

The Week Ahead: Fed's Powell testifies to Congress; BoJ and CBRT likely on hold

► **US: Powell's comments, CPI inflation and retail sales in focus**

Fed Chair Jerome Powell will deliver his semi-annual Humphrey-Hawkins testimony to the House Financial Services Committee (14 July) and Senate Banking Committee (15 July) this week. We will be looking for any new insights on the asset purchase tapering timeline and what constitutes "substantial further progress" in the Fed's view. The June FOMC meeting minutes released last week showed division over asset purchase tapering with several members expecting the economic conditions for tapering to be met sooner than expected, whilst others want to wait for more clarity on the data (page 4). We expect the overall economic conditions including labour market to see further improvement in coming months, supported by summer activity. As such, we believe that the FOMC will gradually arrive at a consensus over asset purchase tapering before the September meeting. Meanwhile, the focus this week will also be on June CPI inflation and retail sales data. Consensus expects another strong headline CPI reading of 0.5% m-o-m in June (4.9% y-o-y), albeit easing from 0.6% in May. Core inflation is seen rising by 0.4% m-o-m in June (from 0.7% in May), taking the annual reading to 4.0% (vs. 3.8%). Rises in used car and shelter prices are likely to be the key drivers of June core inflation.

► **Global: BoJ and CBRT expected to be on hold in July**

The BoJ is widely expected to keep its monetary policy steady at its 16 July policy meeting. Japan's economic recovery continues to lag other developed economies with vaccinations progressing at a slow pace and ongoing local lockdowns. The resurgence of COVID cases led the government to announce a fresh state of emergency in Tokyo last week, which is likely to further impede growth momentum. Against this backdrop, the BOJ is expected to revise down its real GDP growth forecast for FY2021 (Apr.-Mar.) to c.3.8%, from 4.0% in April. Meanwhile, in Turkey, we expect the CBRT to leave its benchmark one-week repo rate steady at 19.0% at its 14 July meeting, with a more hawkish tone. Inflationary pressures rose further in June with higher oil and food prices, and the FX pass-through effect on imported goods costs. Moreover, recent hikes in electricity and residential natural gas prices will add to the upside pressures going forward (page 6).

► **EM: China 2Q GDP and India inflation data due**

Consensus expects China's 2Q GDP growth to moderate to 8.0% y-o-y, from a series high of 18.3% in 4Q. The softening in household consumption following the recent COVID outbreak in Guangdong province and fading of the low annual base are likely to be the key factors behind the growth normalisation. The softening consumption activity was reflected in the June CPI inflation reading, which decelerated to 1.1% y-o-y (May: 1.3%). Signs of moderating growth momentum and contained price pressures prompted the PBOC to cut its Required Reserve Ratio (RRR) by 0.5% on Friday, which will inject c.CNY1.0 trillion into the banking system. Elsewhere, in India, headline inflation is expected to accelerate further to 6.6% y-o-y in June after rising sharply to 6.3% in May, remaining above the RBI's 6.0% upper bound inflation target.

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I. Recent Events and Data Releases

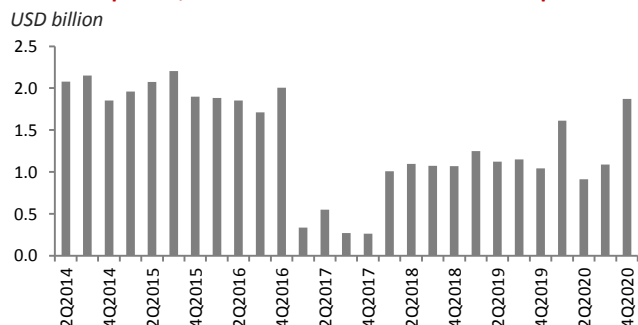
A. MENA Economies

GCC: Saudi Arabia amends import rules from GCC free zones

A ministerial decree published in the official Saudi gazette, Umm al-Qura, on 3 July 2021 indicated that not all goods made in GCC free zones will not be considered locally made and may be subject to customs duties. The decree focuses on tighter rules on local content, labour and added value for production from free trade zones. Saudi Arabia will exclude from the GCC tariff agreement goods made by companies with a workforce made up of less than 25% local people and industrial products with less than 40% of added value after their transformation process. Any goods containing components from Israel or made by Israeli companies will also be excluded from the GCC tariff agreement. We see this as a further move to support FDI inflows into Saudi Arabia and deepen its manufacturing base as it looks to diversify the economy and create jobs for nationals. Other similar moves from the Saudi government included its announcement in February that from 2024 the government will no longer sign contracts with foreign companies that do not have their regional headquarters in the kingdom. For more details, please see our note – **Economic Research Weekly: Global Data Watch 22-26 February 2021**, published on 22 February 2021.

