

The Week Ahead: UK political developments to take centre stage

► **UK: Conservative Party leadership race in focus**

Political uncertainty in the UK has heightened following PM Theresa May's decision to resign on 7 June. The leadership contest in the Conservative Party is likely to start on 10 June, with the new PM likely to assume office anytime between June and September. The GBP continues to remain under pressure as markets are increasingly pricing in for a hard Brexiter to take over from PM May. The incoming PM will face similar challenges as Theresa May did whilst trying to pass her Brexit deal in Parliament. The Conservative Party remains divided, as does Parliament. There remains no consensus on what Brexit should look like and passing any Brexit deal is likely to prove difficult. A general election looks likely at some point to secure a mandate for Brexit and potentially break the deadlock, although this poses various risks for the Conservative Party given indications of a fall in popularity. We currently do not expect to see a resolution to Brexit in 2019.

► **US: April PCE inflation and second estimate of 1Q GDP growth**

The key US data releases this week are April PCE inflation and the second estimate of 1Q GDP. Consensus projects core PCE inflation to have remained steady at 1.6% y-o-y in April after decelerating for four consecutive months. An unexpected softening to 1.5% y-o-y could further raise market expectations that the Fed will lean towards a more dovish stance in the near term, compared to its current patient approach and relatively neutral stance. Personal spending growth is forecast to have softened to 0.2% m-o-m in April, in line with April retail sales data, after rising sharply to 0.9% in March. We continue to expect consumption to provide significant support to 2Q growth. Meanwhile, the second estimate of 1Q GDP growth is forecast to be lowered to 3.1% q-o-q saar from 3.2% previously, likely due to weaker growth contributions from trade and inventories. A number of Fed members have speaking engagements this week, including Vice Chair Richard Clarida and John Williams. We expect them to reiterate that the Fed will continue its patient approach and that it is in no rush to adjust interest rates, in line with the minutes from the FOMC's May meeting (page 3).

► **India: 1Q GDP growth expected to soften**

The focus in India this week will be on the 1Q GDP data (due on 31 May), with the consensus expecting growth to have moderated to a six-quarter low of 6.2% y-o-y from 6.6% in 4Q2018. We believe that the economic momentum remains relatively weak with a number of high-frequency indicators showing soft consumer spending and industrial activity in 1Q. Slower credit disbursements by non-bank finance companies, election-related uncertainty and relatively weak global growth are likely to have weighed on 1Q GDP growth. However, with election-related uncertainty coming to an end last week (page 5), we expect PM Narendra Modi's government to focus on reviving economic activity. Separately, Turkey will also release its 1Q GDP growth data this week. Consensus expects a second consecutive quarterly contraction of 2.9% y-o-y in 1Q (4Q: -3%), with a broad-based weakness.

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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I. Recent Events and Data Releases

A. MENA Economies

Egypt: Rates on hold at CBE’s May meeting

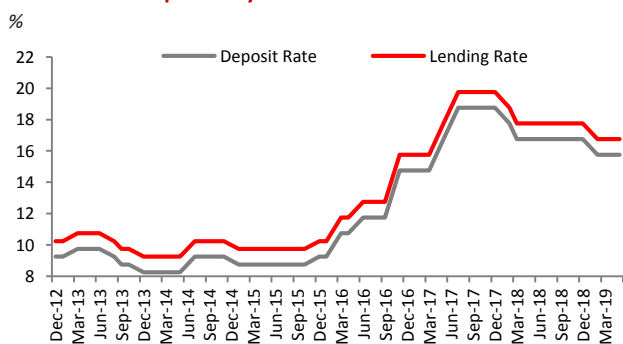
The CBE kept benchmark interest rates steady at its 23 May meeting, in line with our and consensus forecasts. The overnight deposit rate remains at 15.75% and the overnight lending rate at 16.75%. We had expected the rates to be kept on hold ahead of the next round of subsidy reforms in June, including fuel. Egypt started indexing the less-used Octane 95 petrol to international prices in April and will introduce a similar indexation mechanism for other fuel products in June, with the first price adjustments expected in mid-September. As such, we see the central bank remaining on hold until 4Q, as it gauges the impact of the fiscal reforms on underlying inflationary pressure. The CBE’s post-meeting statement noted that its policy decision was “consistent with achieving the inflationary target of 9% (±3pp) in 2020 Q4 and price stability over the medium term”. We believe the latest round of subsidy reforms will have a relatively contained effect on yearly CPI. This is especially as the impact of last year’s fuel price rises drops out of the data.

