

The Week Ahead: UK inflation and China data in spotlight

► **UK: CPI inflation likely to decelerate in December**

This week will feature important UK releases, namely inflation and retail sales data for December. Consensus forecasts headline inflation decelerated slightly to 3% y-o-y in December after reaching a 68-month high of 3.1% in November. We expect headline inflation to weaken gradually in the upcoming months as the 2016 GBP depreciation pass-through effect wanes. Moreover, the recent GBP appreciation remains crucial for the inflation outlook in 2018, with support for sterling in part due to positive sentiment towards the Brexit negotiations. However, the recent surge in crude oil prices will slow the pace of disinflation, in our view. With inflation expected to decelerate, we expect the BoE to remain on hold in 2018. Meanwhile, December retail sales are expected to have accelerated to 2.6% y-o-y in December (November: 1.6%), mainly driven by the holiday spending. Meanwhile, the key releases in the US will be for December industrial production and housing data (starts and building permits). US data published so far for December shows solid momentum, notably with core CPI inflation accelerating more than market expectations (page 3).

► **China: 4Q GDP data, December IP and retail sales**

Consensus expects China's GDP growth to have decelerated slightly to 6.7% y-o-y in 4Q from 6.8% in 3Q. New regulations, including environmental and financial, announced since the Communist Party Congress in mid-November, likely weighed on economic growth. We believe that investment activity and exports slowed in 4Q, with private consumption likely still underpinning overall economic activity. The recent high frequency data also suggests some moderation in activity, as both fiscal and monetary policy have tightened moderately. Notably, money supply (M2) growth decelerated sharply in December to 8.2% y-o-y (November: 9.1%), below the consensus estimate of 9.2%. New yuan loans also halved to CNY573.8 billion in December (November: CNY1,120 billion) as bank lending was reduced to rein in leveraging activity. The other key data releases this week will be industrial production and retail sales for December, and consensus expects both to have remained stable at 10.2% y-o-y and 6.1% y-o-y respectively.

► **Turkey: CBRT to keep rates on hold**

We expect the CBRT to keep monetary policy steady at its 18 January meeting. The tone of the meeting is likely to remain hawkish, as inflation is expected to remain elevated in 2018 despite favourable base effects. Core inflation accelerated to 12.3% y-o-y in December, suggesting cost pressures remain high. Rising crude oil prices, increases in household electricity tariffs (8.8% hike from January 2018), the pass-through effect of TRY weakness and rising demand-side pressures are likely to support the underlying price pressures. Looking ahead, we expect headline inflation to moderate slightly in 2H2018, hovering in the range of 9-10%, after remaining in double digits in 1H. We also see the CBRT maintaining its tight monetary policy to stem capital outflows on the back of a widening benchmark interest rate differential with the US.

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

I.	Recent Events and Data Releases	2
II.	Economic Calendar	7

I. Recent Events and Data Releases

A. MENA Economies

Oman: Raises USD6.5 billion of sovereign debt, strong demand

Oman last week became the first GCC country to issue sovereign debt in 2018, raising USD6.5 billion. The bond was split into three tranches: i) a USD1.25 billion five-year tranche at US Treasury +190 bps; ii) a USD2.5 billion 10-year tranche at US Treasury +310 bps; and iii) a USD2.75 billion 30-year tranche at US Treasury +395 bps. This was Oman's largest ever bond issuance, with strong demand resulting in a tightening in pricing from guidance. The order book was c. USD15 billion, likely supported by the strong oil price. Brent crude touched USD70 p/b at the end of last week, for the first time since end-2014. The order book also reflected strong global demand for long-term, high-yielding assets. The pricing provided attractive margins to investors compared to existing debt, especially for the 10- and 30-year maturities with premiums of c. 30 to 40 bps. Oman is rated at sub-investment grade by S&P and the lowest investment grade by Moody's.

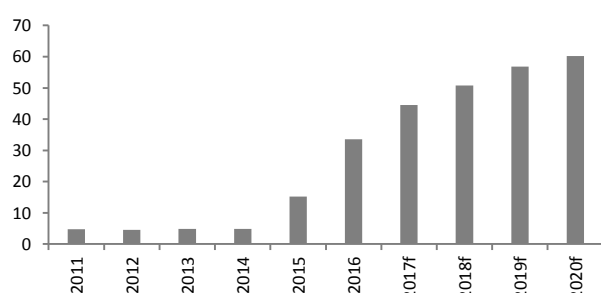
Strong demand for debt with large order book of USD15 billion

Oman has already covered most of its projected deficit in its 2018 budget of OMR3 billion (USD7.8 billion) with this bond. Oman announced an expansionary budget for 2018, with spending slated to rise by 6.8% from the 2017 budget. However, the oil price assumption of the budget is conservative at c.USD50 p/b. We believe that much of the narrowing in the fiscal deficit in 2018 will be due to higher hydrocarbon revenues. Oman could follow the bond issuance with a sukuk offering soon, taking advantage of the high oil price and favourable market conditions. This is despite the budget looking to cover some of the deficit through drawdown of reserves. Other GCC countries are likely to bring forward their debt issuance plans. Market indications suggest that Saudi Arabia and Qatar are looking to tap the international debt capital market in 1Q2018.

