The Week Ahead: US and China to sign phase one trade deal; CBE likely to cut

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US: Core CPI inflation expected to remain steady in December

The key event this week will be the formal signing of the phase one trade deal recently agreed by the US and China. Market focus will be on: i) any additional details regarding the phase one deal; and ii) a schedule or timeline for phase two trade talks. US President Donald Trump last week highlighted that the second phase talks would begin immediately, although he hinted that they may not conclude before the November elections, thus lowering market expectations for further near-term progress. Data-wise, US December CPI inflation, retail sales and January University of Michigan Consumer sentiment will be the key releases this week. Consensus forecasts core inflation to have remained steady for a third consecutive month at 0.2% m-o-m in December, keeping the y-o-y reading unchanged at 2.3%. Meanwhile, a number of Fed members, including John Williams and Robert Kaplan, have speaking engagements this week. We expect their communication to reaffirm that the US economy and monetary policy are in a good place.

EM: CBE likely to cut rates in January despite rise in inflation

We see the possibility of a 100 bps rate cut by the Central Bank of Egypt (CBE) at its 16 January meeting (page 2), taking the lending rate to 12.25% and the deposit rate to 11.25%. Headline inflation remains within the CBE's year-end target, despite its further normalisation and acceleration in December. In Turkey, we expect the CBRT to keep the benchmark one-week repo rate steady at 12.0% at its 16 January meeting, after it lowered rates by 12.0 ppts in 2H2019. Headline inflation strengthened for a second consecutive month in December to 11.8% y-o-y, from 10.6% in November, although this was broadly in line with the central bank's expectations. The real one-week repo rate currently stands at c.0.2% – too low for a further rate cut at this point. The weaker TRY since the 12 December policy meeting and volatile global oil prices also do not justify the need for an immediate rate cut. However, given the CBRT's dovish tilt under Governor Murat Uysal (appointed in mid-2019), a relatively small magnitude (50-100 bps) rate cut cannot be completely ruled out in our view.

EM: China 4Q GDP growth and India CPI inflation

Consensus expects China's 4Q GDP growth to have remained steady at 6.0% y-o-y, reflecting some stabilisation in economic activity. High-frequency data including retail sales, fixed investments and industrial production showed some tentative signs of a tick-up in November. Elsewhere, India's December inflation data will be in focus this week. Consensus forecasts headline inflation to have accelerated to a five-year high of 6.7% y-o-y in December, from 5.5% in November. Rises in food, energy and telecom prices are likely to have been the key drivers of inflation in December alongside the fading favourable base. We expect the RBI to remain on hold at its February policy meeting as headline inflation is likely to hover above the RBI's upper target of 6.0% at least until the February print. Advance estimates suggest that India's real GDP growth slowed to 5.0% in FY2020 (page 4).

I. Recent Events and Data Releases

A. MENA Economies

Oman: Swift and smooth succession removes key uncertainty

Sultan Qaboos had ruled Oman since 1970 and was region's longest serving leader

Sultan Qaboos bin Said, Oman's ruler for almost 50 years and the father of modern Oman, passed away on Friday, with the accession of Haitham bin Tariq al-Said announced shortly after the funeral. The new sultan (born in 1954) has held governmental positions over the last three decades, including as Minister of Heritage and Culture and as Undersecretary of the Ministry of Foreign Affairs for Political Affairs. Moreover, he has been the chair of the Oman Vision 2040 committee since 2013. In his first speech, Sultan Haitham promised to uphold the policies that define Oman's peaceful coexistence with all nations while further developing Oman. The swift and smooth transition removes the long-standing uncertainty over the succession – Sultan Qaboos had no children and had not publicly appointed a successor. The royal family had the responsibility of selecting the successor and decided to honour the wishes of Sultan Qaboos, who had recorded his choice in a sealed letter. Nevertheless, a number of challenges face the new ruler.

Balancing fiscal reforms with job creation remains key economic challenge

One of the greatest economic challenges will be balancing the need for fiscal reforms with supporting growth and job creation for the national population, especially youth. Oman has one of the weakest fiscal positions in the region, and has enacted limited reforms to restructure either the revenue or expenditure side of the government's balance sheet. Current expenditure dominates government spending (as is the case in most GCC countries) and is difficult to retrench; the cost of debt servicing has also been rising. There is limited room for additional fiscal stimulus to support economic activity, whilst foreign capital remains vital in covering the fiscal deficit. Oman's 2020 budget sees government spending rising by 2.0%, with a projected fiscal deficit of around 8.0% of GDP. Oman is looking to borrow OMR2.0 billion (USD5.2 billion) in 2020 to help cover the deficit. Looking ahead, the international debt market will probably need to see signs of greater fiscal reforms, although the low global interest rate environment and search for yield has supported flows into Oman.

