The Week Ahead: Risk-off sentiment likely to continue

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Global: Focus will remain on COVID-19

COVID-19 related developments will continue to drive the financial markets in the coming weeks amidst increasing fears and uncertainty over global growth. Market attention will be particularly on: i) the rate of coronavirus infections internationally; ii) central banks' guidance on monetary easing; and iii) Europe and G-7 countries' fiscal policy response to counter the COVID-19 shock. Policy responses are increasingly being announced, albeit with a relatively limited impact given the increase in cases internationally and the twin nature of the shock – i.e. demand and supply side. The lack of policy space is also a factor. As noted last week, we expect 2020 global growth to slow to its lowest level since the global financial crisis. The risk of a global recession in 2020 is rising, but will largely depend on the length of the virus. Demand for safe haven assets has risen with the heightened uncertainties, including US Treasuries, JPY and gold. We expect this trend to continue until coronavirus tensions ease.

Europe: ECB meeting and UK budget are key events

We believe the ECB is likely to announce additional measures for boosting liquidity to the economy at its 12 March meeting, through the targeted longer-term refinancing operations (TLTRO) mechanism. The tone of the meeting is likely to be significantly dovish, highlighting the need to act constructively to counter any unexpected risks emerging from the spread of coronavirus. We believe that the Governing Council (GC) will also discuss other monetary easing measures, such as deposit rate cuts and increasing the asset purchase programme, but is unlikely to implement these until the April meeting. This will provide the ECB more time to evaluate the impact of COVID-19, alongside any fiscal loosening measures by the government. The market currently sees only a 75% probability of a deposit rate cut at the March meeting, but has priced in a full 10 bps cut at the April meeting. Separately, the UK will announce its FY20-21 (Apr. 2020 – Mar. 2021) budget on 11 March. The Chancellor of the Exchequer Rishi Sunak is widely expected to announce an expansionary budget, with the possibility of temporarily breaking the fiscal deficit targets given COVID-19 and the need to support economic activity.

Oil: OPEC+ fails to strike deal; oil price war concerns

OPEC and its non-OPEC partner countries (OPEC+) failed to reach a consensus on deepening and extending the current production cut agreement beyond 1Q2020 at its 6 March meeting. The failure to reach a deal opens up the possibility of OPEC+ countries significantly increasing their output from 1 April. Expectations of a return to an oil price war has increased with Saudi Arabia sharply reducing its official April selling price for its crude grades to all destinations following the OPEC+ meeting. Moreover, media agencies are outlining Saudi plans to significantly increase output to above 10.0 million b/d in April, citing unnamed officials. The low oil price will also have a significant negative impact on GCC fiscal balances, especially for countries with high budget break-even oil prices (page 2). Brent is currently at USD33.7 p/b, down by 34.1% from before the OPEC+ meeting.

I. Recent Events and Data Releases

A. MENA Economies

GCC: Fiscal pressures to increase with sharp drop in oil price

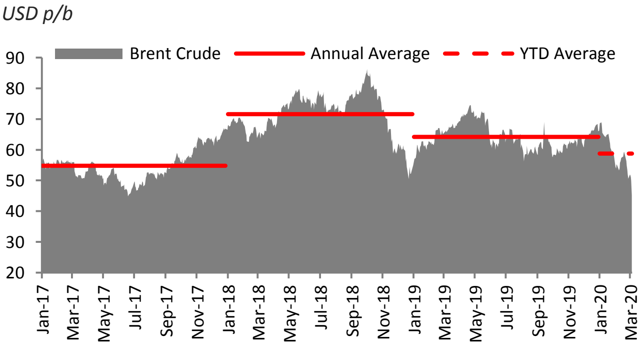
Fiscal pressure to increase significantly with fall in oil price

The failure of OPEC+ to reach an output agreement at the end of last week (see below) adds significant risks to the economic outlooks of the GCC countries. We estimate that all GCC countries will realise a significant fiscal deficit at the current oil price of USD33.7 p/b, with Oman and Saudi Arabia seeing particularly significant shortfalls relative to GDP (double digit in percentage of GDP terms). The fall in revenue will require a meaningful pullback in government spending, as was the case in 2015 and 2016, to limit the size of the fiscal deficit. This, in turn, will lead to a marked softening in non-oil activity, on top of the impact of weakening key external sectors (trade, tourism, logistics, etc.) as a result of COVID-19. Historically in such cases, GCC countries have tended to initially cut back on capital spending, making a deeper cut than to current expenditure. However, sustained downward pressure on the oil price would also require a meaningful retrenchment in current spending. The critical element will be the GCC response to the OPEC+ developments and whether there is a return to producers looking to maintain their market share by significantly increasing output and discounting prices (2014-2016).

