The Week Ahead: Central banks in focus – Fed likely to cut; BoJ to extend guidance

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: Fed to cut with dovish tilt; forward guidance key

The Fed is widely expected to lower the FFTR by 25 bps to 2.0-2.25% at its 30-31 July meeting, albeit with a split vote. Markets will pay particular attention to the forward guidance to understand whether the FOMC sees a July rate cut as largely a pre-emptive move to counter growth uncertainties or if a deeper easing cycle should be expected. We believe that the characterisation of growth and inflation dynamics will be critical to gauging the Fed's outlook. If the Fed emphasises growth concerns (while inflation remains muted) as a key reason for the rate cut, we see the July move and any subsequent cut as largely pre-emptive actions to sustain the economic expansion. However, if the FOMC envisages a persistent inflation undershoot as the key reason for lowering rates, a more sustained rate-cutting cycle could be possible. The market is currently pricing in c.100 bps of cumulative rate cuts by end-2020 (65 bps by end-2019), which looks aggressive at this point given the decent economic momentum (page 3). Data wise, June PCE inflation and the July NFP report will be in focus. We expect GCC central banks to cut benchmark interest rates in line with the Fed, given their currency pegs to the USD. The expected monetary easing is positive given the overall soft regional GDP growth and inflation backdrops.

Japan: BoJ to extend forward guidance on rates to end-2020

The BoJ is expected to keep its monetary policy steady this week, while highlighting that it stands ready to ease further if the global macro outlook continues to deteriorate. Consensus forecasts the BoJ to extend its forward guidance and to emphasise that the current low interest rates will be maintained at least through end-2020, versus the current guidance of "at least until spring 2020". On economic projections, both inflation and growth forecasts are widely expected to see a meaningful downward revision to reflect subdued price pressures and increased uncertainty over the global growth outlook. Recent comments from BoJ Governor Haruhiko Kuroda indicate that the BoJ is increasingly concerned about the heightened global uncertainties and volatility in the financial markets.

UK: BoE likely to remain on hold with dovish tilt

We also expect the BoE to remain on hold at its 1 August policy meeting with a unanimous vote. The tone of the meeting is likely to be dovish with the MPC discussions likely highlighting that the chances of a near-term rate hike have diminished further amid the increasing risk of a no-deal Brexit and the global growth slowdown. However, we do not see the MPC altering its current official forward guidance for gradual and limited rate hikes at this point. The market's focus will also be on BoE Governor Mark Carney's post-meeting press conference to gauge how the BoE would respond to a no-deal Brexit scenario, with the probability increasing under new Prime Minister Boris Johnson (page 5). The market is currently pricing in a 27 bps rate cut by May 2020. Consensus expects the UK's GDP growth forecast to be downgraded to 1.3% for 2019 from 1.5% in May. However, the inflation projections are likely to be revised up marginally for 2019 to reflect the weaker GBP since the May policy meeting.

I. Recent Events and Data Releases

A. MENA Economies

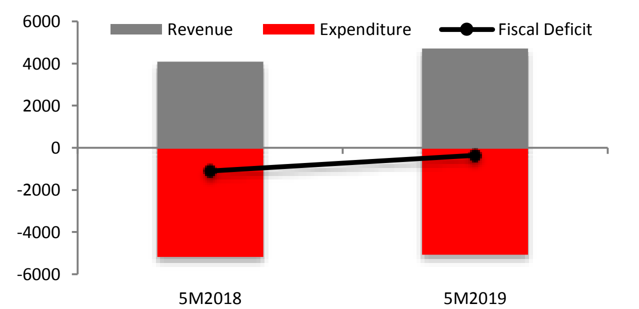
Oman: Raises USD3 billion in first sovereign debt sale this year