GCC countries likely to take advantage of favourable market conditions and bring forward issuance plans

Fig. 1. Oman: Gross government debt expected to rise to c. 50% of GDP in 2018

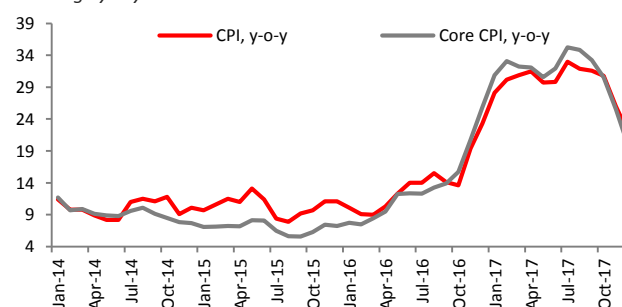
Gross government debt, % of GDP



Source: IMF, ADCB estimates

Fig. 2. Egypt: Both headline and core inflation saw a second month of marked disinflation in December

% change y-o-y



Source: CAPMAS

Egypt: Consumer inflation decelerates sharply in December

CPI disinflation remained strong in December, with headline inflation slowing to 21.9% y-o-y, down from 26% in November and 30.8% in October. The December reading was a 13-month low. Inflation has decelerated sharply over the last two months, as the EGP devaluation, reductions in fuel subsidies and the introduction of VAT (all implemented in November 2016) dropped out of the data. The moderation in December was broad-

Headline inflation fell by 0.2% m-o-m in December – first contraction in two years

based and included a drop in food price inflation to 25.2% from 32.3% in November. Food prices account for around 40% of the inflation basket and saw a recent high of 42.3% y-o-y growth in July. Notably, headline inflation contracted by 0.2% m-o-m in December, the first monthly drop in two years. The fall reflects the dissipation of the inflationary pressures that arose from further subsidy cuts and the increase in the VAT rate in mid-2017.

We expect headline inflation to slow further in 1Q2018, to low double-digit figures, and then stabilise at that level. We believe that the disinflation seen since November should be sufficient to prompt the CBE to start its rate-cutting cycle at its 15 February meeting, reducing benchmark rates by 100 bps. We expect a total of c.400 bps of rate cuts in 2018, though the magnitude of any further potential fuel price increases could be a limiting factor.

We expect CBE to start its interest rate-cutting cycle in February

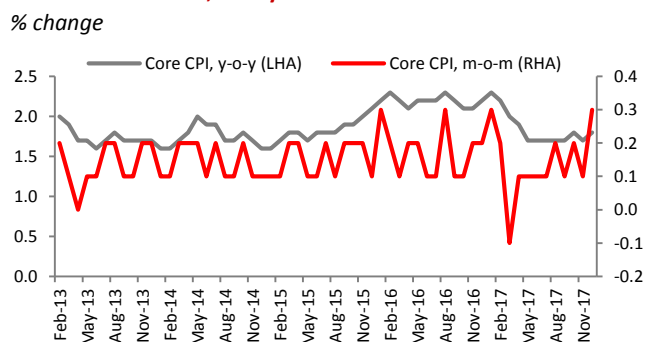
B. G4 Economies

US: Core inflation accelerates to 1.8% y-o-y in December

CPI inflation and retail sales data released last week provided further evidence of strong economic activity during the holiday season. Core CPI inflation accelerated to 0.3% m-o-m in December, beating the consensus estimate of 0.2% (November: 0.1%). This was the highest monthly growth rate since January 2017. The acceleration was mainly driven by services inflation, with the shelter index rising by 0.4% m-o-m in December (November: 0.2%). Transportation service and medical care prices also picked up. However, headline inflation decelerated to 0.1% m-o-m in December (November: 0.4%), as energy prices contracted by 1.2% m-o-m in December. The monthly rise in core inflation help push the yearly rate up to 1.8% y-o-y, from 1.7% in November. Meanwhile, retail sales came in at 0.3% m-o-m, ending 2017 on a healthy note. Strong upward revisions to November retail sales data also suggest that real spending is likely to remain the main driver of 4Q GDP growth.

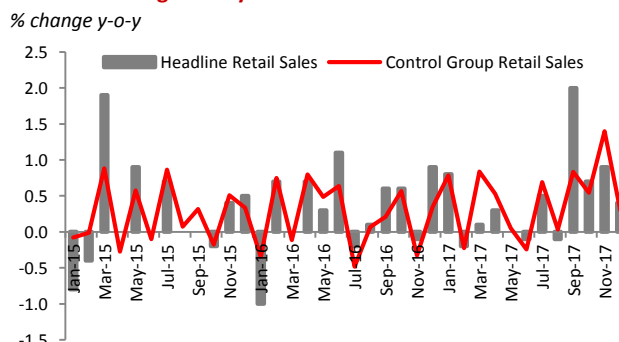
Core inflation surprises to upside – rising by 0.3% m-o-m in December