Oman's rating downgraded by two notches by Moody's

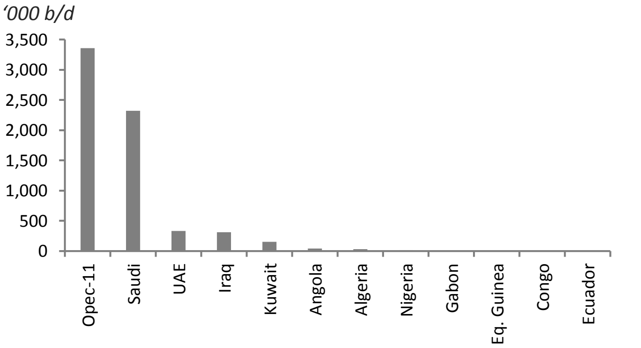
Meanwhile, Moody's downgraded Oman's credit rating to Ba2 from Ba1, pushing it deeper into sub-investment grade territory, and changed the outlook to stable. Moody's cited Oman's lower fiscal strength, evident in its higher government debt and weaker debt affordability metrics than assumed at the time of the previous rating review. The ratings agency expects government debt to continue to rise in the next two years, despite expectations that the government will begin implementing a significant medium-term fiscal adjustment programme in the next few months.

Fig. 1. Oil: Brent dropped to USD45.3 p/b at end of last week after OPEC+ fails to strike deal, further fall today



Source: Bloomberg

Fig. 2. Oil: OPEC-11 countries' spare capacity stands at 3.36 million b/d at end of December 2019



Source: IEA

Oil: OPEC and non-OPEC allies fail to agree on supply cuts

Raising supply at time of weak global demand is likely to keep crude prices under downward pressure in coming months

OPEC and Russia failed to reach an agreement to extend and deepen their production cuts beyond 1Q2020 at the 6 March meeting. The failure to reach a deal resulted in the oil price falling to a multi-year low of 45.3 p/b at the end of last week. Brent is currently at USD33.7 p/b, down by 34.1% from before the OPEC+ meeting. The OPEC members, who met on 5 March, had proposed to deepen the OPEC+ production cuts by an additional 1.5 million b/d to end-2020. However, Russia was looking to just extend the existing production cuts to 2Q2020. The irreconcilable differences led both parties to end the meeting without a deal; the current OPEC+ production agreement ends on 31 March 2020. Indications are that informal discussions among the OPEC+ member countries will continue over the future course of action, though a compromise looks less likely given the existing priorities and differences of the key member countries. Saudi Arabia has been looking for oil price support given its high budget breakeven oil price, even at the expense of a loss in global oil market share. On the other hand, Russia remains increasingly concerned about losing its market share to US shale producers.

Significant downside risks for the oil price, with higher production and build-up in inventories

The failure to reach a deal means that OPEC+ producers will face no restrictions on pumping oil into the market starting from 1 April. Indeed, Russian Energy Minister, Alexander Novak, highlighted that OPEC+ countries can pump without restrictions once the current agreement ends on 31 March. The Saudi oil minister Abdulaziz bin Salman Al Saud also added to the uncertainty, noting that he would “keep you wondering” when asked about the Kingdom’s future production plans. Speculation of a return to an oil price war has increased with Saudi Arabia sharply reducing its official April selling price for its crude grades to all destinations following the OPEC+ meeting. Moreover, media agencies are outlining Saudi plans to significantly increase output to above 10.0 million b/d in April, citing unnamed officials. Saudi Arabia is currently producing around 9.7 million b/d and has capacity to boost production to 12 million b/d. A price war, with a number of countries offering deep discounts to oil importing countries in Asia and Europe, and higher output would place further downward pressure on crude prices. Moreover, increasing crude supply when demand remains lacklustre would further bolster global inventories, weakening oil market fundamentals in the coming months. US shale would also feel the pressure with its relatively high production cost, potentially resulting in a number of small and marginal producers facing financial stress in the near term. On the other hand, soft oil prices at a time of weak global demand would provide some relief for oil importing countries.

