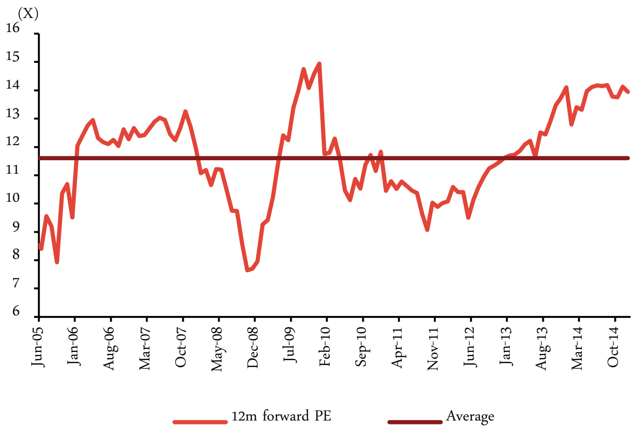


Source: Bloomberg



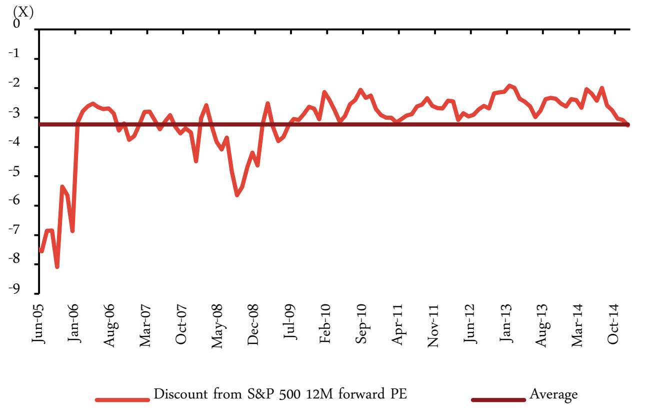
Source: Bloomberg

FTSE 100 12m forward PE



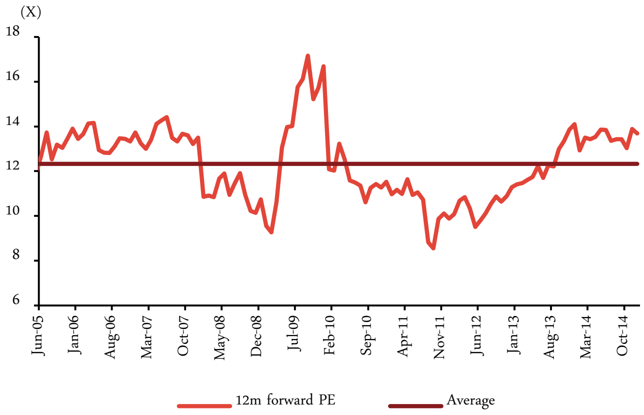
Source: Bloomberg

FTSE 100 12m forward PE - S&P 500 12m forward PE



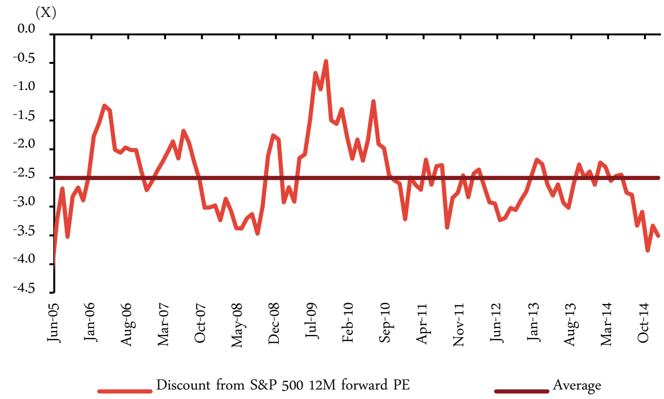
Source: Bloomberg

DAX 12m forward PE



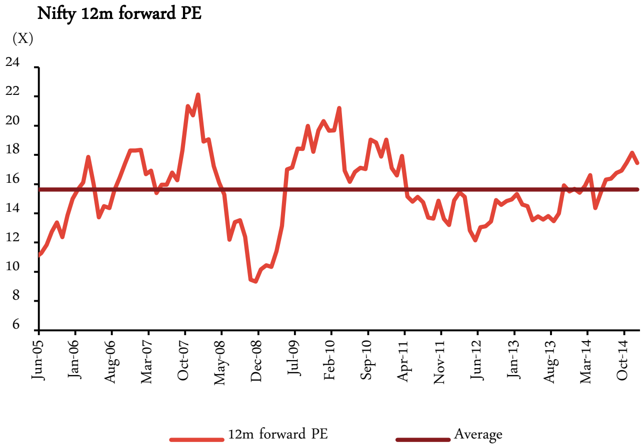
Source: Bloomberg

DAX 12m forward PE - S&P 500 12m forward PE



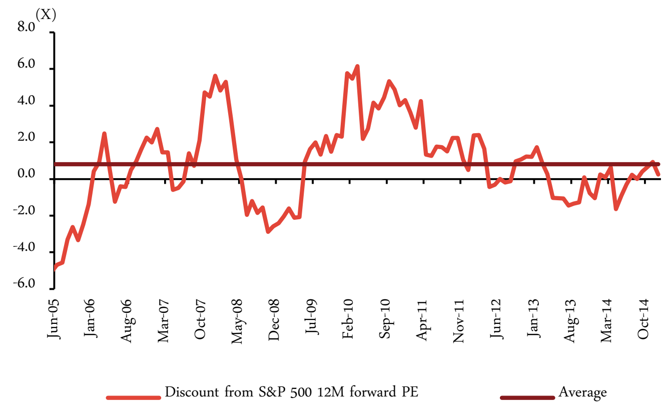
Source: Bloomberg

Nifty 12m forward PE



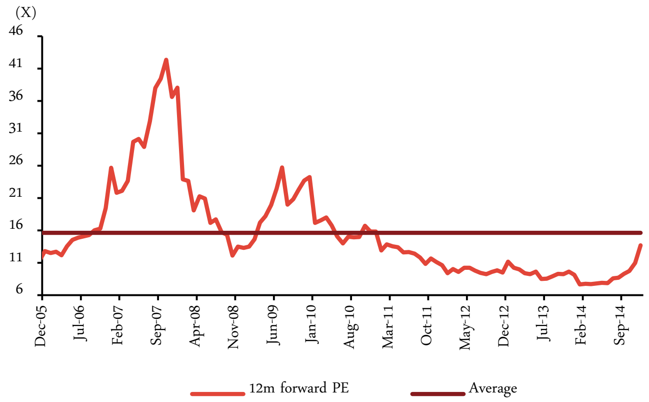
Source: Bloomberg

Nifty 12m forward PE - S&P 500 12m forward PE



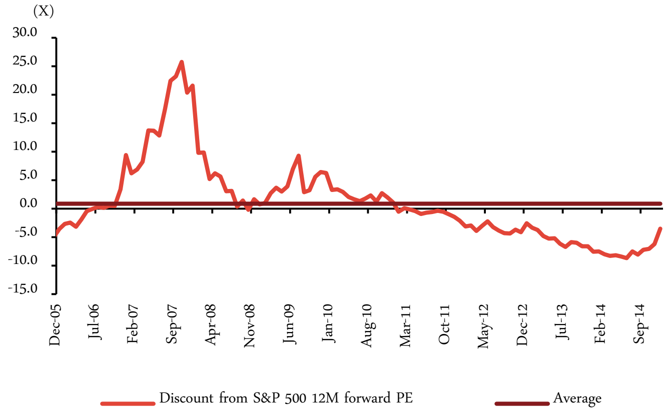
Source: Bloomberg

Shanghai Composite 12m forward PE



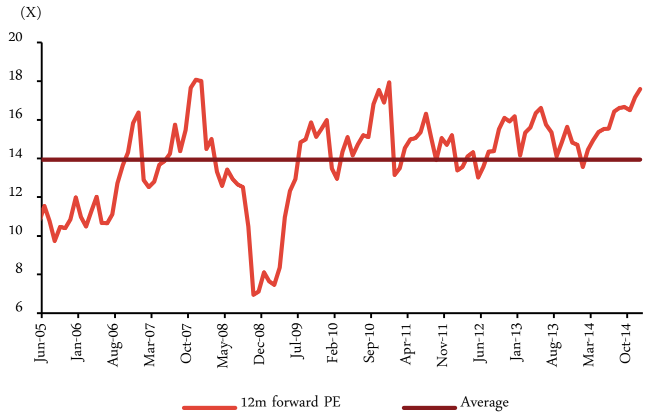
Source: Bloomberg

Shanghai Composite 12m forward PE - S&P 500 12m forward PE



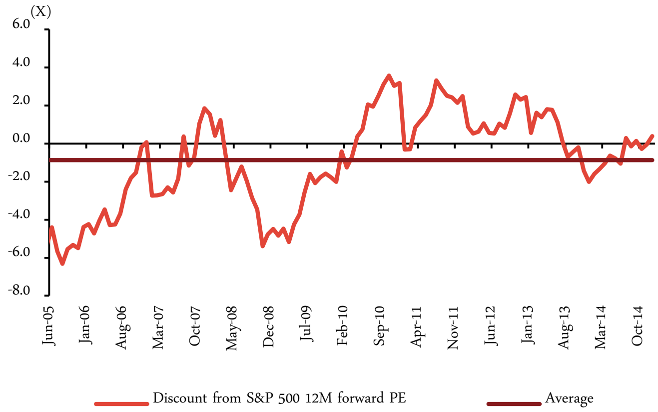
Source: Bloomberg

Jakarta Composite 12m forward PE



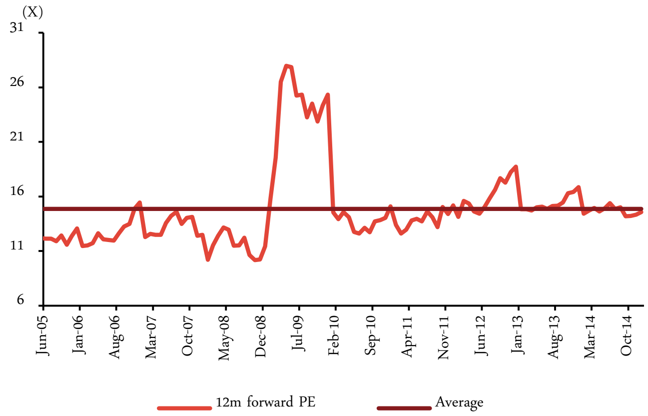
Source: Bloomberg

Jakarta Composite 12m forward PE - S&P 500 12m forward PE



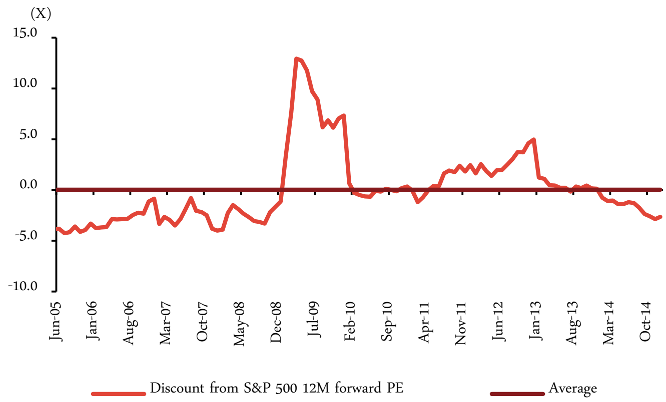
Source: Bloomberg

Taiwan stock exchnage 12m forward PE



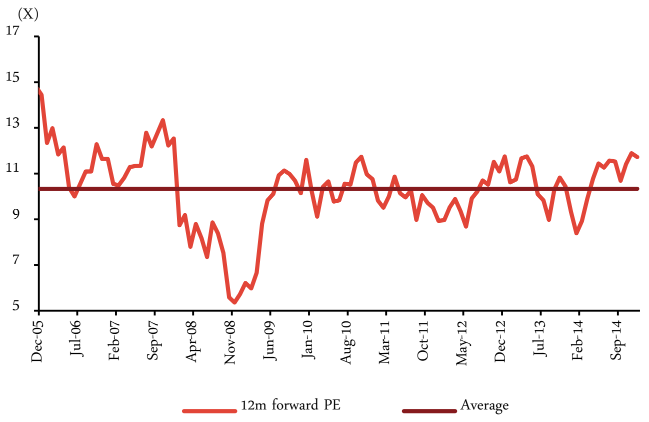
Source: Bloomberg