We see Saudi decision aimed at attracting FDI and manufacturing capacity

Fig. 1. Saudi Arabia: FDI into Saudi has increased in the last quarter, but remains below transformation plan needs



Source: SAMA, ADCB Economic Research

Fig. 2. UAE: UAE exports and re-exports to Saudi Arabia accounted for c.16.0% of total exports in 9M2020



Source: Federal Competitiveness and Statistics Centre, ADCB Economic Research

A number of GCC countries, particularly UAE and Oman, have used the free zone model to attract FDI, boost export capacity in strategic sectors and create employment opportunities. We do not see a marked economic near-term impact as a result of the change in import rules with regards to companies already in the free zones. Many have a wider export base than just Saudi Arabia and benefit from the strong transportation and logistics infrastructure already developed in these free zones. UAE trade data shows that exports (9.5% of total) and re-exports (20.6%) to Saudi Arabia combined accounted for 16.0% of total exports from the UAE in 9M2020. UAE exports to Saudi are considerably higher than from other GCC countries in value terms. However, some companies exporting to Saudi from GCC free zones might have to absorb the cost of tariffs, and Saudi Arabia could also see higher inflation where this impact is passed on to consumers. GCC local (i.e., non-free zone) producers and exporters will benefit in the Saudi market. Following the announcement regarding the regulation change, Saudi Finance Minister Mohammed Al-Jadaan highlighted that the move was meant to support

We do not expect to see shifts in companies already located in GCC free zones on the back of the new Saudi policy

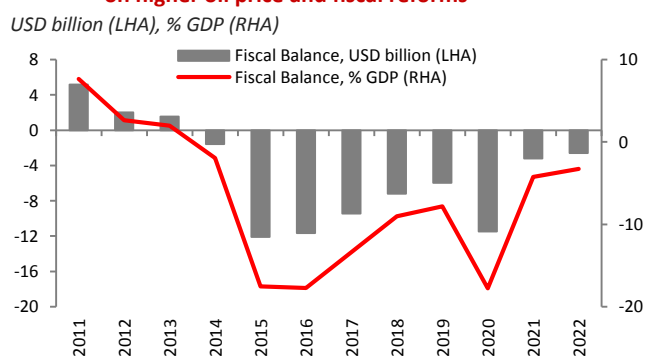
Gulf manufacturing and encourage the use of local inputs. Meanwhile, Saudi Arabia is planning to invest more than SAR500.0 billion (USD133.0 billion) by 2030 to expand its transportation sector as part of a strategy to make the country a global logistics centre. The UAE, particularly Dubai, as well as Oman have developed significant logistics capacities in their free zones.

Oman: Asking IMF for technical assistance to help with debt strategy

Oman has asked the IMF to provide technical assistance to help the country develop a medium-term debt strategy, strengthen its fiscal framework and provide more predictability to the financial system. This was outlined by the IMF in its Concluding Statement of the 2021 Article IV Mission published last week, with additional comments suggesting that there are no plans for a financing package. This is after Oman introduced its Medium-Term Fiscal Plan (MTFP) 2020-24 at end-2020 with the aim of making the fiscal position sustainable by achieving fiscal balance and stabilising debt. We see any IMF assistance as positive to help to further entrench the fiscal reform programme and create a funding framework. We see Oman's funding requirement remaining high, including the debt rollover related requirements, despite seeing a marked narrowing in the fiscal shortfall in 2021. Oman bond prices fell following the announcement of its IMF support. The introduction of the MTFP programme and the subsequent reform measures are very positive, and this will be enhanced by any IMF involvement in our view. Oman has again been able to tap the debt capital markets following the announcement of the MTFP, the introduction of reforms and the rise in the oil price. The Sultanate has twice issued debt in 2021 so far: i) USD1.75 billion in a nine-year sukuk in June, with strong orders of more than USD11.5 billion; and ii) USD3.25 billion of government debt in a three-part bond in January. We estimate that the government has over-funded its 2021 shortfall requirement, though the current low interest rate environment makes this an attractive time to borrow.