B. G4 Economies

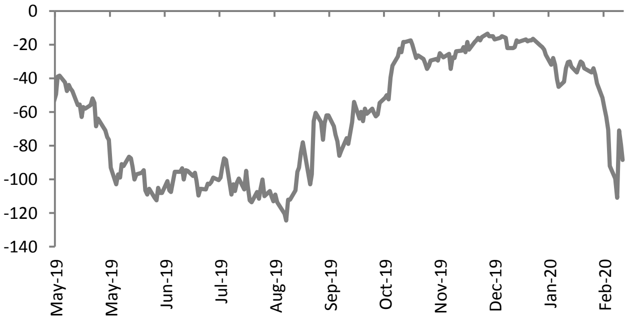
Global: Major central banks including Fed, BoC and RBA cut policy rates

Risk-off sentiment deteriorates further with rising coronavirus cases globally

The coronavirus crisis deepened further last week, with confirmed global cases surpassing 100K and deaths exceeding 3,500. The risk-off sentiment worsened, with increasing demand for safe haven assets, whilst risky assets saw a broad-based sell-off. Most of the global equity markets fell further last week, despite the efforts of various central banks and government authorities to calm the markets with policy easing measures. A number of major central banks, including the Fed, Bank of Canada (BoC) and Reserve Bank of Australia (RBA), cut their benchmark interest rates. The Fed and the BoC lowered their benchmark rates by 50 bps, whilst the RBA reduced its policy rate by 25 bps. Moreover, several countries whose currencies are pegged to the USD, including Hong Kong and a number of GCC countries, followed the Fed in reducing their benchmark rates to counter the negative impact of coronavirus. However, the monetary easing measures failed to calm the markets and instead led the markets to price in additional interest rate cuts in the near term. Markets are now pricing in a further 92 bps of FFTR reductions by the June policy meeting, of which 71 bps are priced in for the 17-18 March meeting. If the Fed cuts rates along the lines of the market’s expectations, the FFTR bound target rate will be at 0.25-0.5% by end-June. The BoE, RBA, BoC, RBNZ and RBI are all expected to cut rates at their next policy meetings (Fig. 4). Meanwhile, the ECB and BoJ, whose benchmark rates were already in negative territory, are expected to announce new asset purchase programmes in their upcoming policy meetings.

Fig. 3. US: Market is pricing in 95 bps of FFTR cuts by end-2020 after 50 bps emergency cut in March

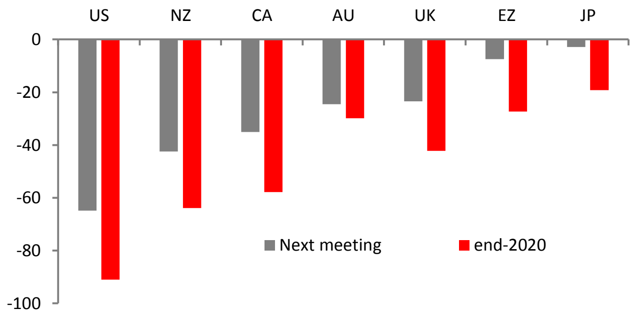
Additional bps of FFTR rate cuts priced in by rates market by end-2020



Source: Bloomberg, ADCB calculations

Fig. 4. Global: Rate cuts priced in by market for major central banks; further easing expected

Bps cuts expected at next policy meeting and by end-2020



Source: Bloomberg

IMF and US announce fiscal stimulus measures to counter coronavirus crisis

On the fiscal side, US President Donald Trump last week signed legislation to release USD8.3 billion (USD7.8 billion discretionary and USD0.5 billion mandatory) of emergency funding to tackle the COVID-19 outbreak. The IMF also pledged USD50 billion worth of stimulus measures to low and middle income countries. The G-7 central bankers and finance ministers pledged to "use all appropriate policy tools" to tackle the economic impact of coronavirus. However, the major European countries (except Italy) are yet to announce any fiscal stimulus measures.

