The Week Ahead: Fed and ECB communicate need for monetary easing

Economics Team

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

Thirumalai Nagesh
Economist
+971 (0)2 696 2704
Thirumalainagesh.Venkatesh@adcb.com

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US: Powell's testimony opens door to July rate cut

Markets will continue to digest last week's central bank communication in what is set to be a relatively quieter data week. After communication from FOMC members raised uncertainties over a July move, Fed Chair Jerome Powell turned more dovish at his semi-annual testimony to Congress and signalled that the FOMC could cut interest rates soon. Powell suggested that the Fed's willingness to lower rates was in order to act pre-emptively to counter headwinds to the US economy, such as from slowing global growth and uncertainties related to trade. He also sounded more dovish on the inflation outlook and emphasised that "there is a risk that weak inflation will be even more persistent than we currently anticipate". We now expect the Fed to cut the FFTR by 25 bps in July and see potential for another 25 bps cut by end-2019. Powell's dovish communication and signalling of rate cuts came despite the resumption US-China trade talks and solid incoming data, including June labour and CPI inflation reports (page 4). Markets are pricing in a total of 65 bps of rate cuts in 2019. Meanwhile, attention this week will be on June retail sales and industrial production data.

Europe: ECB also turns toward further easing; UK data in focus

The minutes of the ECB's June MPC meeting highlighted that the Governing Council (GC) is "ready and prepared" to ease monetary policy further by adjusting any of its instruments (page 5). Recent communication by ECB officials, including Chief Economist Philip Lane, has also become more dovish, supporting the outlook for monetary easing at the upcoming meetings. We believe that the ECB will adjust its forward guidance at its July meeting to prepare markets for a potential deposit rate cut at the subsequent September meeting. Meanwhile, the UK will dominate in terms of data releases this week, with June retail sales and CPI, and the May labour market report due. We expect the data to confirm our bearish view on the economy amid a rising probability of a no-deal Brexit. Consensus estimates June retail sales growth to have contracted for the third consecutive month (-0.3% m-o-m), in line with the weak consumer footfall reported by retailers and signs of de-stocking of goods accumulated ahead of the initial 31 March Brexit deadline. Amid increasing growth concerns, any downside surprises in macro data are likely to lead the market to increasingly price in near-term BoE rate cuts.

EM: Monetary easing expected in China, India and Egypt

China's 2Q2019 real GDP growth was released earlier this morning, printing at a 27-year low of 6.2% y-o-y and down from 6.4% in 1Q. We expect further policy loosening by Beijing to support domestic activity and limit the pace of economic slowdown in 2H, including lowering benchmark rates by some 50-75 bps over the remainder of the year. In India, headline inflation remains under the RBI's 4% target and we maintain our outlook for a 25 bps rate cut in August (page 6). Finally, in Egypt, we now expect the rate easing cycle to start in September versus our earlier forecast of 4Q (page 2).