Egypt: Further rate cut expected despite acceleration in inflation

Headline inflation has largely normalised and remains below CBE's year-end target range

We see the possibility of a 100 bps rate cut by the CBE at its 16 January meeting, taking the lending rate to 12.25% and the deposit rate to 11.25%. The central bank had postponed its 26 December MPC meeting to 16 January as it awaited "the approval of the formation of the Board of Directors and the Monetary Policy Committee for the new term". We had expected the CBE to remain on hold in December as the MPC looked to gauge the impact of the recent consecutive rate cuts and the magnitude of the expected inflation bounce. However, following the release of the December inflation data (published in early January), we believe that there is space for a further rate cut. Headline inflation strengthened to 7.1% in December, from 3.6% in November, as the statistical base continued to normalise. Food inflation was the driver of the yearly acceleration in headline inflation, rising to 1.8% y-o-y in December (November: -4.5%). However, the contained underlying inflationary pressure was reflected in monthly headline inflation contracting by 0.3% m-o-m in December, after falling by 0.2% in the previous month. The monthly rise in core inflation was positive, albeit subdued at 0.2% m-o-m. Annual core inflation also remains historically soft. Despite the overall increase, annual headline inflation remains contained and within the Central Bank of Egypt's target range of 9% (±3 pp) for end-2020. We see headline inflation stabilising around the 6.0-8.0% range in 2020. The real interest rate has moderated with the strengthening in inflation, but still remains high given the private sector economic conditions.

B. G4 Economies

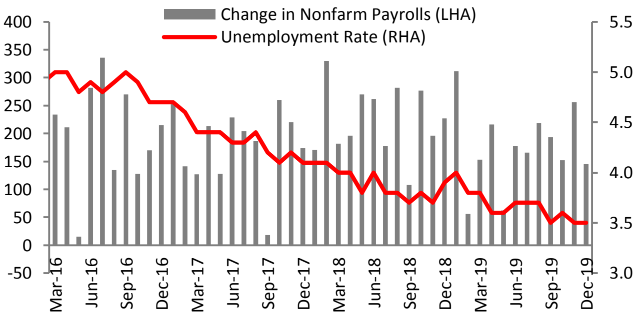
US: Solid hiring activity in December; soft wage growth

Services sector hiring healthy in December, whilst manufacturing sees a drop

The US economy added 145K jobs in December, below the consensus expectation for 160K. The downside surprise could be largely attributed to an unexpected fall in hiring in the manufacturing sector (-12K). However, hiring in the services sector remained solid, adding 140K jobs during the month. Retail trade (41K), leisure and hospitality (40K), education and health services (36K), and professional and business services (10K) were the key sectors leading the hiring activity in December. There were also net negative revisions (-14K jobs) to the previous two months' data. Despite the weaker than expected hiring activity and downward revisions in December, the trend growth remains healthy with the 3-month moving average at 184K and the 6-month moving average at 189K. In annual terms, the US economy added an average of 176K jobs in 2019, broadly matching the 2017 average of 179K jobs, but down from a robust 223K jobs in 2018. Note that the one-off strong jobs growth in 2018 was partly due to the strong fiscal stimulus measures enacted by the Trump administration. Overall, the solid hiring trend and the 50-year low unemployment rate (3.5%) should leave the Fed comfortably on hold during 2020.

Fig. 1. US: Jobs growth averages 176K in 2019, down from a robust 223K in 2018

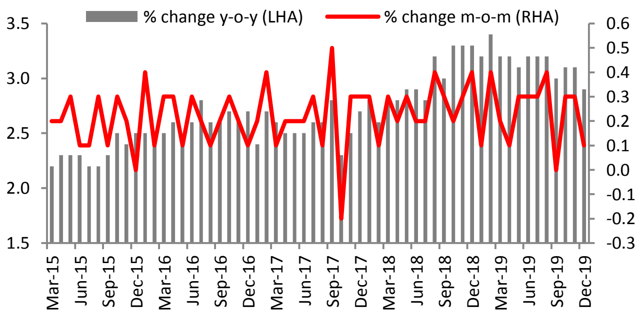
'000 (LHA); % (RHA)