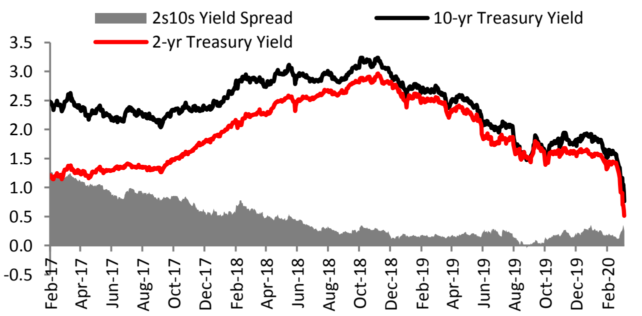
US: Fed cuts FFTR by 50 bps to counter coronavirus related risks

Market pricing in 64.5 bps cut at 17-18 March FOMC policy meeting

The Fed enacted an inter-meeting rate cut of 50 bps in a surprise move last week, lowering the FFTR to 1.0-1.25%. This was the first inter-meeting rate cut since October 2008. The FOMC highlighted that "the coronavirus poses evolving risks to economic activity" and that the Fed stands ready to "act as appropriate" to support the economy. The tone of the meeting was significantly dovish and left the door open for additional easing in the near term. In turn, the emergency rate cut led the market to price in further rate cuts, bringing the long-end Treasury yields to their lowest point in 150 years. The 10-year Treasury yield is currently at 0.52%, whilst the 30-yr yield now stands at 0.97%. However, the closely watched recession indicator, the 2yr-10yr yield curve, steepened to 25 bps at the end of last week, from the recent low of 10.4 bps on 24 February. The steepening was largely due to less demand for short-end bonds compared to longer bonds and does not imply that recession risks in the near term have eased. Going forward, the 2yr-10yr yield curve may not be the right indicator to assess recessionary risks. Moreover, the Fed rate cuts have further reduced the central bank's monetary policy ammunition to counter any new economic risks that arise. We also believe that the FOMC's pre-emptive rate cut is not the right policy tool to counter the coronavirus and is likely to have a very limited positive impact on the real economy.

Fig. 5. US: 10-year Treasury yield falls sharply to all-time low of 0.764% at end of last week

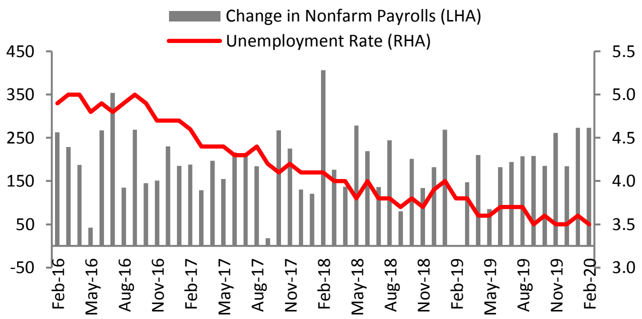
%



Source: Bloomberg

Fig. 6. US: Economy adds robust 273K jobs in February, taking unemployment rate down to 3.5%

'000 (LHA); % (RHA)



Source: Bureau of Labor Statics

US: Solid labour market conditions before COVID-19 outbreak

Solid February NFP data unlikely to alter Fed's bias towards cutting interest rates further

The February labour market report was robust, with strong hiring activity and a pick-up in wage growth, suggesting that economic fundamentals remained strong ahead of the coronavirus outbreak. The US economy added 273K jobs in February boosted by warmer than usual weather, matching the upwardly revised January reading. The February reading was much higher than the consensus expectation for 175K, and resulted in the unemployment rate drop to 3.5% in February, from 3.6% in January. The solid hiring activity also helped to boost wage growth to 0.3% m-o-m in February, from 0.2% in January. However, the healthy labour market data failed to improve the global market sentiment, with coronavirus related fears outweighing the positive data readings. Indeed, the February labour report is unlikely to alter the Fed's inclination to cut rates further to counter the increasing downside risks to the economic outlook. Looking ahead, the spread of the virus and increasing travel and work place restrictions are likely to have a marked negative effect on hiring activity in March. The other February data releases, including manufacturing and non-manufacturing ISM, also indicated that the US economy continued to expand in February, although anecdotal evidence pointed to many industries facing a shortage of inputs due to the disruption of supply chains.