I. Recent Events and Data Releases

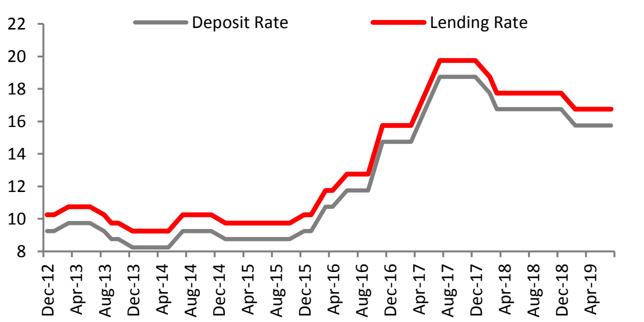
A. MENA Economies

Egypt: Rates on hold, but June inflation points to upcoming cut

CBE cites fiscal reforms for keeping rates steady at its July meeting

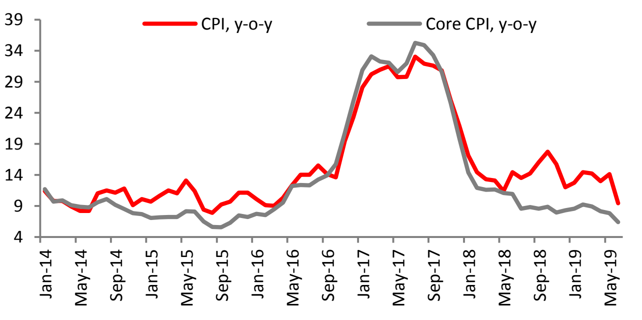
The CBE kept interest rates on hold at its 11 July MPC meeting, in line with our and consensus expectations. We had expected a steady monetary policy as the central bank evaluated the full impact of recent fuel and electricity subsidy reforms on inflation before starting its rate cutting cycle. For further details, please see our note – **Economic Research Weekly - Global Data Watch 8-12 July 2019**, published on 8 July 2019. Indeed, the post-meeting statement noted that the CBE's inflation outlook incorporated the fiscal consolidation measures, which included "reaching cost recovery for most fuel products as well as fuel price indexation to underlying costs". As these reforms were anticipated by the MPC, it decided "that keeping key policy rates unchanged at this juncture remains consistent with achieving the inflation target of 9% (±3 pp) in 4Q2020 and price stability over the medium term".

Fig. 1. Egypt: CBE keeps benchmark rates on hold at last three meetings after cutting by 100 bps in February



Source: Central Bank of Egypt

Fig. 2. Egypt: CPI inflation slows to multi-year low in June, but reflects later timing of subsidy reforms in 2019



Source: CAPMAS, ADCB calculations

CBE could resume its rate cutting cycle from September

However, the probability of an upcoming rate cut has increased following the release of June inflation data. We now see potential for a rate cut (of c.100 bps) at the 26 September meeting rather than our previous expectation of 4Q2019. Headline CPI decelerated to 9.4% y-o-y in June, its lowest level since April 2016 and down from 14.1% in the previous month. It contracted by 0.8% m-o-m, with a 2.2% fall in the volatile food component. The sharp yearly deceleration was partly due to the favourable base, as 2018 fuel price increases were introduced in June versus July in 2019. The June data therefore reflected the impact of the 2018 subsidy reforms dropping out of the data. We expect a pickup in both monthly and annual inflation in July on the back of these price hikes, with yearly inflation returning to double-digit growth. Nevertheless, the degree of price hikes in percentage terms is less in 2019 than in 2018, supporting an overall disinflation trend and providing room for monetary easing. The outlook for a rate cut by the Fed and monetary loosening by other major developed and emerging market central banks also supports the potential for 2H2019 rate cuts by the CBE.

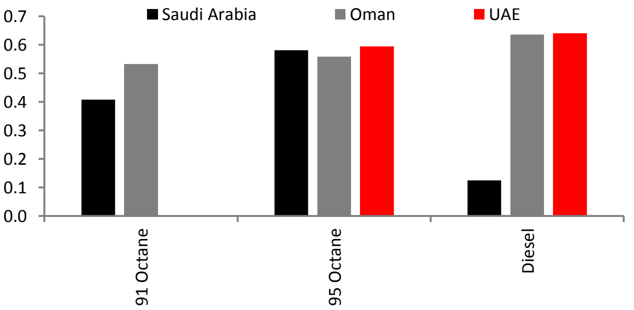
Saudi Arabia: Aramco announces second round of fuel price hikes

Percentage increase in 91 octane greater than for 95 octane, but still below liberalised price in Oman

Aramco raised domestic gasoline prices, effective 14 July, in its second round of quarterly adjustment and in line with changes to Saudi export prices. The prices of domestic fuels were raised by some 4-5% in mid-April in the first round of adjustment, effective mid-April. For further details, please see our report – **Economic Research Weekly: Global Data Watch 15-19 April 2019**, published on 15 April 2019. For 3Q2019, the price for 95 octane petrol has risen by 3.8% to SAR2.18 per litre (from SAR2.1) and 91 octane has increased by 6.3% to SAR1.53 per litre (from SAR1.44). Notably, there were no changes to diesel, kerosene or LPG prices either in 2Q or 3Q. As was the case in 2Q, the price set in Saudi Arabia for the premium 95 octane is broadly in line with that in Oman and UAE (liberalised and set adjusted on a monthly basis) in 3Q, but is lower for 91 octane (probably the most popular) and diesel. The government is likely looking to balance the need for fiscal reforms with containing the impact on consumers and businesses.