IMF support likely to exclude a financing package, rather focusing on technical assistance

Fig. 3. Oman: Fiscal deficit forecast to narrow sharply in 2021 on higher oil price and fiscal reforms



Source: Ministry of Finance, ADCB Economic Research

Fig. 4. Oman: 10-year bond yield on a downtrend since the beginning of 2021 and currently stands at 5.28%



Source: Bloomberg, ADCB Economic Research

Oman's fiscal deficit is forecast to narrow sharply in 2021 with the higher oil price a key factor. Also contributing are the planned shifting of oil and gas spending to the Energy Development Oman (EDO), the introduction of 5.0% VAT in April, the mandatory public sector retirement scheme resulting in lower expenditure on wages, and a reduction in water and electricity subsidies. For more details, please see our note – **Oman Economic Update: 2021 budget looks to reduce fiscal shortfall, in line with medium-term plan**, published on 12 January 2021. Interim fiscal data showed that government spending fell by 2.92% y-o-y in 5M2021, much less than implied in the budget, with the EDO still being

Transfer of oil and gas spending to EDO a significant factor behind reduced deficit

established. We therefore raised our fiscal deficit forecast to 4.2% for 2021 earlier this month, from 2.4% in March. We see a greater spending adjustment in 2H2021, when the EDO is expected to be established. Our deficit forecast is still sharply down from 17.8% of GDP in 2020. Other fiscal reforms to be implemented include the privatisation of government-owned assets and the introduction of an income tax, which are likely to be implemented in 2H2022. The IMF noted that the fiscal consolidation measures are frontloaded and it sees the fiscal position moving into surplus in the medium term. However, we see a potential fiscal risk on the government wages side, especially as the next phases of fiscal reforms will be more socially challenging. Moreover, hydrocarbons will continue to dominate revenues making the fiscal position vulnerable to price movements, alongside downside risks to the GDP growth and tax revenue assumptions in the MTFP. The IMF recommended the development of a "sovereign asset liability management framework" to get a better picture of the sustainability of the public sector beyond the central government budget. This is due to the growing role of state-owned enterprises in the economy.

Egypt: Modest rise in annual inflation in June

Headline inflation rose modestly to 4.9% y-o-y in June from 4.8% in May, driven by food, and household furniture and equipment. We had expected a faster pace of strengthening, particularly on the back of higher food inflation, reflecting the low base and domestic and global price trends. On a monthly basis, headline inflation decelerated to 0.2% m-o-m in June, from 0.7% in May and 0.9% in April. A likely factor for the contained food inflation was the limited pass-through by producers and merchants of the higher prices. However, we expect some gradual pass-through of costs to consumers from rising commodity prices and prevailing supply-chain constraints. As such, we still expect inflation to gradually strengthen in 2H2021 to above 5.0% y-o-y, though to rise in a limited and contained way. Core inflation remains muted at 3.9% y-o-y in June (May: 3.4%), and we continue to expect headline inflation to be well within the CBE's inflation target range of 5.0-9.0% going forward. Despite this, we see rates staying on hold, as the monetary policy focus remains on keeping real interest rates high on a global basis to attract capital inflows to meet both external and fiscal financing needs and support EGP stability.

Rising food prices key driver of inflation in June

B. G4 Economies

US: June FOMC meeting minutes largely along expected lines

The June FOMC meeting minutes did not provide any new insights on the potential timeline for tapering. However, the minutes highlighted that various Fed members are now expecting the conditions for beginning asset purchase tapering to be met "somewhat earlier" than they had anticipated at previous meetings. However, other policymakers saw incoming data as providing a less clear signal about the underlying economic momentum and argued for a wait-and-see approach. These diverging FOMC member views were also evident in the members' recent communications after the June Fed meeting. The minutes also reiterated that the Fed will provide notice well in advance regarding the announcement of asset purchase tapering. On the economy, the committee noted that conditions for achieving "substantial further progress" were not yet met, though it expects progress to continue. There was also no clear indication on what exactly constitutes "substantial further progress". Comments on the inflation outlook were also mixed, as "a substantial majority of participants judged that the risks

June FOMC minutes point to divisions in almost all areas, including inflation outlook and asset purchase tapering timing

to their inflation projections were tilted to the upside”, while others cautioned about downside risks once transitory price pressures fade.