CBE’s policy stance in line with expectations ahead of June fuel price liberalisation

Meanwhile, imported inflation is being contained by the strengthening of the EGP since end-January. The EGP had appreciated to 16.864 against the USD by the end of last week, strengthening c.5.8% from 22 January when the latest round of strengthening began. The EGP is probably being bolstered by the improving external backdrop, including higher tourism receipts, some improvement in the export of goods and the substitution of natural gas imports with domestic production. Looking ahead, the CBE will also take into account global developments, despite the EGP escaping the recent downward pressure on EM currencies due to rising global trade and geopolitical tensions.

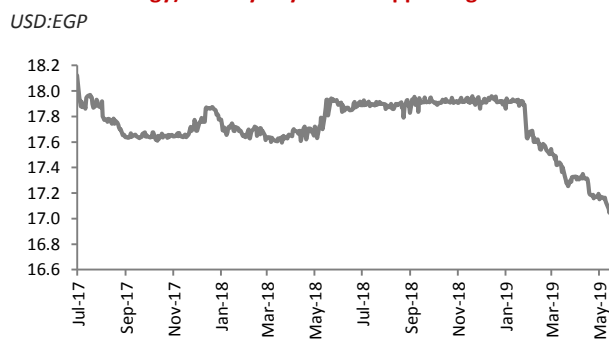
EGP strengthens some 5.8% against USD vs end-January

Fig. 1. Egypt: Second consecutive CBE meeting at which rates are kept steady



Source: Central Bank of Egypt

Fig. 2. Egypt: Improving external backdrop (tourism and energy) is likely key factor supporting EGP



Source: Bloomberg

GCC: UAE and Saudi Arabia announce new residence programmes

Both the UAE and Saudi Arabia have announced new residence programmes for foreigners to help boost investment activity. We expect the short-term economic impact of these moves to be limited. Nevertheless, the reforms highlight both countries’ recent focus on deepening and strengthening their business environment, encouraging the development of new industries, and attracting entrepreneurs. The wider development

Schemes aimed at boosting investment environment; short-term impact likely to be limited

of key regulations will also be important, including the deepening of bankruptcy laws and the opening of various sectors to foreign investment. The UAE has announced a permanent residency framework (Gold Card scheme) for investors and exceptionally skilled professionals (medicine, engineering, etc.). Details of the criteria have not yet been announced, although some 6,800 individuals with a total investment of around AED100 billion have been identified as eligible for the first batch. It therefore seems, at least initially, that the beneficiaries will most likely be those that are already resident and invested in the UAE. As with the ten-year and five-year visas announced last year, the criteria for eligibility are likely to be relatively narrow and the scheme is therefore unlikely to lead to any marked rise in population or demand for real estate. Permanent residency will also be extended to spouses and children.

Meanwhile, Saudi Arabia's new residency scheme came into effect last week. Under the new law, holders of such privileged residency (or Saudi 'Green Cards') can live, move freely, buy property and work in the country without the need for a Saudi sponsor. A permanent residency permit (iqama) costs SAR800K (USD213.3K) and a one-year temporary iqama can be purchased for SAR100K.

Saudi 'Green Card' scheme already in effect

B. G4 Economies

US: May FOMC minutes re-emphasise need for patient approach

The minutes of the FOMC's May meeting reiterated a "patient approach to policy adjustments", implying that near-term interest rate changes remain unlikely. This was largely in line with the recent FOMC members' communications following the meeting and more recently. The minutes continued to indicate upbeat sentiment regarding the economic outlook while inflation remains relatively subdued. The minutes also reiterated Fed Chair Jerome Powell's post-meeting views that the lower-than-expected inflation in recent months was partly due to transitory factors. Meanwhile, some FOMC members highlighted that downside risks to inflation have increased recently, which in turn could lead to lower inflation expectations in the near term. Given that the May FOMC meeting was held before the recent re-escalation of US-China trade tensions, the minutes contained no discussion of the potential upside risks to inflation from the imposition of additional tariffs on Chinese imports. We believe that the June Fed meeting is likely to feature a meaningful discussion of trade tensions and the impact of higher tariffs on the growth and inflation outlooks.