Fig. 3. GCC: Saudi 95 octane gasoline in line with other GCC liberalised markets; diesel still markedly cheaper

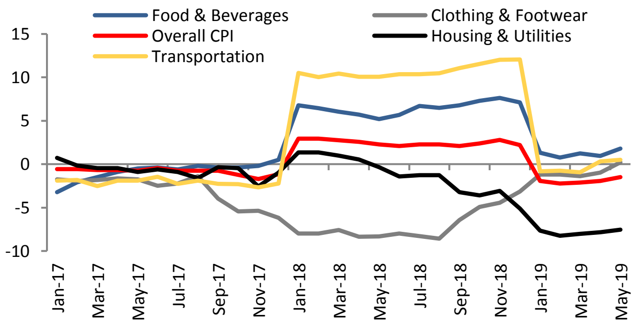
USD per litre, July 2019



Source: Aramco, regional energy ministries, ADCB calculations

Fig. 4. Saudi Arabia: Rise in fuel prices should lead to weaker deflation in 2H; transport prices rising y-o-y from April

% change y-o-y



Source: General Authority for Statistics, ADCB calculations

Pace of fuel price adjustment more contained than in previous rounds of subsidy reforms

The magnitude of the increase in fuel prices this year is still significantly smaller than the adjustments seen in 2016 and 2018. We therefore expect the negative impact on private consumption to be less this year, especially given the expansionary fiscal stance of the government. Nevertheless, the higher fuel prices could contribute to a deceleration in year-on-year private consumption growth in 2H2019, which we had already expected given the less favourable base after 1H2018 activity was dampened by the introduction of VAT. For further details, see our report – **Saudi Arabia Economic Update: 1Q real non-oil GDP growth remains soft; headline slows on oil sector**, published on 30 June 2019. Labour policy and the ongoing loss of expatriates (non-domestic workers) are also suppressing the recovery in household spending, in our view. Meanwhile, we expect the increase in fuel prices to result in a weaker pace of deflation in 2H2019 than seen in 1H. Indeed, the pace of deflation moderated to -1.5% y-o-y in May, versus -2.2% in February 2019.

B. G4 Economies

US: Powell signals July rate cut, citing increasing global uncertainties

Fed could cut rates in 2H2019 to sustain current economic expansion

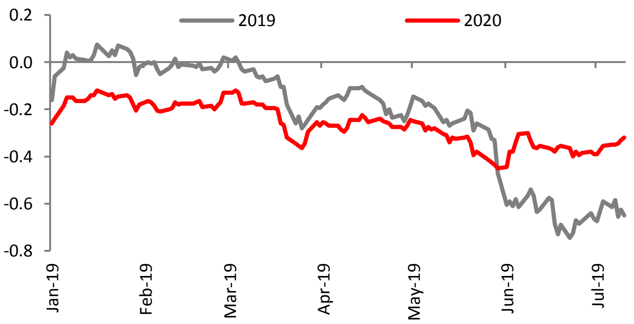
Fed chair Jerome Powell turned significantly more dovish at his Humphrey–Hawkins testimony to Congress and signalled that the FOMC could cut interest rates soon. He highlighted that "based on incoming data and other developments, it appears that uncertainties around trade tensions and concerns about the strength of the global economy continue to weigh on the US economic outlook". The key takeaway from his testimony was that despite the G-20 'trade truce' between the US and China and a solid labour market report in June, the Fed still sees enough economic uncertainty to make a rate cut appropriate. We believe that the Fed's willingness to lower rates in July reflects an intention to act pre-emptively to sustain the current economic expansion. Powell's comments on the inflation outlook also sounded more dovish, emphasising that "there is a risk that weak inflation will be even more persistent than we currently anticipate". A similar tone was expressed in the June FOMC minutes, which showed that many participants see downside risks to the inflation outlook. "Many" participants noted that the case for more accommodation had strengthened amid increasing global uncertainties and falling inflation expectations, while "some" members preferred to gather more information on the trajectory of the economy.

We now expect two 25 bp Fed rate cuts in 2H2019

Overall, Powell's Humphrey–Hawkins testimony and the June FOMC minutes provided more clarity on the Fed's willingness to cut rates, especially to sustain the economic expansion. We believe that the underlying economic momentum in the US remains healthy and does not directly warrant a rate cut at this point. However, with Fed communication leaning towards insurance rate cuts, we now expect the FOMC to initiate a monetary policy easing cycle with a 25 bps rate cut at its July meeting followed by another 25 bps reduction by end-2019. That said, we see the possibility of at least two Fed voting members dissenting at the July meeting and remaining on hold.

