The Week Ahead: Fed's Powell testifies to Congress; CBE on hold

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

Contents

US: Fed communication and June CPI inflation data in focus

Key events this week will be the June FOMC minutes and Fed Chair Jerome Powell's semi-annual Humphrey-Hawkins testimony to Congress (10-11 July). The markets will closely scrutinise Powell's comments and the June FOMC minutes for any clarity on the timing and magnitude of a potential interest rate cut. We expect Powell to push back against market expectations for a July rate cut during his speech, given the strong June labour market report (page 3) and the resumption of US-China trade talks. Indeed, recent comments from Fed members have been less dovish than the June FOMC communication. However, we believe that Powell will reiterate that the Fed stands ready to act if necessary, whilst re-emphasising its data dependent approach. Our base case is for the Fed to remain on hold in 2019 if US data continues to show resilience and trade tensions remain contained. Meanwhile, the main data releases this week will be June CPI inflation and the May JOLTS report. Consensus forecasts headline inflation to decelerate to 0% m-o-m in June (May: 0.1%), taking the y-o-y reading down to 1.6% (May: 1.8), led by lower gasoline prices. However, core inflation is estimated to strengthen marginally to 0.2% in June (May: 0.1%), likely driven by shelter and medical services prices.

Egypt: CBE expected to remain on hold at July meeting

We expect the CBE to keep benchmark interest rates steady at its 11 July MPC meeting, with the lending rate remaining at 16.75%. We believe the CBE will wait to see the full impact of the subsidy reforms on inflation before it resumes its rate cutting cycle. The latest round of fuel reforms (effective 5 July) has raised domestic prices by between 16% and 30%. The price of the widely used 92 octane grade petrol has increased by 18.5%, whilst cooking gas cylinders have risen by 30%. The Ministry of Petroleum noted that most fuel prices are now in line with their costs, although the government is still subsidising fuel for bakeries and power generation. Earlier, the government announced increases in electricity prices of around 15% for the current fiscal year (starting 1 July). Inflation data for June is also due this week (10 July), though will not include these subsidy reforms and is expected to moderate on a yearly basis. The next stage of fuel reform is due in September, with an indexation mechanism that links local fuel prices to international ones.

EM: China's exports growth expected to contract in June

China will release some key high-frequency data this week, including June inflation, trade balance, and money supply. We believe that the trade data will continue to soften, reflecting the negative impact of additional tariffs imposed by the US (announced in May) and weak global demand. The market expects exports growth to decline by 0.6% y-o-y in June (May: +1.1%), with imports also contracting by 4.6% y-o-y (May: -8.5%). Elsewhere, India will release its June inflation data this week, with consensus forecasting headline inflation to tick up to 3.2% y-o-y in June (May: 3.1%) driven by food prices. Nevertheless, inflation will still below the RBI's 4% target, supporting a rate cut in August.

I. Recent Events and Data Releases

A. MENA Economies

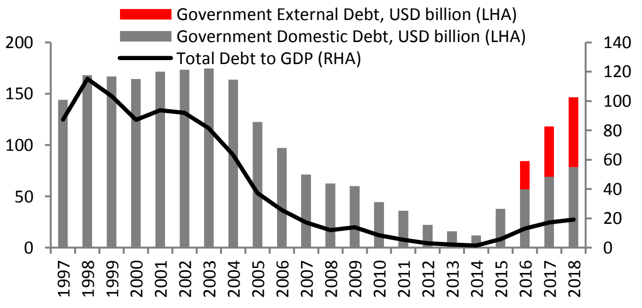
Saudi Arabia: Issues first EUR-denominated sovereign debt

Yield on EUR debt substantially less than on USD debt of similar maturity

The government of Saudi Arabia issued its first EUR-denominated debt last week as part of its funding programme, raising EUR3 billion. Prior to this, Saudi Arabia had only issued bonds denominated in SAR and USD. The issue was oversubscribed by more than four times, with orders in excess of EUR13.5 billion according to the Ministry of Finance. It was comprised of two tranches – a EUR1 billion 8-year note priced at 80 bps over mid-swaps (c.0.78% yield), and a EUR2 billion 20-year note priced at 140 bps over mid-swaps (c.2.04% yield). The pricing tightened from the initial guidance by some 35 bps for the eight-year note and 30 bps for the 20-year due to the strong demand. Issuing debt in EUR has a number of advantages in our view, especially the lower rates versus the USD debt of similar maturity thanks to the negative interest rates. The EUR issuance also diversifies the funding base, and meets the strong appetite for Saudi paper from European investors looking for higher yields than those available at home. The tenors also help in extending Saudi Arabia's debt maturity profile, avoiding any front loading of the curve.