Source: Bureau of Labor Statistics

Fig. 2. US: Wage growth decelerates to 2.9% y-o-y in December, from 3.1% in November

% change



Source: Bureau of Labor Statistics

Softening wage growth in December

Wage growth surprised to the downside and decelerated to 0.1% m-o-m in December, down from the consensus expectation and the previous month's 0.3%. This resulted in the y-o-y reading slowing to a 17-month low of 2.9%, from 3.1% in November. The softening in monthly wage growth came after strong prints in the previous two months (0.3% m-o-m). Notably, the same pattern was observed in 3Q, with the first two months witnessing solid wage growth, followed by a flat (0.0% m-o-m) reading in September. We await further data on wage growth at this point. However, we envisage that any further weakening in the subsequent months should raise concerns about the inflation outlook.

Eurozone: Core inflation steady in December

Headline inflation strengthens in December led by energy prices.

Headline inflation in the Eurozone accelerated to 1.3% y-o-y in December (November: 1.0%), in line with the consensus expectation. The acceleration was mostly due to energy prices strengthening. However, core inflation remained unchanged at 1.3% y-o-y in December, suggesting subdued underlying price pressures. Core inflation averaged around 1.0% for the third consecutive year in 2019, suggesting that the accommodative monetary policies have had a limited impact in boosting inflation. The ECB's restart of its monthly asset purchase programme (EUR20 billion from 1 November 2019) is also yet to show any signs of improving inflation in the region. Looking ahead, we expect the ECB to remain on hold in 1Q2020 as it continues to assess the impact of the recent monetary easing on economic activity. However, we see the potential for a further 10 bps deposit rate cut from the ECB in 2020, although this will largely depend on domestic and global economic conditions worsening.

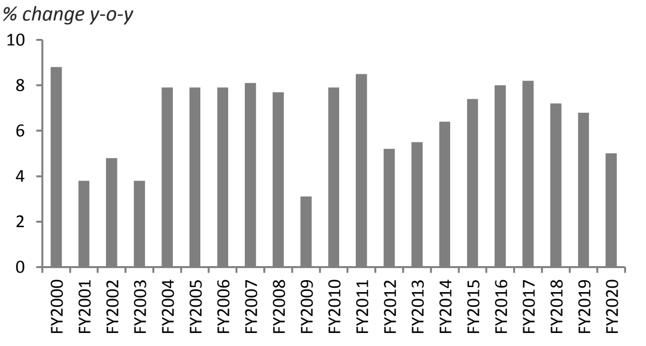
C. Emerging Market Economies

India: Real GDP growth estimated to slow to 5.0% for FY2020

We now forecast FY2020 GDP growth of 4.8% – lower than RBI and CSO's 5.0% estimate

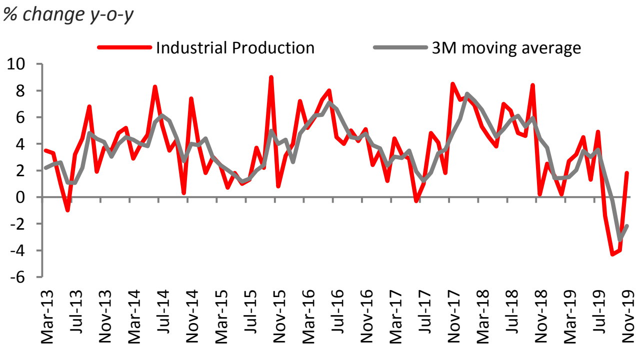
Real GDP growth for FY2020 (April 2019 - March 2020) has been estimated at an 11-year low of 5.0%, down from 6.8% in FY2019, according to the advance estimate from India's central statistics office (CSO). Decelerating personal consumption growth and investment activity are expected to be the key drags on headline GDP growth in FY2020. The stressed balance sheets of banks, non-banking financial companies (NBFCs), corporates and households suggest that any revival in domestic demand in 1Q2020 is likely to be slow and gradual. The CSO forecasts fixed capital formation to grow at an anaemic 1.0% in FY2020, down from 10.0% in FY2019. This suggests that the number of policy initiatives taken by the government, including corporate tax rate cuts, and the RBI's interest rate cuts are yet to have a material positive effect on the economy. The incoming high-frequency data is also yet to show any clear signs of a meaningful revival in economic momentum in our view. We believe that the CSO and RBI's 5.0% GDP growth forecast for FY2020 still looks optimistic as it assumes 5.2% growth in 2H FY2020 compared to 4.8% in 1H FY2020. We now see scope for FY2020 GDP growth to be revised down to 4.8% in the subsequent updates.