Fig. 5. US: Market pricing in a total of 65 bps of Fed rate cuts in 2019

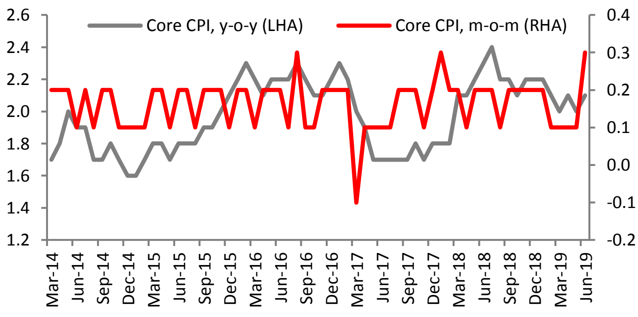
Bps changes to FFTR priced in by rates market



Source: Bloomberg

Fig. 6. US: Core inflation accelerates to 0.3% m-o-m in June (May: 0.1%), beating market expectations of 0.2%

% change



Source: Bureau of Labor statistics

US: Core inflation strengthens sharply in June

Solid June CPI report should boost core PCE inflation in both monthly and annual terms

Core CPI inflation surprised to the upside and accelerated to 0.3% m-o-m in June (consensus: 0.2%; May: 0.1%), the largest monthly gain since January 2018. Annual core inflation also strengthened to 2.1%, from 2% in May. The upside surprise came after monthly inflation disappointed in each of the previous four months. There was a broad-based strengthening of the core print in June, including owners' equivalent rent (OER), medical care services, household furnishings & supplies, and used car prices, suggesting that transitory factors, which were a key cause of recent weak inflation, are waning. Meanwhile, headline CPI remained steady at 0.1% m-o-m in June, as the rise in core inflation was offset by a 2.3% drop in energy prices. Looking ahead, the solid June CPI report is likely to lead the core PCE deflator to strengthen to 0.3% m-o-m in June (May: 0.2%), taking the annual print higher to 1.7% y-o-y (May: 1.6%).

Eurozone: ECB ready to ease monetary policy in 2H

Governing council discusses fresh bond buying and lower rates at June meeting

Minutes of the ECB's June monetary policy meeting largely echoed ECB President Mario Draghi's dovish tone during the post-meeting press conference. The minutes showed that ECB officials were in "broad agreement" that they should "be ready and prepared" to ease monetary policy further by adjusting any of its instruments, including further rate cuts and a re-starting of QE. The Governing Council (GC) expressed particular concern about the inflation outlook, which is significantly lower than the 2% target, alongside the deteriorating growth outlook. Moreover, ECB officials' communication since the June policy meeting has been more dovish, including ECB Chief Economist Philip Lane and board member Benoit Coeure, supporting further monetary easing at the upcoming meetings. However, there was still no clarity on whether the ECB will announce new policy measures at its upcoming July meeting or whether it will wait until the September meeting when the GC will have fresh economic forecasts. We expect the ECB to adjust the forward guidance at its July meeting to prepare markets for a deposit rate cut at its September meeting. We also see a strengthening case for the ECB to announce fresh QE stimulus measures either in 2H2019 or in early 2020.

UK: Monthly GDP data points to flat q-o-q growth in 2Q

May GDP growth and back-series revisions likely to help UK avoid technical contraction in 2Q2019

UK GDP grew by 0.3% m-o-m in May, in line with market expectations, after contracting by 0.4% in April. The key drivers of the rebound were industry (1.4% m-o-m) and construction (0.6% m-o-m), while services output was flat. The strengthening in industrial activity is linked to the resumption of car production in May after Brexit-related factory shutdowns in April. The other key takeaway from the May report was that back-series revisions are likely to help the UK avoid a potential GDP growth contraction in 2Q2019. The BoE currently forecasts GDP growth of 0% q-o-q in 2Q, which looks plausible at this point. However, given the ongoing Brexit-related uncertainty and global growth slowdown, we expect the UK economy to expand at a relatively slow pace in 2H2019 as compared to 2H2018. The weakening economic activity has also led BoE Governor Mark Carney to turn more dovish recently, which in turn could result in the BoE making some changes to its policy guidance at the upcoming MPC meetings. However, we do not see the BoE making any policy rate adjustments (either cuts or hikes) in 2019 until there is more clarity on Brexit.