Fig. 1. Saudi Arabia: Government debt remains low in GDP terms, but is rising sharply on absolute basis

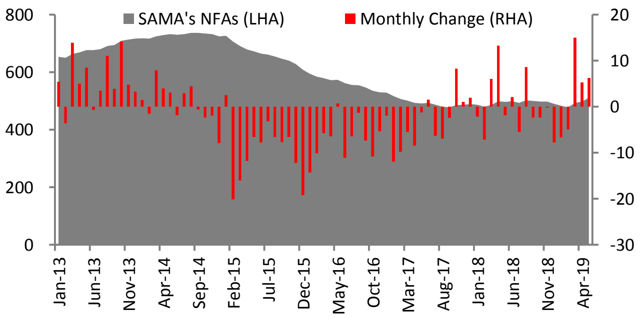
USD billion (LHA); % of GDP (RHA)



Source: Ministry of Finance, ADCB calculations

Fig. 2. Saudi Arabia: SAMA's NFAs have risen for three months consecutively from March 2019

USD billion



Source: SAMA, ADCB calculations

Bond issuance will help cover government's expected fiscal shortfall

The proceeds of the bond will help cover the government's projected fiscal deficit, which we estimate to be around 7.1% of GDP partly due to the government's expansionary stance. Saudi Arabia had already raised USD7.5 billion of sovereign debt in January. For further details, please see our note – **Economic Research Weekly: Global Data Watch 14-18 January 2019**, published on 14 January 2019. The latest issuance should help to raise the government's foreign reserves further, which we believe have already been boosted by the January USD issuance and transfers and payments from Aramco (reflected in the government's 1Q fiscal surplus). For further details, please see our note – **Saudi Arabia Economic Update: Fiscal surplus realised in 1Q, revenues boosted by transfers**, published on 2 May 2019. We believe that transfers from other government-related entities (GRE) could have supported the rise in SAMA's net foreign assets (NFAs) in April and May, alongside government deposits with the central bank. SAMA's NFA position stood at USD534 billion in May, up USD21.3 billion from December 2018 and 2.8% y-o-y. Saudi Arabia still has the space to increase debt (both at a central government and GRE level), although the key issue remains the utilisation of this to diversify the economy and raise employment opportunities.

UAE: Announces sectors open to 100% foreign ownership

Ownership level to be decided at emirate level

The UAE Cabinet has announced 13 broad sectors eligible for up to 100% foreign ownership under a law ratified last November. This is a further move to strengthen the investment environment and create jobs. The list includes 122 economic activities across 13 sectors, including renewable energy, space, agriculture, manufacturing, transport, logistics, hospitality, food services, information and communications, amongst others. Previously, foreign investors could hold up to 49% of a company registered in the UAE, unless it was in a designated free trade zone, and would have to partner with an Emirati investor who would hold the remaining 51%. Each emirate will decide the maximum foreign ownership allowed within its jurisdiction, which could suggest liberalisation on a specific and targeted manor, at least in the near term. So far, there are no indications for the timeline for individual emirates to finalise and/or announce foreign ownership levels across the various activities and sectors. Nevertheless, we believe the announcement highlights the policy commitment to attracting FDI and developing new economic sectors. We believe that 100% ownership will be particularly important in attracting new tech-heavy sectors, where protecting intellectual property might be a key factor.