Fig. 3. India: Real GDP growth forecast to slow to multi-year low of 5.0% in FY2020, from 6.8% in FY2019



Source: India Central Statistical Organisation

Fig. 4. India: Industrial production growth slows sharply to 1.0% y-o-y in 11M2019, from 5.4% in 11M2018



Source: India Central Statistical Organisation

Fiscal deficit to widen to c.3.8-3.9% for FY2020 from budget estimate of 3.3%

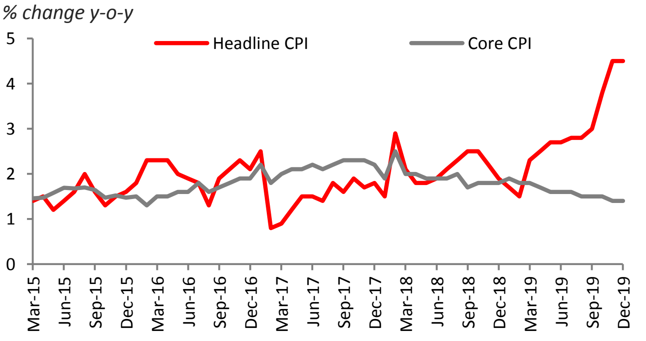
The CSO estimates that India's nominal GDP will grow by 7.5% in FY2020 (a 42-year low) compared to the government's estimate of 12% in the Budget. The downwards revision to the nominal GDP growth and related year-on-year fall in government revenues suggest that India's fiscal deficit is likely to rise to c.3.8-3.9% of GDP in FY2020, above the government's estimate of 3.3%. This will further reduce the government's fiscal space to enact new spending plans in the upcoming budget to revive the slowing economy. Finance Minister Nirmala Sitharaman is likely to present the FY2021 budget on 1 February, with personal income tax cuts widely expected. We believe that the expected cuts are likely aimed at boosting taxpayers' disposable income, which in turn could help revive personal consumption in the next fiscal year. However, any income tax cuts are also likely to add further stress to the fiscal deficit if the government fails to curb some of its existing spending plans.

China: Stable inflation backdrop provides space for further rate cuts

Food prices soften in December after rising consecutively in previous nine months

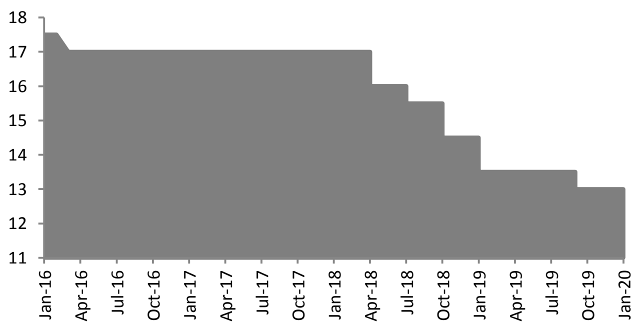
China's headline CPI inflation remained unchanged at 4.5% y-o-y in December (consensus: 4.7%) after rising sharply in the previous three months. Food price inflation, which had been the key driver in previous months, softened in December. However, this was offset by a pick-up in non-food inflation. Inflationary pressure emanating from food prices is likely to ease gradually in the coming months, in our view. Meanwhile, producer prices remained in deflationary territory for a sixth consecutive month in December, albeit narrowing to -0.5% y-o-y from -1.4% in November. The moderation in PPI deflation likely reflects the recent strengthening in commodity prices, including iron ore and crude oil.

Fig. 5. China: Headline inflation steadies in December, after rising in previous three months due to food prices



Source: National Bureau of Statistics of China

Fig. 6. China: Reserve requirement ratio for major banks is lowered to 12.5% in January, from 13.0% earlier



Source: PBOC

We expect further targeted monetary easing in 2020

The steady CPI inflation in December is likely to support the continued targeted monetary easing by the PBoC. The central bank already lowered the reserve requirement ratio (RRR) by 50 bps for all banks effective 6 January, to 12.5% for larger banks and 10.5% for smaller. According to the PBoC, the RRR cuts in total will release around CNY800 billion of liquidity into the financial system. The central bank highlighted that this round of funding was partially to offset cash withdrawals before the Lunar New Year. We believe that the move was also in part aimed at supporting lending to the private sector to bolster domestic demand. Looking ahead, we see the potential for another 100 bps RRR cut in 2020.