On asset purchase tapering discussions, the minutes highlighted that "several" participants saw the "benefits" of a quicker potential tapering of mortgage backed securities (MBS) than for Treasuries. However, “several others” signalled that reducing them “commensurately” (equal/proportionate amount) would better align with the Fed’s previous communications. The mixed comments on all fronts indicate that it will take some time before the FOMC arrives at a consensus on the timing and pace of asset purchase tapering, in our view. We continue to expect a formal announcement regarding scaling back asset purchases at the September policy meeting, with actual reduction beginning in either December or January.

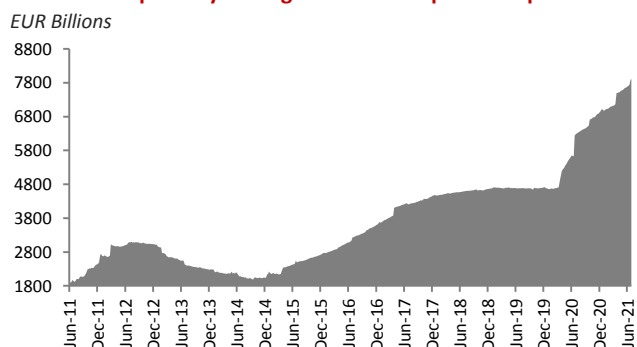
We expect a formal announcement regarding scaling back asset purchases at the September policy meeting

Eurozone: ECB adopts a symmetric 2.0% inflation target

The ECB published its monetary policy strategy review last week, which had no major surprises that could change the way it conducts policy currently in our view. Rather the ECB’s new symmetric 2.0% inflation target indicates to us the continuation of loose monetary policy, with a greater tolerance for any short-term spikes in inflation. The key takeaways from the ECB’s strategy review are: i) it adopts a symmetric 2.0% inflation target over medium term; ii) it includes climate change in its decision making; iii) adds QE to its permanent toolbox of instruments; and iv) uses new monetary policy instruments if/when necessary. The ECB also highlighted that the Harmonised Index of Consumer Prices (HICP) remains the appropriate price measure, although it recommends including owner-occupied housing costs in the index over the coming years. The ECB’s new symmetric 2.0% inflation goal will allow overshooting of prices, which is a shift away from its earlier objective of inflation level “below, but close to, 2.0%”. ECB President Christine Lagarde highlighted that the new inflation target is “clear and easy to communicate”. Looking ahead, the ECB will likely incorporate these policy adjustments into its forward guidance at its upcoming 21-22 July policy meeting. The minutes of the June ECB meeting released last week showed that some members had pushed back against the decision to keep a “significantly higher” pace of pandemic emergency purchase programme (PEPP) purchases. Indeed, the debate on reducing the PEPP pace is likely to get more intense in the coming months, in our view. Consensus expects the ECB to scale back the pace of PEPP purchases at its September meeting, though we still see overall monetary policy remaining accommodative.

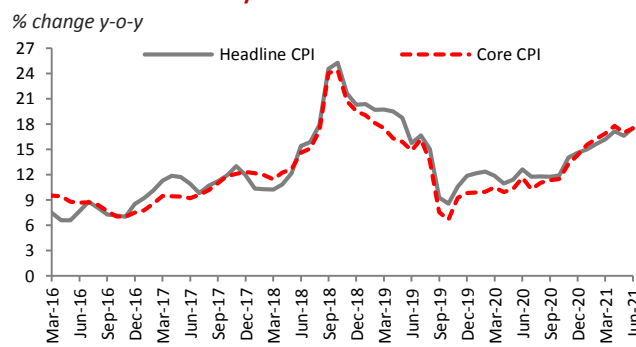
ECB pledges to incorporate climate change considerations into its monetary policy

Fig. 5. Eurozone: ECB balance sheet size to remain large despite any scaling back of PEPP purchase pace



Source: ECB, ADCB Economic Research

Fig. 6. Turkey: Strengthening price pressures diminish chances of any rate cuts in the immediate term