Fed minutes suggest that near-term interest rate changes are unlikely

The Fed minutes also showed that the members discussed the maturity composition of the Fed's balance sheet at the May FOMC meeting, but made no decisions on the same. Notably, Fed staff briefed FOMC members about different scenarios for the maturity composition of the Fed's portfolio of Treasury securities. The minutes revealed that the FOMC members were divided over the composition of the balance sheet and maturity length of the Treasuries.

Fed members evaluate different scenarios regarding maturity composition of Fed balance sheet

UK: Theresa May to resign; leadership contest to decide on new PM

UK Prime Minister Theresa May last week announced that she will resign as Conservative Party leader on 7 June, but will remain as interim PM during the leadership contest. The leadership contest is due to start on 10 June, with a series of votes to narrow down the number of candidates. The process could continue over the summer, lasting from June to September. Current polls suggest that anti-EU politician Boris Johnson leads the race,

Leadership contest could continue until September

although it is unlikely to be smooth sailing for him given the divided Conservative Party. We believe that the incoming PM will face similar challenges as Theresa May did in trying to pass a Brexit deal in Parliament. Support for a no deal Brexit will likely be a central battleground in the leadership contest.

The parliamentary arithmetic will complicate the passage of any Brexit deal. It is yet to be seen if the EU is willing to negotiate a new deal with the UK, with ongoing uncertainties over its ability to secure parliamentary backing. The new PM could call for a general election to get a mandate for Brexit and other policies, although falling support for the Conservative Party makes this a risky scenario for a new leader. A second Brexit referendum remains a possible alternative, but is also a risky scenario, given the opposition from some Conservative MPs. The new PM will also have to decide quickly on whether to leave the EU with or without a deal as the extended Article 50 term ends on 31 October. Another extension of Article 50 looks more likely at this point given the time constraints the new leader is expected to encounter. This is especially if the leadership contest is protracted and lasts until September. Chances of a no-deal exit cannot be ruled out, especially if an anti-EU candidate is chosen, although a parliamentary no-confidence vote could avoid this scenario. The GBP has come under pressure with the rising uncertainties and is expected to remain volatile over the summer. We currently do not expect to see a resolution to Brexit in 2019.

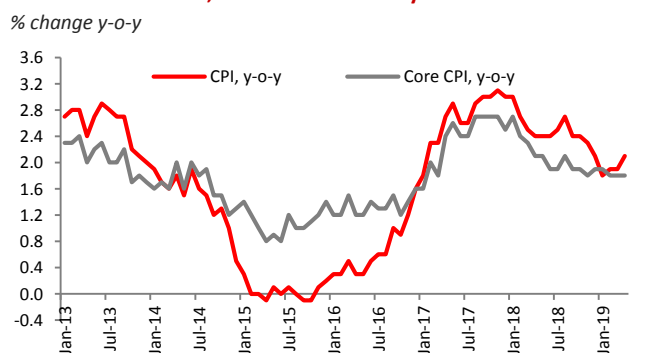
Political uncertainties to remain elevated over summer period

UK: Headline inflation accelerates, led by energy and airfare prices

Headline CPI inflation accelerated to 2.1% y-o-y in April from 1.9% in March, but came in modestly softer than the consensus expectation of 2.2%. The pick-up in inflation was driven by: i) higher global crude oil prices; ii) the spike in utility prices after the government lifted the cap on default energy tariffs; and iii) the rise in air fares over the Easter period. We believe that the spike in headline inflation caused by idiosyncratic factors will gradually wane over the coming months. Core inflation remained steady at 1.8% y-o-y in April (consensus: 1.9%), suggesting limited underlying price pressures. We believe that the BoE will look through the one-off strengthening in headline inflation in April and remain on hold in 2019 amidst the ongoing Brexit deadlock.