II. Economic Calendar

Fig. 7. The week ahead

Time*	Country	Event	Period	Prior	Consensus
Expected this week					
	UAE	Abu Dhabi CPI, y-o-y	Dec	-0.3%	
	UAE	Dubai CPI, y-o-y	Dec	-2.8%	
	Oman	CPI, y-o-y	Dec	-0.2%	
	China	New Yuan Loans CNY	Dec	1390.0B	1200.0B
	China	Money Supply M2, y-o-y	Dec	8.2%	8.3%
Monday, 13 January					
13:30	UK	Trade Balance, Million	Nov	-£5188M	-£2539M
13:30	UK	Industrial Production, m-o-m	Nov	0.1%	0.0%
16:00	India	CPI, y-o-y	Dec	5.5%	6.7%
21:40	US	Fed's Bostic Discusses Economic Outlook and Monetary Policy			
Tuesday, 14 January					
10:30	India	Wholesale Prices, y-o-y	Dec	0.6%	2.4%
17:30	US	CPI, m-o-m	Dec	0.3%	0.3%
17:30	US	CPI, ex-Food and Energy, m-o-m	Dec	0.2%	0.2%
17:30	US	CPI, y-o-y	Dec	2.1%	2.4%
17:30	US	CPI, ex-Food and Energy, y-o-y	Dec	2.3%	2.3%
18:00	US	Fed's Williams Discusses Behavioural Science at London Event			
	China	Exports, y-o-y	Dec	-1.3%	2.5%
	China	Imports, y-o-y	Dec	0.3%	9.6%
	China	Trade Balance	Dec	$38.7B	$45.7B
Wednesday, 15 January					
3:50	Japan	Money Stock M2, y-o-y	Dec	2.8%	2.7%
4:30	Japan	Kuroda Speech at Branch Managers' Meeting			
13:30	UK	CPI, y-o-y	Dec	1.5%	1.6%
13:30	UK	CPI Core, y-o-y	Dec	1.7%	1.7%
14:00	Eurozone	Industrial Production SA, m-o-m	Nov	-0.5%	0.3%
17:30	US	PPI Final Demand, m-o-m	Dec	0.0%	0.2%
17:30	US	Empire Manufacturing	Jan	3.5	3.6
20:00	US	Fed's Harker Speaks in New York			
Thursday, 16 January					
3:50	Japan	Core Machine Orders, m-o-m	Nov	-6.0%	3.0%
15:00	Turkey	One-Week Repo Rate	16-Jan	12.0%	11.5%
17:30	US	Import Price Index, m-o-m	Dec	0.2%	0.4%
17:30	US	Retail Sales Advance, m-o-m	Dec	0.2%	0.3%
17:30	US	Retail Sales Control Group	Dec	0.1%	0.5%
	Egypt	Deposit Rate	16-Jan	12.25%	11.50%
Friday, 17 January					
6:00	China	Retail Sales, y-o-y	Dec	8.0%	7.9%
6:00	China	Industrial Production, y-o-y	Dec	6.2%	5.9%
6:00	China	Fixed Assets, ex-Rural, YTD y-o-y	Dec	5.2%	5.2%
6:00	China	GDP, y-o-y	4Q	6.0%	6.0%
8:30	Japan	Tertiary Industry Index, m-o-m	Nov	-4.6%	1.0%
13:30	UK	Retail Sales, inc-Auto Fuel, m-o-m	Dec	-0.6%	0.6%
13:30	UK	Retail Sales, inc-Auto Fuel, y-o-y	Dec	1.0%	2.7%
14:00	Eurozone	CPI, y-o-y	Dec F	1.0%	1.3%
17:30	US	Housing Starts	Dec	1365K	1380K
18:15	US	Industrial Production, m-o-m	Dec	1.1%	0.1%
19:00	US	Univ. of Michigan Sentiment	Jan P	99.3	99.3
19:00	US	JOLTS Job Openings	Nov	7267	7267

* UAE time
Source: Bloomberg

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