Attractive pricing and search for yield likely behind demand for Oman's bond

The government of Oman returned to the international debt market last week, raising USD3 billion in its first issuance this year. The sale was split into two tranches: i) a USD750 million five-year note with a yield of 4.95%, and ii) a USD2.25 billion 10-year note at 6%. There was strong demand with an order book of nearly USD14 billion according to Reuters, with Bloomberg noting a preference for the 10-year tranche. Demand was likely supported by the attractive pricing and global investors hunting for high returns in a low yield environment. The pricing tightened from the initial guidance of 5.375% for the five-year note and 6.375% for the 10 year. The funds raised will probably be used to help cover Oman's fiscal deficit, with the 2019 budget projecting a shortfall of OMR2.8 billion (USD7.3 billion). We still forecast a larger fiscal deficit than the budget assumes, but highlight the positive fiscal developments in 5M2019. The strong fiscal performance so far this year could result in the final deficit printing closer to the official forecast, although we see some downside risks going forward. Meanwhile, we believe the need to issue new debt was likely delayed by the sale of a 10% stake in the Khazzan gas field to Malaysia's Petronas, either at the end of 2018 or in early 2019. The delay in issuing debt has benefited Oman with the outlook for lower global interest rates. Oman is rated sub-investment grade by all three major credit agencies, and Fitch reiterated its long-term issuer default rating of BB+ last week (the highest non-investment grade).

Fig. 1. Oman: Fiscal deficit narrows sharply in 5M2019 but is likely to deteriorate in 2H2019

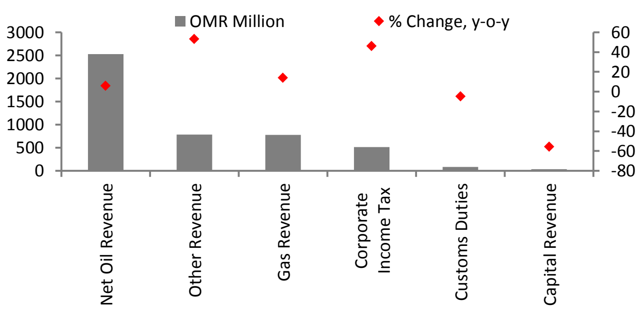
OMR million



Source: Ministry of Finance, ADCB calculations

Fig. 2. Oman: Both hydrocarbon and non-hydrocarbon revenues rise in 5M2019

OMR million (LHA); % change y-o-y (RHA)



Source: Ministry of Finance, ADCB calculations

Oman's fiscal position improves in 5M2019, but some support factors are likely to be temporary

Oman's fiscal deficit narrowed to OMR358.4 million (USD932.1 billion) in 5M2019, versus OMR1.095 billion in the same period of 2018. The improvement was due to both cyclical and structural factors (gas related) in our view, with positive developments on both the revenue and expenditure fronts. Hydrocarbon revenue was boosted by oil (+6.0% y-o-y in 5M2019) and gas (+13.9%), likely due to higher prices and new gas production from the Khazzan field. However, we believe that lower hydrocarbon prices will be increasingly reflected in the data from June onwards. We believe the 46.0% y-o-y rise in corporate tax revenue could have been a result of new gas production and the related tax increase – corporate tax is a standard 15%, but the hydrocarbon sector is an exception as it is taxed at 55% (this is usually covered by special rules in concession agreements). Meanwhile, a significant contributing factor to the improvement in non-oil revenue was an increase in 'other revenue' of 53.1% y-o-y in 5M2019. The factors driving this expansion are unclear at this point, but could be due to Khazzan asset sale, which might be difficult to replicate in the rest of the year. Meanwhile, government expenditure fell by 4.3% y-o-y, with an 18.9% contraction in investment spending. However, current expenditure was broadly flat (up 0.2% y-o-y) over this period reflecting the limited progress in reducing the government's wage and subsidy bill. The fiscal deficit in 5M2019 was under 2% of our full-year GDP growth forecast. However, it is difficult to extrapolate the fiscal data so far into full-year projections. Much of the government's spending is registered in December and, as mentioned above, the support from hydrocarbon prices is expected to wane in 2H. The need for Oman to make a meaningful fiscal adjustment remains vital, given its fragile budget position that is still dependant on hydrocarbon revenue.