Taiwan stock exchnage 12m forward PE - S&P 500 12m forward PE



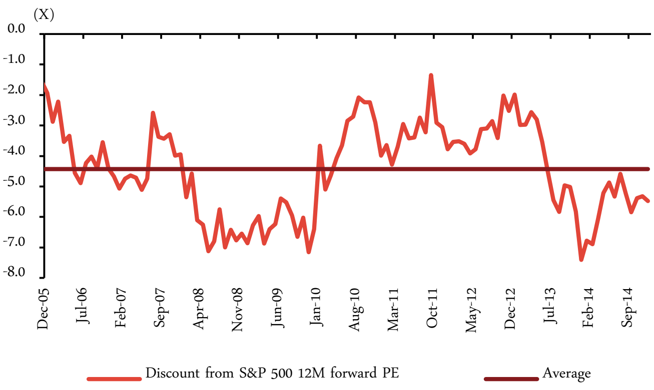
Source: Bloomberg

Istnabul stock exchnage 12m forward PE



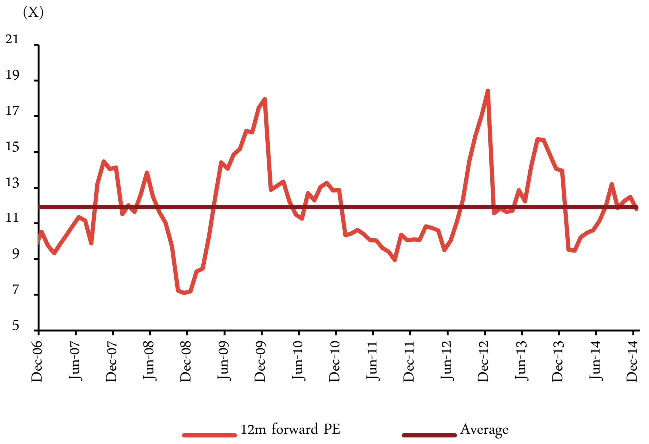
Source: Bloomberg

Istnabul stock exchnage 12m forward PE - S&P 500 12m forward PE



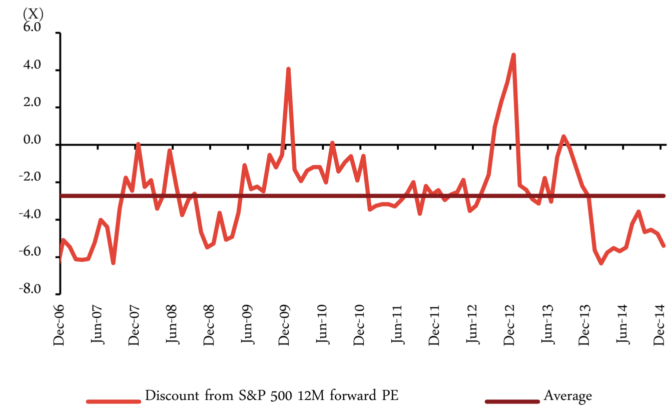
Source: Bloomberg

Bovespa 12m forward PE



Source: Bloomberg

Bovespa 12m forward PE - S&P 500 12m forward PE



Source: Bloomberg

Sources

All information in this report has been obtained from the following sources except where indicated otherwise:

1. Bloomberg
2. Wall Street Journal
3. RTTNews
4. Reuters
5. Gulfbase
6. Zawya

Disclaimer

*This publication is intended for general information purposes only. It should not be construed as an offer, recommendation or solicitation to purchase or dispose of any securities or to enter in any transaction or adopt any hedging, trading or investment strategy. Neither this publication nor anything contained herein shall form the basis of any contract or commitment whatsoever. Distribution of this publication does not oblige Abu Dhabi Commercial Bank PJSC ("**ADCB**") to enter into any transaction.*