Source: Turkish Statistical Institute, ADCB Economic Research

C. Emerging Market Economies

Turkey: Both headline and core inflation strengthen in June

Headline inflation accelerated markedly to a 25-month high of 17.5% y-o-y in June after surprising to the downside in May (16.6%). The sharp rise in the June headline reading was mainly due to a strengthening in food prices, driven by weather-related losses to agricultural production. Core inflation also rose to 17.5% y-o-y in June (May: 17.0%), reflecting the impact of TRY weakness on imported goods prices. Moreover, the government recently announced electricity and natural gas price hikes (effective from 1 July), which are likely to add additional upward pressure to inflation in the coming months, in our view. The real one-week repo rate stands at 1.5% after the June inflation reading, which is significantly lower than in many other major EM economies. We expect inflationary pressures to continue to strengthen and potentially lead to another drop in real interest rates ahead, which in turn diminishes the chance of rate cuts in 3Q2021. As such, we expect the tone of the upcoming CBRT meeting on 14 July to become more hawkish. We believe that the MPC will highlight the need to maintain “tight” monetary policy until there is a meaningful improvement in the inflation outlook.

Real one-week repo rate now stands at 1.5% after June spike in inflation

II. Economic Calendar

Fig. 7. The week ahead

Time*	Country	Event	Period	Prior	Consensus
Expected this week					
	UAE	Dubai CPI, y-o-y	Jun	-2.8%	
	Kuwait	CPI, y-o-y	May	3.1%	
	Oman	CPI, y-o-y	Jun	1.7%	
Monday, 12 July					
8:15	UAE	Dubai PMI	Jun	51.6	
10:00	Japan	Machine Tool Orders, y-o-y	Jun P	141.9%	
16:00	India	Industrial Production, y-o-y	May	134.4%	32.0%
16:00	India	CPI, y-o-y	Jun	6.3%	6.6%
20:00	US	Fed's Kashkari Speaks at Townhall			
Tuesday, 13 July					
11:00	Turkey	Industrial Production, m-o-m	May	-0.9%	-0.4%
14:00	US	NFIB Small Business Optimism	Jun	99.6	99.5
16:30	US	CPI, m-o-m	Jun	0.6%	0.5%
16:30	US	CPI, ex-Food and Energy, m-o-m	Jun	0.7%	0.4%
16:30	US	CPI, y-o-y	Jun	5.0%	4.9%
16:30	US	CPI, ex-Food and Energy, y-o-y	Jun	3.8%	4.0%
	China	Trade Balance	Jun	\$45.5B	\$44.4B
	China	Exports, y-o-y	Jun	27.9%	23.1%
	China	Imports, y-o-y	Jun	51.1%	29.8%
Wednesday, 14 July					
10:00	UK	CPI, y-o-y	Jun	2.1%	2.2%
10:00	UK	CPI Core, y-o-y	Jun	2.0%	2.0%
10:30	India	Wholesale Prices, y-o-y	Jun	12.9%	12.2%
13:00	Eurozone	Industrial Production SA, m-o-m	May	0.8%	-0.2%
15:00	Turkey	One-Week Repo Rate	14-Jul	19.0%	19.0%
16:30	US	PPI Final Demand, m-o-m	Jun	0.8%	0.5%
20:00	US	Powell to Deliver Semi-Annual Testimony to House Panel			
21:00	UK	BOE's Ramsden speaks at King's Business School			
Thursday, 15 July					
6:00	China	GDP, y-o-y	2Q	18.3%	8.0%
6:00	China	Retail Sales, y-o-y	Jun	12.4%	10.9%
6:00	China	Industrial Production, y-o-y	Jun	8.8%	8.0%
10:00	UK	Average Weekly Earnings, 3M/y-o-y	May	5.6%	7.1%
10:00	UK	ILO Unemployment Rate, 3M	May	4.7%	4.7%
10:00	Saudi Arabia	CPI, y-o-y	Jun	5.7%	
14:00	UK	BOE's Saunders Speaks on Inflation Outlook			
15:30	India	Exports, y-o-y	Jun	69.4%	
16:30	US	Import Price Index, m-o-m	Jun	1.1%	1.2%
16:30	US	Empire Manufacturing	Jul	17.4	18.0
16:30	US	Philadelphia Fed Business Outlook	Jul	30.7	28.0
16:30	US	Initial Jobless Claims	10-Jul	373K	350K
16:30	US	Continuing Claims	3-Jul	3339K	3300K
17:15	US	Industrial Production, m-o-m	Jun	0.8%	0.6%
17:30	US	Powell to Deliver Semi-Annual Testimony to Senate			
19:00	US	Fed's Evans Discusses the Economy			
Friday, 16 July					
13:00	Eurozone	CPI, y-o-y	Jun F	2.0%	1.9%
16:30	US	Retail Sales Advance, m-o-m	Jun	-1.3%	-0.4%
16:30	US	Retail Sales Control Group	Jun	-0.7%	0.4%
18:00	US	University of Michigan Consumer Sentiment	Jul P	85.5	86.5
	Japan	BOJ Policy Balance Rate	16-Jul	-0.1%	-0.1%