B. G4 Economies

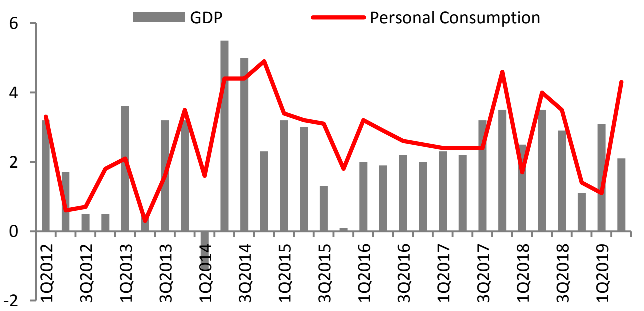
US: Solid 2Q GDP growth, led by consumption activity

Strong consumption but weak investments and net exports in 2Q

Headline GDP growth surprised to the upside, expanding by 2.1% q-o-q SAAR in 2Q and beating the consensus forecast of 1.8%, albeit decelerating from 3.1% growth in 1Q2019. The better-than-expected GDP growth was largely due to personal consumption (4.3% q-o-q SAAR) and government spending (5%). Personal consumption contributed 2.85pp to headline growth, while government consumption boosted it by 0.85pp. Excluding these two components, the other segments of the 2Q GDP report, including investments, net exports and inventories, contributed negatively to headline growth. Notably, private investment growth contracted by 5.5% q-o-q SAAR in 2Q, with both residential and non-residential investments falling. The Bureau of Economic Analysis published its annual revisions to GDP data last week, which showed that real GDP growth was revised up from 2014 until 2Q2018, but has been downgraded since then. The downward revisions to 2H2018 GDP growth suggest that either the fiscal stimulus provided by the Trump administration gave a smaller-than-expected boost to the economy or the trade war was a bigger drag than previously envisaged.

Fig. 3. US: Real GDP grows by healthy 2.1% q-o-q SAAR in 2Q, led by personal and government consumption

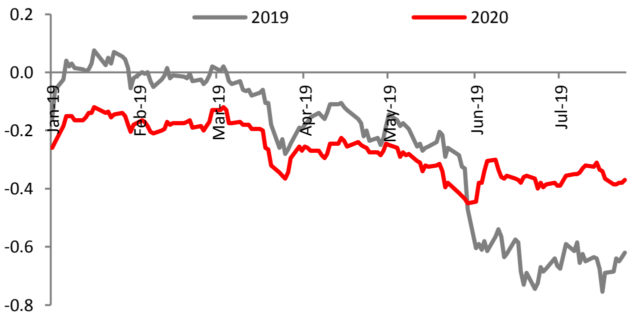
% change q-o-q SAAR



Source: Bureau of Economic Analysis

US: Market pricing in total of c.100 bps of Fed rate cuts by end 2020

Bps changes to FFTR priced in by rates market



Source: Bloomberg

Looking ahead, we believe that consumer spending growth will remain solid and the key driver of GDP growth in 2H2019. Moreover, the negative contribution from inventories in 2Q is likely to fade and provide some support to growth in the coming quarters. However, we do not expect any significant improvement in investment activity and the external sector in the near term amid the slowing global growth outlook and ongoing trade tensions. On balance, the indications are that the US economy will continue to expand above its trend growth of 2% in 2019, led by consumption, albeit decelerating modestly from the solid 1H level. We believe that the solid 2Q GDP report is unlikely to change the Fed's intention to cut the FFTR by 25 bps this week.