C. Emerging market Economies

India: Headline inflation picks up in June, while core softens further

Food inflation strengthens in June to 2.2% y-o-y, from 1.8% in May

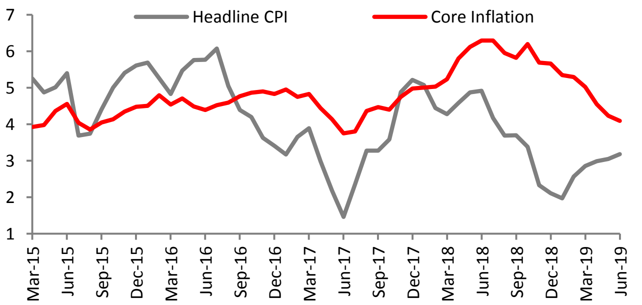
Headline CPI inflation rose marginally to 3.2% y-o-y in June (consensus: 3.1%), from 3.1% in May. It averaged 3.1 % y-o-y in 2Q2019, slightly higher than the RBI forecast of 3.0%, but well below the RBI's 4% target. The strengthening in June inflation was mainly driven by a seasonal increase in food prices, led by cereals, pulses, and vegetables. With the government already starting to offload food grain stocks, we expect prices of cereals and pulses to moderate in the coming weeks, limiting the upward inflationary pressure. However, the monsoon rainfall, which has been deficient until now, will remain critical in shaping vegetable price inflation, which has a c.6% weightage in the CPI basket, in the near term.

Softening core inflation strengthens case for 25 bp rate cut in August

Core inflation (ex-food, tobacco and fuel) decelerated for the eighth straight month to 4.1% y-o-y in June, from 4.2% in May. Weakening transportation costs, led by moderating global crude prices, have been one of the key factors behind the softening of core prices in recent months, alongside housing inflation. Nevertheless, the transportation component is likely to see some upward price pressures in the coming months in our view, with the government raising the excise duty on fuel in the latest budget. Despite that, we expect overall core inflation to remain benign in the coming quarters. Given this expectation, coupled with slowing growth, we expect the RBI to maintain an accommodative monetary policy stance in the near term. We continue to expect the RBI to lower the benchmark repo rate by 25 bps at its 7 August meeting, followed by another 25 bps cut in 4Q2019.

Fig. 7. India: Core inflation eases to 4.1% y-o-y in June, while headline inflation ticks up

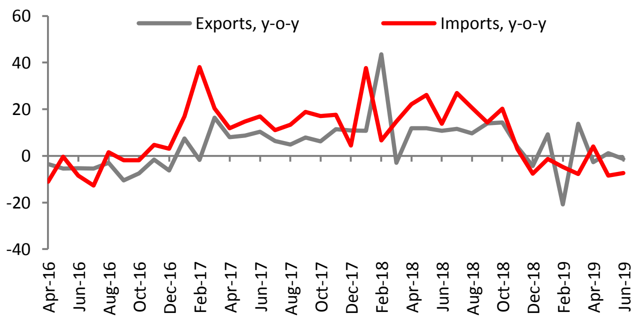
% change y-o-y



Source: India Central Statistical Organisation

Fig. 8. China: Both exports and imports contract in June, led by trade tensions and slowing demand

% change y-o-y



Source: Customs General Administration PRC

China: Weak exports and inflation strengthen case for policy support

Exports contract by 1.3% y-o-y in June, from +1.1% in May, led by trade uncertainties and weakening global demand

China's exports growth contracted in June, led by both the US's tariff hikes on Chinese goods that came into effect in May and slowing external demand. Exports fell by 1.3% y-o-y in June (May: +1.1%), but slightly less than the consensus forecast of a 1.4% drop. The data breakdown shows that exports to the US, EU, and Japan contracted in June, while shipments to ASEAN countries grew at a solid 12.9% y-o-y. Meanwhile, imports fell by 7.3% y-o-y in June (May: -8.5%), the sixth contraction since December 2018, reflecting weak domestic demand. In 1H2019, imports fell by 4.3% y-o-y, as compared to 20.2% y-o-y growth in 1H2018. To offset the impact of the existing tariffs and softening growth outlook (domestic and global), we think China is likely to ease both its monetary and fiscal policy in 2H2019.