* UAE time

Source: Bloomberg

Fig. 8. Last week's data

Time*	Country	Event	Period	Prior	Consensus	Actual
GCC Economies						
	Bahrain	CPI, y-o-y	May	-0.1%		-0.3%
	Bahrain	GDP Constant Prices, y-o-y	1Q	-5.5%		-2.1%
	Egypt	Gross Official Reserves	Jun	40.5B		40.6B
	Egypt	GDP Constant, q-o-q	1Q	6.2%		3.5%
Monday, 5 July						
5:45	China	Caixin China PMI Services	Jun	55.1	54.9	50.3
8:15	Saudi Arabia	IHS Markit Saudi Arabia PMI	Jun	56.4		56.4
8:15	UAE	IHS Markit UAE PMI	Jun	52.3		52.2
9:00	India	Markit India PMI Services	Jun	46.4		41.2
11:00	Turkey	CPI, y-o-y	Jun	16.6%	16.8%	17.5%
11:00	Turkey	CPI Core Index, y-o-y	Jun	17.0%	16.9%	17.5%
12:00	Eurozone	Markit Eurozone Composite PMI	Jun F	59.2	59.2	59.5
12:30	Eurozone	Sentix Investor Confidence	Jul	28.1	30.0	29.8
12:30	UK	Markit/CIPS UK Services PMI	Jun F	61.7	61.7	62.2
13:00	Qatar	IHS Markit Qatar PMI	Jun	51.5		54.6
Tuesday, 6 July						
8:15	Egypt	IHS Markit Egypt PMI	Jun	48.6		49.9
12:30	UK	Markit/CIPS UK Construction PMI	Jun	64.2	64.0	66.3
13:00	Eurozone	Retail Sales, m-o-m	May	-3.9%	4.3%	4.6%
13:00	Eurozone	ZEW Survey Expectations	Jul	81.3		61.2
17:45	US	Markit US Services PMI	Jun F	64.8	64.8	64.6
18:00	US	ISM Services Index	Jun	64.0	63.5	60.1
Wednesday, 7 July						
9:00	Japan	Leading Index CI	May P	103.8	102.7	102.6
18:00	US	JOLTS Job Openings	May	9193K	9325K	9209K
	China	Foreign Reserves	Jun	\$3221.8B	\$3209.5B	\$3214.0B
Thursday, 8 July						
3:50	Japan	BoP Current Account Balance	May	¥1321.8B	¥1807.2B	¥1979.7B
16:30	US	Initial Jobless Claims	3-Jul	371.0K	350.0K	373.0K
16:30	US	Continuing Claims	26-Jun	3469.0K	3325.0K	3339.0K
	Egypt	Urban CPI, y-o-y	Jun	4.8%		4.9%
Friday, 9 July						
3:50	Japan	Money Stock M3, y-o-y	Jun	6.8%	5.2%	5.2%
5:30	China	CPI, y-o-y	Jun	1.3%	1.2%	1.1%
5:30	China	PPI, y-o-y	Jun	9.0%	8.8%	8.8%
10:00	UK	Monthly GDP, m-o-m	May	2.0%	1.5%	0.8%
10:00	UK	Industrial Production, m-o-m	May	-1.0%	1.4%	0.8%
10:00	UK	Index of Services, 3M/3M	May	1.4%	4.1%	3.9%
10:00	UK	Trade Balance, GBP Mn	May	-£1595.0M	-£1250.0M	£884.0M
11:00	Turkey	Current Account Balance	May	-1.73B	-2.95B	-3.08B
13:00	China	Money Supply M2, y-o-y	Jun	8.3%	8.2%	8.6%
13:00	China	New Yuan Loans CNY	Jun	1500.0B	1825.0B	2120.0B

* UAE time

Source: Bloomberg

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