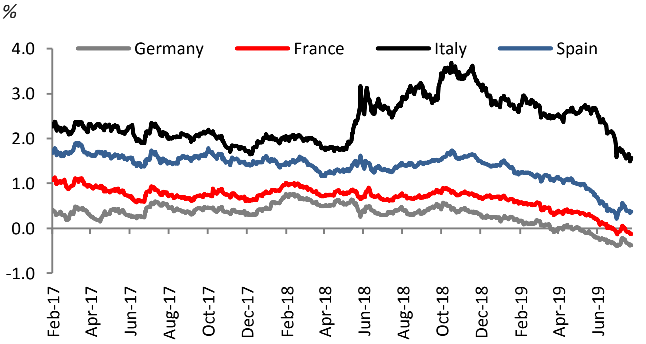
2Q GDP report unlikely to change Fed's intention to cut FFTR at its July meeting

Eurozone: ECB signals its intention to cut policy rate in September

The ECB kept rates unchanged at its July meeting, but gave a strong signal that monetary easing measures are likely to be announced at its September policy meeting. As widely expected, the GC (Governing Council) changed its forward guidance, noting that interest rates will be "at their present or lower levels" at least through 1H2020, versus its previous stance that they would remain on hold. The change to the forward guidance strengthens our view that the ECB is likely cut the deposit rate by 10 bps to -0.5% at its September meeting, followed by another 10 bps reduction in December. No specific measures were announced last week, with indications of differences within the GC over the direction to proceed. As such, the GC tasked the relevant sub-committees with examining the easing options, including: i) policy rates; ii) mitigating measures, such as the design of a tiered system for reserve remuneration; and iii) options for the size and composition of potential new net asset purchases. This indicates that the GC is evaluating interest rate tiering for excess reserves held by the banks at the ECB, as well as looking to restart the asset purchase programme. ECB President Mario Draghi highlighted in his press conference that the rate cuts would be paired with a move to a "two-tier" reserve system. However, he did not provide additional information regarding the magnitude of the possible rate cut or asset purchases. We now believe that the likelihood of QE being restarted in 2019 has increased further, especially if economic activity remains weak or deteriorates further in the near term.

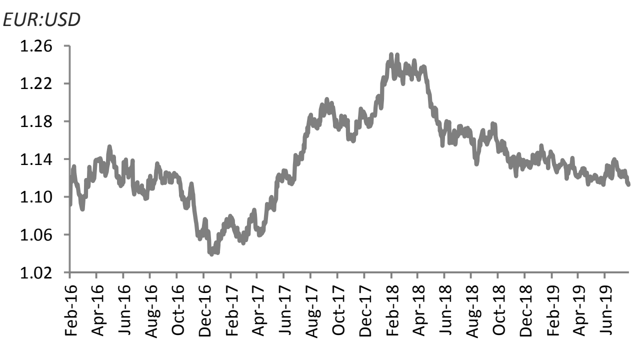
ECB likely to announce monetary easing measures at its September policy meeting

Fig. 4. Eurozone: German and French 10-year bond yields in negative territory, led by dovish ECB communication



Source: Bloomberg

Fig. 5. Eurozone: EUR:USD ends week at 1.128, down from 1.14 at end-June



Source: Bloomberg

On the macro side, the ECB remains concerned about the persistently low inflation outlook, which was highlighted as the key reason for the ECB's intention to ease monetary policy further. Even on the growth front, the ECB sees a risk of the economic

ECB remains concerned about persistently low inflation outlook

outlook tilting to the downside. The GC cited increased global uncertainties, threats of protectionism and emerging market vulnerabilities as the reasons for the deteriorating economic activity. However, Draghi noted that private consumption was still supportive and that he sees little chances of a recession in the Eurozone. Following the ECB meeting, the 10-year Bund yield ended the week at -0.38%, with the EUR:USD falling to 1.1128.