The content of this publication should not be considered legal, regulatory, credit, tax or accounting advice. Anyone proposing to rely on or use the information contained in the publication should independently verify and check the accuracy, completeness, reliability and suitability of the information and should obtain independent and specific advice from appropriate professionals or experts regarding information contained in this publication.

Information contained herein is based on various sources, including but not limited to public information, annual reports and statistical data that ADCB considers accurate and reliable. However, ADCB makes no representation or warranty as to the accuracy or completeness of any statement made in or in connection with this publication and accepts no responsibility whatsoever for any loss or damage caused by any act or omission taken as a result of the information contained in this publication. This publication is intended for qualified customers of ADCB.

Charts, graphs and related data or information provided in this publication are intended to serve for illustrative purposes only. The information contained in this publication is prepared as of a particular date and time and will not reflect subsequent changes in the market or changes in any other factors relevant to their determination. All statements as to future matters are not guaranteed to be accurate. ADCB expressly disclaims any obligation to update or revise any forward looking statements to reflect new information, events or circumstances after the date of this publication or to reflect the occurrence of unanticipated events.

ADCB does and may at any time solicit or provide commercial banking, investment banking, credit, advisory or other services to the companies covered in its publications. As a result, recipients of this publication should be aware that any or all of the foregoing services may at time give rise to a conflict of interest that could affect the objectivity of this publication.

Past performance does not guarantee future results. Investment products are not bank deposits and are not guaranteed by ADCB. They are subject to investment risks, including possible loss of principal amount invested. Please refer to ADCB's Terms and Conditions for Investment Services.

This publication is being furnished to you solely for your information and neither it nor any part of it may be used, forwarded, disclosed, distributed or delivered to anyone else. You may not copy, reproduce, display, modify or create derivative works from any data or information contained in this publication.