PPI inflation decelerates sharply to 0% y-o-y in June, from 0.6% in May

Meanwhile, headline CPI inflation remained unchanged at 2.7% y-o-y in June, in line with market expectations, with rising food prices offset by slowing non-food inflation. However, producer price inflation softened sharply in June to 0% y-o-y (consensus: 0.2%), from 0.6% in May, again likely reflecting weakening domestic demand. A breakdown of the PPI index suggests that raw material prices contracted at a faster pace in June (vs. May), whilst manufacturing and mining segments saw disinflation. We believe that PPI inflation is likely to remain under downward pressure and that it could contract in 3Q, led by both a decline in global commodity prices and weakening demand. Overall, we expect inflationary pressures to remain benign in China, with headline inflation running below the PBoC's 3% target in 2H2019.

II. Economic Calendar

Fig. 9. The week ahead

Time*	Country	Event	Period	Prior	Consensus
Expected this week					
	UAE	Central Bank Foreign Assets	Jun	379.2B	
	Oman	CPI, y-o-y	Jun	0.2%	
	Bahrain	CPI, y-o-y	May	1.0%	
Monday, 15 July					
6:00	China	Industrial Production, y-o-y	Jun	5.0%	5.2%
6:00	China	Retail Sales, y-o-y	Jun	8.6%	8.5%
6:00	China	GDP, y-o-y	2Q	6.4%	6.2%
10:30	India	Wholesale Prices, y-o-y	Jun	2.5%	2.3%
16:30	US	Empire Manufacturing	Jul	-8.6	2.0
16:50	US	Fed's Williams Speaks at Libor briefing			
	India	Exports, y-o-y	Jun	3.9%	
Tuesday, 16 July					
12:30	UK	Average Weekly Earnings, 3M/y-o-y	May	3.1%	3.1%
12:30	UK	ILO Unemployment Rate, 3M	May	3.8%	3.8%
13:00	Eurozone	Trade Balance SA	May	15.3B	17.5B
13:00	Germany	ZEW Survey Current Situation	Jul	7.8	5.0
16:00	UK	BOE's Carney speaks on panel in Paris			
16:15	US	Fed's Bostic Moderates Fed Listens Event in Augusta, Georgia			
16:15	US	Fed's Bowman Makes Introductory Remarks at Fed Listens Event			
16:30	US	Import Price Index, m-o-m	Jun	-0.3%	-0.6%
16:30	US	Retail Sales Advance, m-o-m	Jun	0.5%	0.1%
16:30	US	Retail Sales, ex-Auto, m-o-m	Jun	0.5%	0.3%
16:30	US	Retail Sales Control Group	Jun	0.5%	0.3%
17:15	US	Industrial Production, m-o-m	Jun	0.4%	0.1%
21:00	US	Powell Speaks at Bank of France Dinner in Paris			
23:30	US	Fed's Evans to Speak in Chicago			
Wednesday, 17 July					
12:30	UK	CPI, m-o-m	Jun	0.3%	0.0%
12:30	UK	CPI, y-o-y	Jun	2.0%	2.0%
12:30	UK	CPI Core, y-o-y	Jun	1.7%	1.8%
13:00	Eurozone	CPI, m-o-m	Jun	0.1%	0.1%
13:00	Eurozone	CPI, y-o-y	Jun F	1.2%	1.2%
13:00	Eurozone	CPI Core, y-o-y	Jun F	1.1%	1.1%
16:30	US	Housing Starts	Jun	1269K	1260K
16:30	US	Building Permits	Jun	1294K	1300K
22:00	US	US Federal Reserve Releases Beige Book			
Thursday, 18 July					
3:50	Japan	Trade Balance	Jun	-¥967.1B	¥406.0B
12:30	UK	Retail Sales, inc-Auto Fuel, m-o-m	Jun	-0.5%	-0.3%
12:30	UK	Retail Sales, inc-Auto Fuel, y-o-y	Jun	2.3%	2.6%
16:30	US	Philadelphia Fed Business Outlook	Jul	0.3	5.0
18:00	US	Leading Index	Jun	0.0%	0.1%
22:15	US	Fed's Williams speaks on monetary policy			
	Egypt	Trade Balance	May	-3875M	
Friday, 19 July					
3:30	Japan	National CPI, y-o-y	Jun	0.7%	0.7%
3:30	Japan	National CPI, ex-Fresh Food, y-o-y	Jun	0.8%	0.6%
8:30	Japan	All Industry Activity Index, m-o-m	May	0.9%	0.3%
12:30	UK	PSNB, ex-Banking Groups	Jun	5.1B	3.9B
18:00	US	University of Michigan Sentiment	Jul P	98.2	98.6
19:05	US	Fed's Bullard Speaks at Central Bank Research in New York			