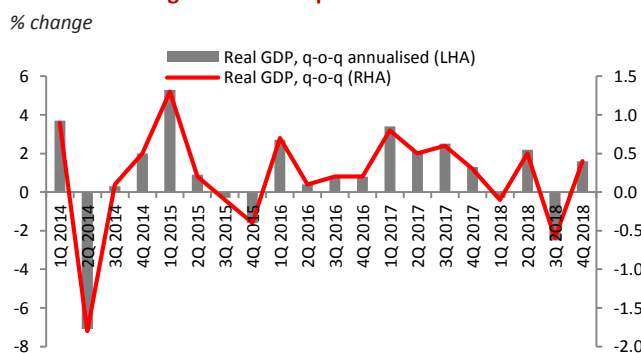
Headline inflation accelerates in April but core inflation remains steady

Fig. 3. UK: Headline inflation strengthens in April due to one-off factors; core remains steady



Source: UK Office for National Statistics

Fig. 4. Japan: GDP growth strengthens to 2.1% q-o-q saar, beating consensus expectation of -0.2%



Source: Economic and Social Research Institute Japan

Japan: 1Q GDP growth accelerates but masks underlying weakness

Japan's 1Q GDP growth surprised to the upside and accelerated to 2.1% q-o-q SAAR (4Q: 1.6%), beating the consensus expectations of a contraction of 0.2%. The acceleration in 1Q growth was driven mainly by the sharp drop in imports, which resulted in net exports contributing 1.6pp to headline growth. The other key driver of growth was inventory accumulation, which added 0.5pp to the headline print. We believe that the economic expansion seen in 1Q is unsustainable given the growth drivers. The contraction in import growth reflects the underlying weaknesses in domestic demand, with a fall in both private and government consumption. Indeed, private consumption dropped by 0.3% q-o-q SAAR in 1Q and we expect the overall growth momentum to remain relatively weak.

Solid headline growth driven by fall in imports and inventory accumulation

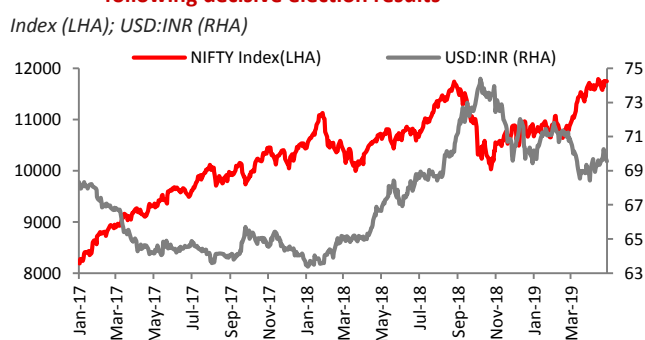
C. Emerging Market Economies

India: BJP wins second consecutive term with absolute majority

The National Democratic Alliance (NDA) led by Narendra Modi's Bharatiya Janata Party (BJP) registered a decisive victory in the 2019 general elections, securing a second consecutive term with a parliamentary majority. The NDA won 355 seats out of the 542 in the Lok Sabha (BJP: 303), beating most of the exit poll results published early last week and its own tally in the 2014 elections. Notably, with the BJP securing over 272 seats (to reach majority), they will not need to rely on their coalition partner's to push through policies in the Parliament. The focus will now be on the composition of the cabinet. We believe that the most senior ministers in the cabinet are likely to continue with their current portfolios, whilst there could be a reshuffle in the less important cabinet berths.