C. Emerging Market Economies

Turkey: Both headline and core inflation strengthen in February

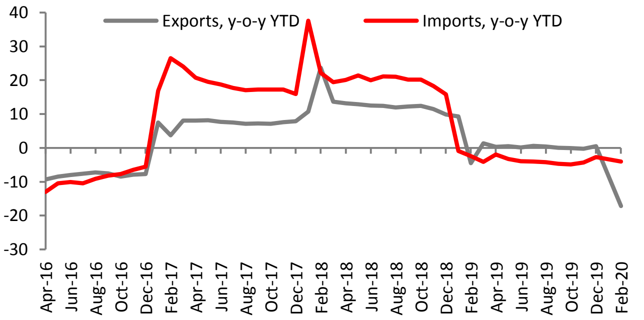
Rising inflation unlikely to stop CBRT from cutting rates further at its 19 March policy meeting

Turkey's headline inflation accelerated to a six-month high of 12.4% y-o-y in February, from 12.2% in January. The pick-up was broad based, with nine of the 12 major sub components of the CPI index printing double-digit inflation. Core inflation also strengthened to 10.0% y-o-y in February, from 9.9% in the previous month. However, both headline and core inflation came in lower than the consensus expectations. The rise in core inflation was probably partly due to some pass-through from the weakening TRY since early August 2019. The weaker-than-expected February inflation reading and the recent surprise rate cut by the Fed on the back of the coronavirus crisis are likely to lead the CBRT to continue with its easing cycle at its 19 March policy meeting. We expect the CBRT to cut benchmark rates by 50-100 bps at the coming meeting. However, the additional rate cuts will push the real one-week repo rate further into negative territory.

A number of EM economies, including India, Poland and Hungary, have a negative real interest rate that is greater than Turkey's real rate.

Fig. 7. China: Exports growth contracts by 17.2% y-o-y YTD in February, from 0.5% in December

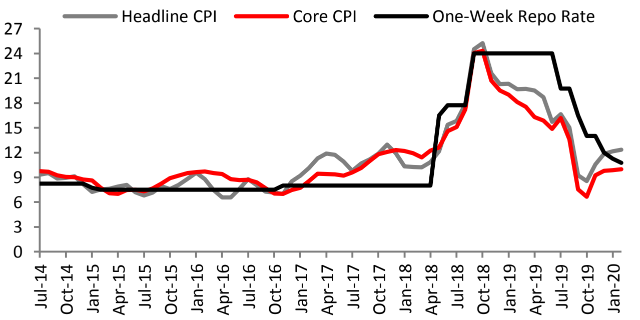
% change y-o-y YTD



Source: Customs General Administration PRC

Fig. 8. Turkey: Headline inflation accelerates to 12.4% y-o-y in February, from 12.2% in January

%



Source: Turkish Statistical Institute, CBRT

China's exports fell by a marked 17.2% y-o-y in 2M2020

China trade data: Exports growth contracts by 17.2% y-o-y YTD in 2M2020, beating the market's expectation for a 16.2% drop. The exports data largely reflects the negative impact of coronavirus on economic activity in early 2020, which is likely to continue into March. Imports growth also fell by 4.0% y-o-y YTD in 2M2020, but was much better than the consensus expectation of a 16.1% drop. The imports data suggests that domestic demand remained relatively strong in 2M2018, but this could be due to increased spending ahead of Lunar New year in early January before the spread of COVID-19 to broader regions in the country.