UK: Boris Johnson becomes new UK Prime Minister

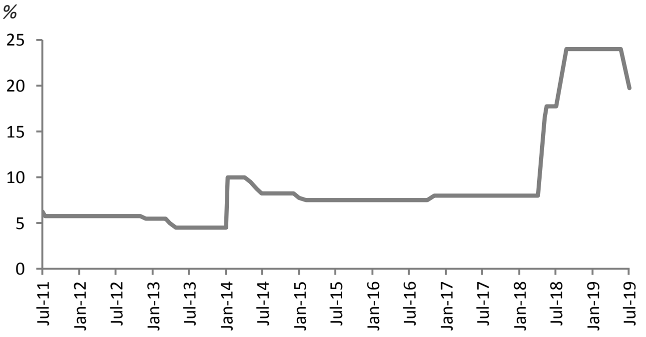
Johnson chooses hardline Brexiteers for key posts in Cabinet

Boris Johnson was appointed the new Prime Minister of the UK last week. During his induction speech, Johnson re-emphasised his earlier pledge that the UK would leave the EU by 31 October "no ifs or buts". Johnson also announced his cabinet, which is full of hardline Brexiteers including Dominic Raab (Foreign Secretary), Priti Patel (Home Secretary) and Sajid Javid (Chancellor). We believe that the probability of a no-deal Brexit increased last week following Johnson's appointment, but we still do not see enough Parliamentary numbers to push either a Brexit deal or no deal through the House of Commons. The government's lack of a majority in Parliament also increases the chance of a general election in the near term, which would require another extension of Article 50 beyond 31 October. All the Brexit options are still on the table, but no single option has majority support in Parliament. Our base-case scenario still favours an orderly UK exit from the EU despite the increasing probability of both a no-deal Brexit and a general election. Looking ahead, we expect Johnson to start negotiations with the EU to get a better Brexit deal than Theresa May's deal. However, it is not yet clear whether the EU will agree to any changes to the Northern Ireland backstop, which remains the major sticking point between both parties, or renegotiate a new deal.

C. Emerging Market Economies

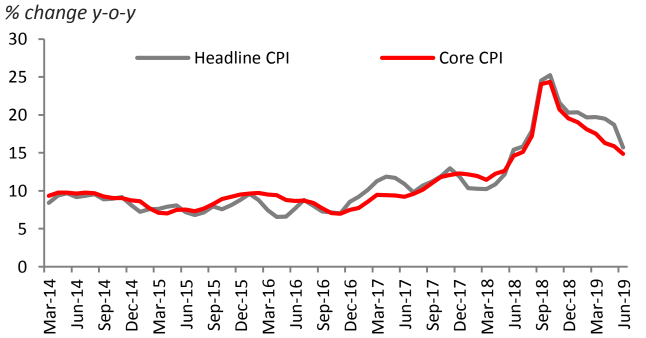
Turkey: CBRT slashes benchmark rate by 425 bps, surprising markets

Fig. 6. Turkey: One-week repo rate is lowered to 19.75% at July meeting, from 24%



Source: CBRT

Fig. 7. Turkey: Softening inflation is key reason for CBRT's rate cut in July



Source: Turkish Statistical Institute

CBRT highlights near-term risk of inflation outlook tilting to downside

The CBRT started its monetary easing cycle with a 425 bps cut to its one-week repo rate at its July meeting, taking the policy rate to 19.75%. The first interest rate cut since February 2015 was deeper than most of the consensus forecasts, which were largely for a 200–300 bp cut. The CBRT's July rate reduction under the new governor Murat Uysal suggests that the MPC is inclined towards frontloading rate cuts to support the economy while the disinflationary trend continues. The MPC statement highlighted that weak domestic demand and still elevated interest rates will continue to support disinflation. However, the CBRT promised to maintain a cautious monetary policy stance in order to achieve the targeted disinflation. The MPC's emphasis on the external sector's improvement was a key development in our view, and implies that the central bank is less concerned now about heightened geo-political tensions and potential US sanctions.

We now forecast additional 200 bps policy rate cut in September meeting

We believe that headline inflation will soften further in the coming months and bottom out around 10% y-o-y by September, before seeing a rebound in 4Q2019. We expect the CBRT's 3Q inflation report, which is due this week (31 July), to show a further decline in its 2019 year-end inflation forecast to below 14%, from 14.6%. The downgrading of inflation projections will also provide additional space for the CBRT to cut interest rates at its September meeting. We now expect the CBRT to lower the one-week repo rate by an additional 200 bps in September, taking the benchmark rate to 17.75%.