B. G4 Economies

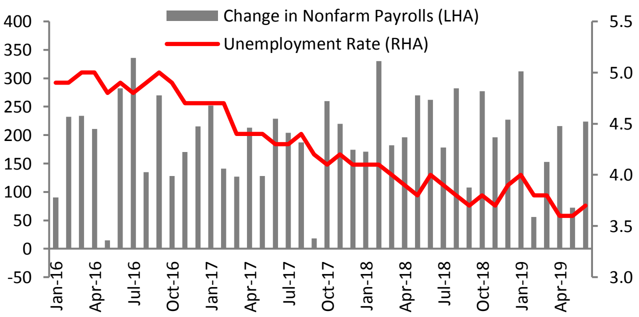
US: Hiring activity rebounds in June but wage growth softens

US economy adds 224K jobs in June, rebounding from 72K in May

The June NFP report showed that the US economy added jobs at a steady pace, albeit with relatively subdued wage growth. It added 224K jobs in June, rebounding from just 72K in May (revised down from 75K). Payrolls averaged a solid 172K jobs per month in 1H2019 (1H2018: 235K), though more volatile. The slowdown in average jobs growth in 1H2019 is broadly consistent with the softening underlying momentum of the economy, which is trending towards 2% GDP growth in 2019 from 2.9% in 2018. Professional and business services (51K), health care (35K), transportation and warehousing (24K), construction (21K), and manufacturing (17K) were the key drivers of the jobs growth in June. Meanwhile, employment in other key sectors, including mining, wholesale trade, retail trade, information, financial activities and leisure and hospitality were broadly unchanged in June, as compared to the previous month.

Fig. 3. US: Jobs growth averaged a healthy 172K in 1H2019, despite increased volatility in payroll data

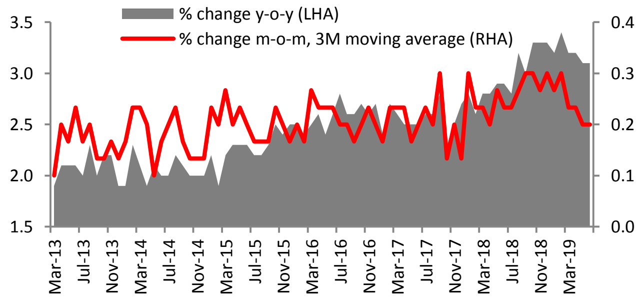
'000 (LHA); % (RHA)



Source: Bureau of Labor Statics

Fig. 4. US: Monthly wage growth softened to 0.2% in June (May: 0.3%), though annual print steady at 3.1%

% change



Source: Bureau of Labor Statics

Wage growth remains subdued in June

Average hourly earnings growth decelerated to 0.2% m-o-m in June (consensus: 0.3%), from an upwardly revised 0.3% in May. This resulted in annual growth remaining unchanged at 3.1% in June, showing some early signs that wage growth is levelling off at just above 3%. Meanwhile, the unemployment rate ticked up marginally to 3.7% in June, with the participation rate rising to 62.9% from 62.8% in May. Overall, the June jobs report should ease market concerns about the underlying strength of the US economy. We believe that in their communication this week, the Fed members are likely to push back against market expectations for a July rate cut, whilst reiterating their data-dependent approach.

Eurozone: Christine Lagarde nominated for ECB presidency

We expect Christine Lagarde to maintain ECB's current dovish monetary policy stance

The EU leaders last week announced their nominations for the presidencies of the European Central Bank (ECB), the European Commission (EC) and the European Council. Germany's Defence Minister Ursula von der Leyen was nominated for the new EU Commission presidency, whilst Belgium's Charles Michel was chosen for the EU Council presidency. Importantly, the IMF director Christine Lagarde was nominated for the ECB president's role, and if approved, will replace Mario Draghi effective from 1 November. The initial market reaction to Lagarde's appointment was positive and consensus believes that she will broadly continue with the ECB's accommodative monetary policy stance. Moreover, her experience in public policy at the IMF and as France's finance minister during the global financial crisis is likely to help her convince member countries to increase fiscal spending, especially in the event of any adverse economic situation. However, unlike the previous ECB presidents, Lagarde does not have direct monetary policy experience, which, in our view, is likely to make the current ECB chief economist Philip Lane more important in shaping the policy, alongside the other executive board members. Overall, we expect Lagarde to maintain the ECB's current dovish monetary policy stance. We now believe that the ECB is likely to cut its deposit rate by 10 bps at its September meeting, potentially followed by another 10 bps in December, taking the deposit rate to -0.60 bps by end-2019.