II. Economic Calendar

Fig. 9. The week ahead

Time*	Country	Event	Period	Prior	Consensus
Expected this week					
	UAE	Dubai CPI, y-o-y	Feb	-1.3%	
	Oman	CPI, y-o-y	Feb	0.4%	
	Qatar	CPI, y-o-y	Feb	-0.4%	
	China	New Yuan Loans CNY	Feb	3340.0B	1100.0B
	China	Money Supply M2, y-o-y	Feb	8.4%	8.5%
	India	Exports, y-o-y	Feb	-1.7%	
	India	Imports, y-o-y	Feb	-0.8%	
Monday, 9 March					
3:50	Japan	GDP SA, q-o-q	4Q F	-1.6%	-1.7%
3:50	Japan	GDP Annualized SA, q-o-q	4Q F	-6.3%	-6.6%
8:15	UAE	Dubai PMI	Feb	50.6	
13:30	Eurozone	Sentix Investor Confidence	Mar	5.2	
Tuesday, 10 March					
5:30	China	PPI, y-o-y	Feb	0.1%	-0.3%
5:30	China	CPI, y-o-y	Feb	5.4%	5.2%
14:00	Eurozone	GDP SA, q-o-q	4Q F	0.1%	0.1%
14:00	Eurozone	GDP SA, y-o-y	4Q F	0.9%	0.9%
14:00	Eurozone	Gross Fix Cap, q-o-q	4Q	0.3%	
14:00	Eurozone	Household Cons, q-o-q	4Q	0.5%	
14:00	Eurozone	Govt Expenditure, q-o-q	4Q	0.4%	
14:00	US	NFIB Small Business Optimism	Feb	104.3	103.0
	Egypt	Urban CPI, y-o-y	Feb	7.2%	
	Egypt	CPI Core, y-o-y	Feb	2.7%	
Wednesday, 11 March					
11:00	Turkey	Current Account Balance	Jan	-2.8B	-2.7B
13:30	UK	Monthly GDP, m-o-m	Jan	0.3%	0.20%
13:30	UK	Index of Services, 3M/3M	Jan	0.1%	0.1%
13:30	UK	Industrial Production, m-o-m	Jan	0.1%	0.3%
13:30	UK	Manufacturing Production, m-o-m	Jan	0.3%	0.2%
13:30	UK	Trade Balance, GBP million	Jan	£7715M	-£500M
15:30	UK	UK Government Announces 2020 Budget			
16:30	US	CPI, m-o-m	Feb	0.1%	0.0%
16:30	US	CPI, ex-Food and Energy, m-o-m	Feb	0.2%	0.2%
16:30	US	CPI, y-o-y	Feb	2.5%	2.2%
16:30	US	CPI, ex-Food and Energy, y-o-y	Feb	2.3%	2.3%
22:00	US	Monthly Budget Statement	Feb	-$234.0B	-$238.5B
Thursday, 12 March					
14:00	Eurozone	Industrial Production SA, m-o-m	Jan	-2.1%	1.4%
16:00	India	CPI, y-o-y	Feb	7.6%	6.7%
16:00	India	Industrial Production, y-o-y	Jan	-0.3%	0.7%
16:30	US	PPI Final Demand, m-o-m	Feb	0.5%	-0.1%
16:30	US	PPI Final Demand, y-o-y	Feb	2.1%	1.7%
16:45	Eurozone	ECB Main Refinancing Rate	12-Mar	0.0%	0.0%
16:45	Eurozone	ECB Marginal Lending Facility	12-Mar	0.25%	0.25%
16:45	Eurozone	ECB Deposit Facility Rate	12-Mar	-0.5%	-0.5%
Friday, 13 March					
8:30	Japan	Tertiary Industry Index, m-o-m	Jan	-0.2%	0.3%
11:00	Turkey	Industrial Production, m-o-m	Jan	1.9%	0.5%
11:00	Turkey	Industrial Production, y-o-y	Jan	8.6%	8.5%
16:30	US	Import Price Index, m-o-m	Feb	0.0%	-1.0%
18:00	US	University of Michigan Consumer Sentiment	Mar P	101.0	95.0