II. Economic Calendar

Fig. 8. The week ahead

Time*	Country	Event	Period	Prior	Consensus
Expected this week					
	UAE	CPI, y-o-y	Jun	-1.1%	
	Saudi Arabia	Non-Oil Exports, y-o-y	May	-15.5%	
	Bahrain	M2 Money Supply, y-o-y	Jun	8.6%	
	Bahrain	CPI, y-o-y	Jun	0.5%	
	Kuwait	M2 Money Supply, y-o-y	Jun	0.6%	
	Kuwait	Annual GDP Current, y-o-y	2018	9.7%	
	Oman	Nominal GDP YTD, y-o-y	1Q	12.0%	
	Egypt	Trade Balance	May	-3875M	
Monday, 29 July					
12:30	UK	Mortgage Approvals	Jun	65.4K	65.8K
Tuesday, 30 July					
3:50	Japan	Industrial Production, m-o-m	Jun P	2.0%	-1.8%
16:30	US	Personal Income	Jun	0.5%	0.4%
16:30	US	Personal Spending	Jun	0.4%	0.3%
16:30	US	PCE Core Deflator, m-o-m	Jun	0.2%	0.2%
16:30	US	PCE Core Deflator, y-o-y	Jun	1.6%	1.7%
16:30	US	PCE Deflator, m-o-m	Jun	0.2%	0.1%
16:30	US	PCE Deflator, y-o-y	Jun	1.5%	1.5%
18:00	US	Conf. Board Consumer Confidence	Jul	121.5	125.0
	Japan	BOJ Policy Balance Rate	30-Jul	-0.1%	-0.1%
	Japan	BOJ 10-Yr Yield Target	30-Jul	0.0%	0.0%
Wednesday, 31 July					
11:30	Turkey	Central Bank Inflation Report			
13:00	Eurozone	Unemployment Rate	Jun	7.5%	7.5%
13:00	Eurozone	GDP SA, q-o-q	2Q A	0.4%	0.2%
13:00	Eurozone	GDP SA, y-o-y	2Q A	1.2%	1.0%
13:00	Eurozone	CPI Core, y-o-y	Jul A	1.1%	1.0%
13:00	Eurozone	CPI Estimate, y-o-y	Jul	1.2%	1.1%
16:15	US	ADP Employment Change	Jul	102K	150K
17:45	US	MNI Chicago PMI	Jul	49.7	51.5
22:00	US	FOMC Rate Decision (Upper Bound)	31-Jul	2.5%	2.25%
22:00	US	FOMC Rate Decision (Lower Bound)	31-Jul	2.25%	2.0%
22:00	US	Interest Rate on Excess Reserves	1-Aug	2.35%	2.1%
22:30	US	Fed Chair Powell Holds Press Conference After FOMC Meeting			
Thursday, 01 August					
5:45	China	Caixin China PMI Manufacturing	Jul	49.4	49.6
12:30	UK	Markit UK PMI Manufacturing SA	Jul	48.0	47.7
15:00	UK	Bank of England Bank Rate	1-Aug	0.75%	0.75%
15:00	UK	BOE Asset Purchase Target	Aug	435B	435B
15:30	UK	BOE's Carney speaks at press conference in London			
18:00	US	ISM Manufacturing	Jul	51.7	52.0
18:00	US	ISM Prices Paid	Jul	47.9	49.0
Friday, 2 August					
13:00	Eurozone	Retail Sales, y-o-y	Jun	1.3%	1.3%
16:30	US	Change in Nonfarm Payrolls	Jul	224K	169K
16:30	US	Change in Private Payrolls	Jul	191K	166K
16:30	US	Unemployment Rate	Jul	3.7%	3.7%
16:30	US	Average Hourly Earnings, m-o-m	Jul	0.2%	0.2%
16:30	US	Average Hourly Earnings, y-o-y	Jul	3.1%	3.1%
16:30	US	Trade Balance	Jun	-$55.5B	-$54.6B
18:00	US	Factory Orders	Jun	-0.7%	0.8%