C. Emerging Market Economies

India: Fiscal deficit target lowered to 3.3% of GDP for FY2019-20

Government chooses fiscal consolidation at a time of weakening growth momentum

In a surprise move, India's finance minister lowered the country's fiscal deficit target to 3.3% of GDP for FY2019-20 (April 2019 to March 2020), from 3.4% at the interim budget approved in February. The market was expecting a widening of the deficit target to help support economic activity. The budget is therefore prioritising fiscal consolidation over support to growth. However, we believe that the government's revenue assumptions are still optimistic and will likely lead to a higher deficit than outlined. There were tax reforms announced to increase revenue, including increasing fuel taxes by INR1 per litre, raising customs duty on gold (12.5% from 10%) and hiking income tax for high net worth individuals (INR2-5 crore per annum: 39%, and above INR5 crore: 42.7%). On the expenditure side, no new spending measures were announced, although the fiscal stimulus measures announced during the interim budget were retained, including the farm support programme. For further details, see our note – **Economic Research Weekly: Global Data Watch 4-8 February 2019**, published on 4 February 2019. The FY2019-20 budget's retention of earlier stimulus measures without announcing any fresh fiscal loosening is an attempt to maintain a balance between supporting the economy and fiscal discipline, in our view. The government's balanced approach is likely to place onus on the RBI to ease monetary policy further to support growth. We now expect an additional 50 bps of rate cuts in the current RBI easing cycle – 25 bps in August, followed by another 25 bps in 4Q2019. We continue to forecast real GDP growth of 7% for FY2019-20 at this point, though highlight increasing downside risks emanating from: i) the government's fiscal consolidation; ii) deficient monsoon rainfall affecting agricultural growth; and iii) external headwinds from the global growth slowdown.

Government to open up key industrial sectors, including aviation and media, to attract FDI

Despite not providing any major new fiscal stimulus to the economy, the budget's focus was on opening up the economy to improve the investment climate in the medium term. The new policy measures announced include: i) allowing 100% FDI in insurance intermediaries; ii) easing local sourcing requirements for single retail brands to boost FDI; and iii) a proposal to open up the media and aviation sectors to attract FDI, etc. The government also highlighted its intention to issue foreign currency sovereign bonds, a move which will widen the scope of Indian bond and deepen capital markets.

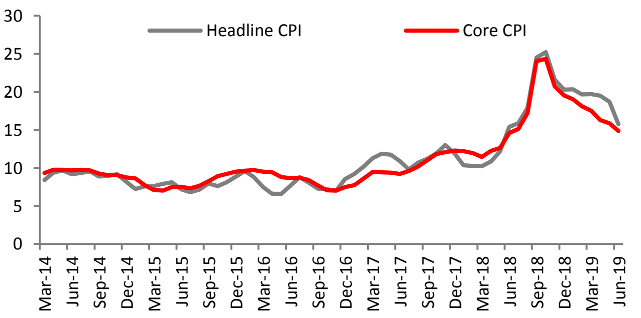
Turkey: Softening inflation opens door for July rate cut

Core inflation decelerates to 14.9% y-o-y in June, from a recent peak of 24.3% in October 2018

Headline CPI inflation surprised to the downside for the third consecutive month and decelerated to a 12-month low of 15.7% y-o-y in June (consensus: 16.1%), from 18.7% in May. The softening in June was broad-based, though partly due to the higher base during the corresponding month of the previous year. Core inflation also weakened to 14.9% y-o-y in June, from 15.9% in the previous month. Core goods has seen a greater disinflation trend than the core services sector, with the recent strengthening of the TRY likely a factor. Looking ahead, we expect headline inflation to increase marginally in the coming months, reflecting the recently announced increases to administered prices (oil, gas and electricity prices), which came into effect on 1 July.

Fig. 5. Turkey: Both headline and core inflation decelerate further in June

% change y-o-y



Source: Turkish Statistical Institute

Fig. 6. Turkey: TRY strengthens against USD from May, though could come under pressure with CBRT changes

USD:TRY

Source: Bloomberg

CBRT likely to start its easing cycle in July with 100 bps rate cut

With inflation softening more meaningfully in recent months, we now believe that the CBRT will start its monetary easing cycle at its 25 July meeting, with a 100 bps rate cut. We also see more scope for the CBRT to slash benchmark rates by an additional 200-300 bps in the subsequent MPC meetings, even if inflation broadly remains around June levels. The slowing domestic and global growth backdrop, alongside the dovish Fed, are also likely to remain supportive for the CBRT to provide a more accommodative monetary policy stance in 2H2019 and in 2020. The removal of Murat Cetinkaya as CBRT governor by the Turkish President Tayyip Erdogan during the weekend is likely to add more pressure on the central bank to cut rates significantly in 2H2019. We believe that the new governor, Murat Uysal, is likely to be more dovish and supportive of rate cuts to revive the recession-hit economy. However, the change in the governor raises further questions on the independence of the central bank, which could dent confidence, and potentially impact capital inflows and the TRY. This in turn could dampen the ability to lower rates in the near term, or the magnitude of the cuts.