* UAE time
Source: Bloomberg

Fig. 10. Last week's data

Time*	Country	Event	Period	Prior	Consensus	Actual
GCC Economies						
	UAE	CPI, y-o-y	Jan	-1.4%		-1.3%
	UAE	IHS Markit UAE PMI	Feb	49.3		49.1
	Saudi Arabia	IHS Markit Saudi Arabia PMI	Feb	54.9		52.5
	Qatar	Qatar Financial Center PMI	Feb	48.7		49.3
Monday, 2 March						
9:00	India	Markit India PMI Manufacturing	Feb	55.3		54.5
11:00	Turkey	Markit/ISO Turkey PMI Manufacturing	Feb	51.3		52.4
13:00	Eurozone	Markit Eurozone Manufacturing PMI	Feb F	49.1	49.1	49.2
13:30	UK	Markit UK PMI Manufacturing SA	Feb F	51.9	51.9	51.7
13:30	UK	Mortgage Approvals	Jan	67.9K	68.0K	70.9K
18:45	US	Markit US Manufacturing PMI	Feb F	50.8	50.8	50.7
19:00	US	ISM Manufacturing	Feb	50.9	50.5	50.1
19:00	US	ISM New Orders	Feb	52.0	51.8	49.8
Tuesday, 3 March						
3:50	Japan	Monetary Base, y-o-y	Feb	2.9%		3.6%
8:15	Egypt	IHS Markit Egypt PMI	Feb	46.0		47.1
11:00	Turkey	CPI, y-o-y	Feb	12.2%	12.7%	12.4%
11:00	Turkey	CPI, m-o-m	Feb	1.4%	0.7%	0.4%
11:00	Turkey	CPI Core Index, y-o-y	Feb	9.9%	10.4%	10.0%
13:30	UK	Markit/CIPS UK Construction PMI	Feb	48.4	49.0	52.6
14:00	Eurozone	CPI Core, y-o-y	Feb P	1.1%	1.2%	1.2%
14:00	Eurozone	CPI Estimate, y-o-y	Feb	1.4%	1.2%	1.2%
14:00	Eurozone	Unemployment Rate	Jan	7.4%	7.4%	7.4%
Wednesday, 4 March						
4:30	Japan	Jibun Bank Japan PMI Composite	Feb F	47.0		47.0
5:45	China	Caixin China PMI Manufacturing	Feb	51.1	46.0	40.3
5:45	China	Caixin China PMI Services	Feb	51.8	48.0	26.5
9:00	India	Markit India PMI Composite	Feb	56.3		57.6
13:00	Eurozone	Markit Eurozone Composite PMI	Feb F	51.6	51.6	51.6
13:30	UK	Markit/CIPS UK Composite PMI	Feb F	53.3	53.3	53.2
14:00	Eurozone	Retail Sales, m-o-m	Jan	-1.1%	0.6%	0.6%
14:00	Eurozone	Retail Sales, y-o-y	Jan	1.7%	1.1%	1.7%
17:15	US	ADP Employment Change	Feb	209K	170K	183K
19:00	US	ISM Non-Manufacturing Index	Feb	55.5	54.8	57.3
Thursday, 5 March						
19:00	US	Factory Orders	Jan	1.9%	-0.1%	-0.5%
19:00	US	Factory Orders, ex-Transport	Jan	0.6%		-0.1%
19:00	US	Durable Goods Orders	Jan F	-0.2%	-0.2%	-0.2%
19:00	US	Capital Goods Shipments, Non-defence, ex-Air	Jan F	1.1%		1.0%
Friday, 6 March						
9:00	Japan	Leading Index CI	Jan P	91.0	91.1	90.3
17:30	US	Trade Balance	Jan	-$48.6B	-$46.1B	-$45.3B
17:30	US	Change in Nonfarm Payrolls	Feb	273K	175K	273k
17:30	US	Change in Manufacturing Payrolls	Feb	-20K	-3K	15k
17:30	US	Unemployment Rate	Feb	3.6%	3.6%	3.5%
17:30	US	Average Hourly Earnings, m-o-m	Feb	0.2%	0.3%	0.3%
17:30	US	Average Hourly Earnings, y-o-y	Feb	3.1%	3.0%	3.0%
17:30	US	Labor Force Participation Rate	Feb	63.4%	63.4%	63.4%

* UAE time
Source: Bloomberg

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