* Bloomberg

Source: Bloomberg

Fig. 9. Last week's data

Time*	Country	Event	Period	Prior	Consensus	Actual
GCC Economies						
	UAE	Central Bank Foreign Assets	Jun	379.2B		364.3B
	UAE	M2 Money Supply, m-o-m	Jun	-1.0%		2.2%
	Saudi Arabia	CPI, y-o-y	Jun	-1.5%		-1.4%
	Kuwait	CPI, y-o-y	Jun	0.8%		1.1%
Monday, 22 July						
16:30	US	Chicago Fed Nat Activity Index	Jun	0.0	0.1	0.0
Tuesday, 23 July						
10:00	Japan	Machine Tool Orders, y-o-y	Jun F	-38.0%		-37.9%
11:00	Turkey	Consumer Confidence SA	Jul	57.6		56.5
17:00	US	FHFA House Price Index, m-o-m	May	0.4%	0.4%	0.1%
18:00	US	Richmond Fed Manufacturing Index	Jul	2.0	5.0	-12.0
18:00	Eurozone	Consumer Confidence	Jul A	-7.2	-7.1	-6.6
18:00	US	Existing Home Sales	Jun	5.36M	5.32M	5.27M
18:00	US	Existing Home Sales, m-o-m	Jun	2.9%	-0.4%	-1.7%
Wednesday, 24 July						
4:30	Japan	Japan PMI Manufacturing	Jul P	49.3		49.6
9:00	Japan	Leading Index CI	May F	95.2		94.9
11:30	Germany	Germany Manufacturing PMI	Jul P	45.0	45.2	43.1
12:00	Eurozone	Markit Eurozone Manufacturing PMI	Jul P	47.6	47.7	46.4
12:00	Eurozone	M3 Money Supply, y-o-y	Jun	4.8%	4.6%	4.5%
15:00	US	MBA Mortgage Applications	19-Jul	-1.1%		-1.9%
17:45	US	Markit US Manufacturing PMI	Jul P	50.6	51.0	50.0
18:00	US	New Home Sales	Jun	604K	658K	646K
Thursday, 25 July						
11:00	Turkey	Capacity Utilization	Jul	77.1%		76.2%
12:00	Germany	IFO Business Climate	Jul	97.5	97.2	95.7
12:00	Germany	IFO Expectations	Jul	94.2	94.0	92.2
15:00	Turkey	One-Week Repo Rate	25-Jul	24.0%	21.5%	19.75%
15:45	Eurozone	ECB Main Refinancing Rate	25-Jul	0.0%	0.0%	0.0%
15:45	Eurozone	ECB Marginal Lending Facility	25-Jul	0.25%	0.25%	0.25%
15:45	Eurozone	ECB Deposit Facility Rate	25-Jul	-0.4%	-0.4%	-0.4%
16:30	US	Wholesale Inventories, m-o-m	Jun P	0.4%	0.5%	0.2%
16:30	US	Durable Goods Orders	Jun P	-2.3%	0.7%	2.0%
16:30	US	Cap Goods Shipments, Non-defence, ex-Air	Jun P	0.5%	-0.2%	0.6%
16:30	US	Cap Goods Orders, Non-defence, ex-Air	Jun P	0.3%	0.2%	1.9%
Friday, 26 July						
3:30	Japan	Tokyo CPI, y-o-y	Jul	1.1%	1.0%	0.9%
3:30	Japan	Tokyo CPI, ex-Fresh Food, y-o-y	Jul	0.9%	0.8%	0.9%
16:30	US	GDP Annualized, q-o-q	2Q A	3.1%	1.8%	2.1%
16:30	US	Personal Consumption	2Q A	1.1%	4.0%	4.3%
16:30	US	GDP Price Index	2Q A	1.1%	2.0%	2.4%
16:30	US	Core PCE, q-o-q	2Q A	1.1%	2.0%	1.8

* UAE time
Source: Bloomberg

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