* UAE time

Source: Bloomberg

Fig. 10. Last week's data

Time*	Country	Event	Period	Prior	Consensus	Actual
GCC Economies						
	UAE	CPI, y-o-y	May	-2.1%		-1.1%
	Kuwait	M2 Money Supply, y-o-y	May	2.6%		0.6%
Monday, 8 July						
3:50	Japan	BoP Current Account Balance	May P	¥1707.4B	¥1395.3B	¥1594.8B
3:50	Japan	Core Machine Orders, m-o-m	May	5.2%	-3.8%	-7.8%
3:50	Japan	Core Machine Orders, y-o-y	May	2.5%	-3.6%	-3.7%
10:00	Germany	Industrial Production SA, m-o-m	May	-2.0%	0.4%	0.3%
Tuesday, 9 July						
3:50	Japan	Money Stock M2, y-o-y	Jun	2.6%	2.6%	2.3%
8:15	UAE	Dubai Economy Tracker SA	Jun	58.5		58.4
10:00	Japan	Machine Tool Orders, y-o-y	Jun P	-27.3%		-38.0%
14:00	US	NFIB Small Business Optimism	Jun	105.0	103.1	103.3
18:00	US	JOLTS Job Openings	May	7372	7470	7323
Wednesday, 10 July						
3:50	Japan	PPI, y-o-y	Jun	0.6%	0.4%	-0.1%
5:30	China	CPI, y-o-y	Jun	2.7%	2.7%	2.7%
5:30	China	PPI, y-o-y	Jun	0.6%	0.2%	0.0%
12:30	UK	Industrial Production, m-o-m	May	-2.7%	1.5%	1.4%
12:30	UK	Manufacturing Production, m-o-m	May	-4.2%	2.2%	1.4%
12:30	UK	Trade Balance	May	-£3716M	-£3200M	-£2324M
12:30	UK	Index of Services, 3M/3M	May	0.3%	0.1%	0.3%
18:00	US	Wholesale Inventories, m-o-m	May F	0.4%	0.4%	0.4%
	Egypt	Urban CPI, y-o-y	Jun	14.1%		9.4%
	Egypt	CPI Core, y-o-y	Jun	7.8%		6.4%
Thursday, 11 July						
8:30	Japan	Tertiary Industry Index, m-o-m	May	0.8%	-0.1%	-0.2%
10:00	Germany	CPI EU Harmonized, y-o-y	Jun F	1.3%	1.3%	1.50%
11:00	Turkey	Current Account Balance	May	-1.30B	0.28B	0.15B
16:30	US	CPI, m-o-m	Jun	0.1%	0.0%	0.1%
16:30	US	CPI, ex-Food and Energy, m-o-m	Jun	0.1%	0.2%	0.3%
16:30	US	CPI, y-o-y	Jun	1.8%	1.6%	1.6%
16:30	US	CPI, ex-Food and Energy, y-o-y	Jun	2.0%	2.0%	2.1%
22:00	US	Monthly Budget Statement	Jun	-$74.9B	-$7.9B	-$8.5B
	Egypt	Lending Rate	11-Jul	16.75%		16.75%
	Egypt	Deposit Rate	11-Jul	15.75%	15.75%	15.75%
Friday, 12 July						
11:00	Turkey	Industrial Production, m-o-m	May	-0.9%	-0.4%	1.3%
13:00	Eurozone	Industrial Production SA, m-o-m	May	-0.4%	0.2%	0.9%
16:00	India	CPI, y-o-y	Jun	3.1%	3.1%	3.2%
16:00	India	Industrial Production, y-o-y	May	3.4%	2.9%	3.1%
16:30	US	PPI Final Demand, m-o-m	Jun	0.1%	0.0%	0.1%
16:30	US	PPI Final Demand, y-o-y	Jun	1.8%	1.6%	1.7%
	China	Trade Balance	Jun	$41.65B	$45.0B	$50.98B
	China	Exports, y-o-y	Jun	1.1%	-1.4%	-1.3%
	China	Imports, y-o-y	Jun	-8.5%	-4.6%	-7.3%
	China	Money Supply M2, y-o-y	Jun	8.5%	8.6%	8.5%
	China	New Yuan Loans CNY	Jun	1180B	1700B	1660B

* UAE time
Source: Bloomberg

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