BJP wins outright majority in 2019 Parliamentary elections

Fig. 5. India: Equity markets touch new high last week following decisive election results



Source: Bloomberg

Fig. 6. India: Bond market continues to price in further rate cuts by RBI in near term



Source: Bloomberg

We believe that the government's immediate focus will be on reviving economic momentum, with a stronger reform agenda to attract foreign investment and targeted spending in key sectors. Given its decisive victory, the Modi administration is also likely to prioritise structural reforms, including land and labour laws, which are hard to achieve under a coalition government. Meanwhile, the FY2020 (April 2019 – March 2020) budget is likely to be presented by mid-July, which could be an extended version of the interim budget presented in February 2019. The government will probably reaffirm its intention to keep the fiscal deficit range bound, with a targeted increase in spending to key industrial sectors to boost economic activity. The agricultural sector is also likely to

Government likely to prioritise structural reforms, including land and labour laws

remain high on the government's agenda, especially given its promise to increase farm incomes and exports. On the financial markets front, equity markets rallied last week and reached record highs, with more foreign inflows likely to continue in the coming months. We continue to believe that the RBI will make another 25 bps rate cut at its June meeting to support economic growth whilst inflation remains well within its lower target range of 4% (+/-2pp). Moreover, the election results also led the USD:INR to outperform other EM currencies last week and we expect it to further strengthen towards the 68 level in the short term, from 69.5 at the end of last week, assuming that global crude oil prices remain broadly around USD 70 p/b in the near term.

II. Economic Calendar

Fig. 7. The week ahead

Time*	Country	Event	Period	Prior	Consensus
Expected this week					
	UAE	CPI, y-o-y	Apr	-2.5%	
	Saudi Arabia	M2 Money Supply, y-o-y	Apr	1.3%	
	Saudi Arabia	SAMA Net Foreign Assets SAR	Apr	1848.7B	
	Saudi Arabia	Non-Oil Exports, y-o-y	Mar	-5.1%	
	Kuwait	M2 Money Supply, y-o-y	Apr	5.0%	
	Oman	CPI, y-o-y	Apr	0.4%	
Monday, 27 May					
5:30	China	Industrial Profits, y-o-y	Apr	13.9%	
9:00	Japan	Leading Index CI	Mar F	96.3	
Tuesday, 28 May					
10:00	Germany	GfK Consumer Confidence	Jun	10.4	10.4
11:30	Eurozone	ECB's Villeroy Speaks in Paris			
12:00	Eurozone	M3 Money Supply, y-o-y	Apr	4.5%	4.4%
13:00	Eurozone	Consumer Confidence	May F	-6.5	-6.5
18:00	US	Conf. Board Consumer Confidence	May	129.2	130
Wednesday, 29 May					
4:00	Japan	BOJ Kuroda speaks in Tokyo			
11:55	Germany	Unemployment Change (000's)	May	-12K	-8K
12:00	Eurozone	ECB's Rehn Speaks in London			
Thursday, 30 May					
16:30	US	Wholesale Inventories, m-o-m	Apr P	-0.1%	0.1%
16:30	US	GDP Annualized, q-o-q	1Q S	3.2%	3.1%
16:30	US	Personal Consumption	1Q S	1.2%	1.2%
16:30	US	Core PCE, q-o-q	1Q S	1.3%	1.3%
16:30	US	Initial Jobless Claims	25-May	211K	214K
16:30	US	Advance Goods Trade Balance	Apr	-\$71.4B	-\$72.3B
18:00	US	Pending Home Sales, m-o-m	Apr	3.8%	0.5%
20:00	US	Fed's Clarida Speaks to the Economic Club of New York			
Friday, 31 May					
3:30	Japan	Jobless Rate	Apr	2.5%	2.4%
3:30	Japan	Tokyo CPI, y-o-y	May	1.4%	1.2%
3:30	Japan	Tokyo CPI, ex-Fresh Food, y-o-y	May	1.3%	1.2%
3:50	Japan	Industrial Production, m-o-m	Apr P	-0.6%	0.2%
3:50	Japan	Retail Sales, m-o-m	Apr	0.2%	0.6%
5:00	China	Manufacturing PMI	May	50.1	49.9
11:00	Turkey	GDP, y-o-y	1Q	-3%	-2.9%
11:00	Turkey	Trade Balance	Apr	-2.14B	-2.83B
12:00	Italy	ECB's Visco Speaks at Bank of Italy Annual Gathering			
12:30	UK	Mortgage Approvals	Apr	62.3K	63.5K
16:00	Germany	CPI EU Harmonized, m-o-m	May P	1%	0.3%
16:00	Germany	CPI EU Harmonized, y-o-y	May P	2.1%	1.4%
16:00	India	GDP, y-o-y	1Q	6.6%	6.2%
16:30	US	Personal Income	Apr	0.1%	0.3%
16:30	US	Personal Spending	Apr	0.9%	0.2%
16:30	US	PCE Deflator, m-o-m	Apr	0.2%	0.3%
16:30	US	PCE Deflator, y-o-y	Apr	1.5%	1.6%
16:30	US	PCE Core Deflator, m-o-m	Apr	0.0%	0.2%
16:30	US	PCE Core Deflator, y-o-y	Apr	1.6%	1.6%
17:15	US	Fed's Bostic Moderates a Discussion on the Global Economy			
20:00	US	Fed's Williams Discusses Monetary Policy Theory and Practice			