II. Economic Calendar

Fig. 7. The week ahead

Time*	Country	Event	Period	Prior	Consensus
Expected this week					
	UAE	CPI, y-o-y	May	-2.1%	
	Kuwait	M2 Money Supply, y-o-y	May	2.6%	
	Bahrain	CPI, y-o-y	May	1.0%	
	Oman	CPI, y-o-y	Jun	0.2%	
	China	Money Supply M2, y-o-y	Jun	8.5%	8.6%
	China	New Yuan Loans CNY	Jun	1180B	1675B
Monday, 8 July					
4:30	Japan	Kuroda Speaks at Branch Managers Meeting			
10:00	Germany	Industrial Production SA, m-o-m	May	-1.9%	0.4%
Tuesday, 9 July					
3:50	Japan	Money Stock M2, y-o-y	Jun	2.7%	2.6%
8:15	UAE	Dubai Economy Tracker SA	Jun	58.5	
14:00	US	NFIB Small Business Optimism	Jun	105.0	103.3
18:00	US	JOLTS Job Openings	May	7449	7465
18:10	US	Fed's Bullard to Make Welcoming Comments in St. Louis			
12:00	Eurozone	ECB's Lane Comments in Twitter Q&A			
Wednesday, 10 July					
3:50	Japan	PPI, y-o-y	Jun	0.7%	0.4%
5:30	China	CPI, y-o-y	Jun	2.7%	2.7%
5:30	China	PPI, y-o-y	Jun	0.6%	0.3%
12:30	UK	Industrial Production, m-o-m	May	-2.7%	1.5%
12:30	UK	Trade Balance	May	-£2740M	-£3200M
12:30	UK	Index of Services, 3M/3M	May	0.2%	0.1%
18:00	US	Fed's Powell Testifies Before House Financial Services Panel			
18:00	US	Wholesale Inventories, m-o-m	May F	0.4%	0.4%
21:30	US	Fed's Bullard To Speak at Washington University in St. Louis			
22:00	US	FOMC Meeting Minutes	19-Jun		
	Egypt	Urban CPI, y-o-y	Jun	14.1%	
Thursday, 11 July					
8:30	Japan	Tertiary Industry Index, m-o-m	May	0.8%	0.1%
11:00	Turkey	Current Account Balance	May	-1.33B	0.26B
13:30	UK	BOE publishes Financial Stability Report			
15:30	Eurozone	ECB Publishes Account of June 5-6 Policy Meeting			
16:30	US	CPI, m-o-m	Jun	0.1%	0.0%
16:30	US	CPI, ex-Food and Energy, m-o-m	Jun	0.1%	0.2%
16:30	US	CPI, y-o-y	Jun	1.8%	1.6%
16:30	US	CPI, ex-Food and Energy, y-o-y	Jun	2.0%	2.0%
18:00	US	Fed's Powell Testifies Before Senate Banking Committee			
19:10	US	Fed's Williams To Speak on Revitalizaiton in Albany, New York			
22:00	US	Monthly Budget Statement	Jun	-$207.8B	-$12.5B
	Egypt	Lending Rate	11-Jul	16.75%	
	Egypt	Deposit Rate	11-Jul	15.75%	
Friday, 12 July					
11:00	Turkey	Industrial Production, m-o-m	May	-1.0%	-0.4%
13:00	Eurozone	Industrial Production SA, m-o-m	May	-0.5%	0.2%
16:00	India	CPI, y-o-y	Jun	3.1%	3.2%
16:00	India	Industrial Production, y-o-y	May	3.4%	3.1%
16:30	US	PPI Final Demand, m-o-m	Jun	0.1%	0.1%
	China	Trade Balance	Jun	$41.65B	$45.3B
	China	Exports, y-o-y	Jun	1.1%	-0.6%
	China	Imports, y-o-y	Jun	-8.5%	-4.6%