* UAE time

Source: Bloomberg

Fig. 8. Last week's data

Time*	Country	Event	Period	Prior	Consensus	Actual
GCC Economies						
	UAE	M2 Money Supply, m-o-m	Apr	0.6%		0.5%
	Saudi Arabia	CPI, y-o-y	Apr	-2.1%		-1.9%
	Kuwait	CPI, y-o-y	Apr	0.8%		0.7%
	Oman	Nominal GDP YTD, y-o-y	4Q	15.3%		12%
	Bahrain	CPI, y-o-y	Apr	1.2%		1%
Monday, 20 May						
3:50	Japan	GDP SA, q-o-q	1Q P	0.4%	-0.1%	0.5%
3:50	Japan	GDP Private Consumption, q-o-q	1Q P	0.2%	-0.2%	-0.1%
8:30	Japan	Industrial Production, m-o-m	Mar F	-0.9%		-0.6%
8:30	Japan	Capacity Utilization, m-o-m	Mar	1.0%		-0.4%
12:00	Eurozone	ECB Current Account SA	Mar	27.9B		24.7B
Tuesday, 21 May						
18:00	Eurozone	Consumer Confidence	May A	-7.3	-7.7	-6.5
18:00	US	Existing Home Sales	Apr	5.21M	5.35M	5.19M
Wednesday, 22 May						
3:50	Japan	Trade Balance	Apr	¥528.5B	¥232.7B	¥60.4B
3:50	Japan	Core Machine Orders, m-o-m	Mar	1.8%	0%	3.8%
12:30	UK	CPI, y-o-y	Apr	1.9%	2.2%	2.1%
12:30	UK	CPI Core, y-o-y	Apr	1.8%	1.9%	1.8%
Thursday, 23 May						
4:30	Japan	Nikkei Japan PMI Manufacturing	May P	50.2		49.6
10:00	Germany	GDP SA, q-o-q	1Q F	0.4%	0.4%	0.4%
12:00	Eurozone	Markit Eurozone Manufacturing PMI	May P	47.9	48.1	47.7
12:00	Germany	Ifo Business Climate	May	99.2	99.1	97.9
17:45	US	Markit US Manufacturing PMI	May P	52.6	52.6	50.6
18:00	US	New Home Sales	Apr	723K	675K	673K
	Egypt	Lending Rate	23-May	16.75%		16.75%
	Egypt	Deposit Rate	23-May	15.75%		15.75%
Friday, 24 May						
3:30	Japan	National CPI, y-o-y	Apr	0.5%	0.9%	0.9%
3:30	Japan	National CPI, ex-Fresh Food, y-o-y	Apr	0.8%	0.9%	0.9%
9:30	Japan	All Industry Activity Index, m-o-m	Mar	-0.2%	-0.2%	-0.4%
12:30	UK	Retail Sales, inc-Auto Fuel, m-o-m	Apr	1.2%	-0.3%	0%
12:30	UK	Retail Sales, inc-Auto Fuel, y-o-y	Apr	6.7%	4.5%	5.2%
16:30	US	Durable Goods Orders	Apr P	1.7%	-2.0%	-2.1%
16:30	US	Cap Goods Ship Non-def, ex-Air	Apr P	-0.6%	-0.1%	0.0%

* UAE time

Source: Bloomberg

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