* UAE time

Source: Bloomberg

Fig. 8. Last week's data

Time*	Country	Event	Period	Prior	Consensus	Actual
MENA Economies						
	Saudi Arabia	GDP Constant Prices, y-o-y	1Q	3.6%		1.7%
	Bahrain	M2 Money Supply, y-o-y	May	8.8%		8.6%
Monday, 1 July						
9:00	India	Markit India PMI Manufacturing	Jun	52.7		52.1
11:00	Turkey	Turkey PMI Manufacturing	Jun	45.3		47.9
12:00	Eurozone	M3 Money Supply, y-o-y	May	4.7%	4.6%	4.8%
12:30	UK	Mortgage Approvals	May	66K	65.5K	65.4K
12:30	UK	Markit UK PMI Manufacturing SA	Jun	49.4	49.5	48.0
13:00	Eurozone	Unemployment Rate	May	7.6%	7.6%	7.5%
18:00	US	ISM Manufacturing	Jun	52.1	51.0	51.7
18:00	US	ISM Prices Paid	Jun	53.2	53.0	47.9
18:00	US	Construction Spending, m-o-m	May	0.4%	0.0%	-0.8%
Tuesday, 2 July						
3:50	Japan	Monetary Base, y-o-y	Jun	3.6%		4.0%
12:30	UK	Markit/CIPS UK Construction PMI	Jun	48.6	49.2	43.1
Wednesday, 3 July						
4:30	Japan	Markit Japan PMI Composite	Jun	50.7		50.8
5:45	China	Caixin China PMI Manufacturing	Jun	50.2	50.1	49.4
8:15	Egypt	Egypt PMI	Jun	48.2		49.2
8:15	Saudi Arabia	Saudi Arabia PMI	Jun	57.3		57.4
8:15	UAE	UAE PMI	Jun	59.4		57.7
9:00	India	Markit India PMI Composite	Jun	51.7		50.8
11:00	Turkey	CPI, y-o-y	Jun	18.7%	16.1%	15.7%
11:00	Turkey	CPI Core Index, y-o-y	Jun	15.9%	14.7%	14.9%
12:00	Eurozone	Markit Eurozone Composite PMI	Jun F	52.1	52.1	52.2
12:30	UK	UK Services PMI	Jun	51.0	51.0	50.2
12:30	UK	UK Composite PMI	Jun	50.9	51.0	49.7
13:00	Qatar	Qatar Financial Center PMI	Jun	48.1		47.2
16:15	US	ADP Employment Change	Jun	41K	140K	102K
16:30	US	Trade Balance	May	-$51.2B	-$54B	-$55.5B
17:45	US	Markit US Composite PMI	Jun F	50.6		51.5
18:00	US	Durable Goods Orders	May F	-1.3%	-1.3%	-1.3%
18:00	US	Cap Goods Shipments, Non-defence, ex-Air	May F	0.7%		0.6%
18:00	US	Factory Orders	May	-1.2%	-0.6%	-0.7%
18:00	US	ISM Non-Manufacturing Index	Jun	56.9	56.0	55.1
Thursday, 4 July						
13:00	Eurozone	Retail Sales, m-o-m	May	-0.1%	0.3%	-0.3%
Friday, 5 July						
9:00	Japan	Leading Index CI	May P	95.9	95.4	95.2
10:00	Germany	Factory Orders, m-o-m	May	0.4%	-0.2%	-2.2%
16:30	US	Change in Nonfarm Payrolls	Jun	72K	160K	224K
16:30	US	Change in Private Payrolls	Jun	83K	150K	191K
16:30	US	Unemployment Rate	Jun	3.6%	3.6%	3.7%
16:30	US	Average Hourly Earnings, m-o-m	Jun	0.3%	0.3%	0.2%
16:30	US	Average Hourly Earnings, y-o-y	Jun	3.1%	3.2%	3.1%

* UAE time
Source: Bloomberg

This report 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 report nor anything contained herein shall form the basis of any contract or commitment whatsoever. Distribution of this report does not oblige Abu Dhabi Commercial Bank PJSC ("ADCB") to enter into any transaction.

The content of this report should not be considered legal, regulatory, credit, tax or accounting advice. Anyone proposing to rely on or use the information contained in the report 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 report.

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 report 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 report.

Charts, graphs and related data or information provided in this report are intended to serve for illustrative purposes only. The information contained in this report 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.

This report 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 report.