Fig. 3. US: Core inflation accelerate to 0.3% m-o-m in December, led by services inflation



Source: Bureau of Labor statistics

Fig. 4. US: Headline retail sales point to healthy growth during holiday season



Source: US Census Bureau

The strong data, particularly inflation, strengthens the case for a FFTR hike in March, with markets now assigning an 88% probability versus 56% a month ago. Recent comments from Fed members also indicate gradual monetary policy tightening will continue in 2018. Recent Fed comments suggest either two to three rate hikes in 2018, with those

Market expectations of March rate hike have increased following December data

looking for two highlighting the weak inflation backdrop. However, with core inflation surprising to the upside, we see a chance of the FFTR hikes being frontloaded in 2018. We and the markets had expected to see core inflation starting to tick up from March 2018. If the pickup in core inflation is sustained, we could also see upside risks to our assumption of two 25 bps rate hikes in 2018, especially given the easy financial conditions which are further supported by the tax reforms. The weakening in the USD will also increase imported inflation. We expect labour market conditions and the growth outlook to remain healthy, though would like to see more data on inflation before changing our forecast. We continue to believe that the change in FOMC composition will take time to be reflected in Fed communication.

Eurozone: ECB minutes highlight forward guidance tweaks in early-2018

The minutes of the ECB's December meeting highlighted that the Governing Council (GC) is getting ready to adjust its language on policy and forward guidance in early-2018. The tone of the meeting was seen as hawkish, as markets anticipated only very minor changes to the language in December, after the majority of the QE adjustments were taken at the October meeting. The minutes indicated that the GC's communication "would need to evolve gradually" given the improving economy. We and markets believe this likely refers to the ECB potentially removing the "well past" wording when referring to the timing of the first rate hike following the end of net asset purchases.

December minutes highlight forward guidance language to be revisited in early-2018

Nevertheless, the GC suggested that the communication changes would evolve gradually only to prevent unwarranted tightening in monetary conditions. This could be the reason for the more muted comments by ECB President Mario Draghi in his post-meeting press conference. Draghi mentioned that the GC did not discuss delinking asset purchases and the inflation outlook in the forward guidance. The minutes of the meeting continued to highlight that an "ample" degree of monetary accommodation was still needed until inflation sees a sustained uptrend towards the ECB's inflation target level of close to 2%. We continue to believe that key policy rates will not rise until net asset purchases end and we expect the ECB to raise deposit rates only in early-2019.

We expect deposit rate hikes only in early-2019

UK: Key ministers retained in cabinet reshuffle

Prime Minister Theresa May reshuffled her cabinet last week, though she again appeared to fail to show authority over some cabinet ministers. Key ministers such as Philip Hammond, Boris Johnson, David Davis and Amber Rudd have retained their posts. However, education secretary Justine Greening resigned from the government, resisting May's proposal to shift her to the Department for Work and Pensions. Meanwhile, two other ministers, Health Secretary Jeremy Hunt and Business Secretary Greg Clark, also resisted May's plans to change their portfolios and managed to retain their posts. We believe that attention will now shift to the next phase of Brexit talks, especially the tough trade negotiations. Clarity on a transition deal is likely to remain a crucial factor affecting business sentiment and capital investment. Looking ahead, the EU Withdrawal Bill will have to be formally ratified, with the House of Commons likely to finalise its amendments by 17 January. It will then be sent to the House of Lords for further examination. PM May is also expected to give another important speech on Brexit by early-February.

UK cabinet reshuffle turned out to be low-key affair, with attention now shifting to trade talks

C. Emerging Market Economies

India: Inflation accelerated in December, likely to impact RBI outlook

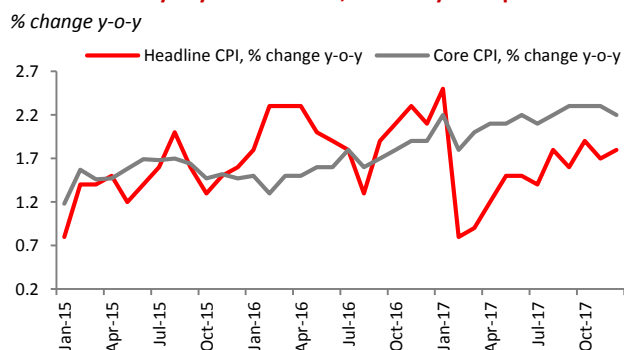
Headline inflation accelerated to a 17-month high of 5.2% y-o-y in December (November: 4.9%), beating the consensus expectation of 5.1%. Food and housing prices continued to drive the acceleration in prices. Food inflation strengthened to 4.9% y-o-y in December as vegetable prices (29.1%) surged to a four-year high. We expect food inflation to moderate in the upcoming months as the new harvest is expected to reach the market soon. Housing prices also accelerated to 8.3% y-o-y in December as rent allowances to government employees continue to support prices. However, fuel inflation moderated to 7.9% y-o-y in December (November: 8.2%), mainly reflecting the fuel price cuts announced by the government. We believe that the risks to headline inflation are skewed to the upside as the crude oil price continued to rise.

Headline inflation accelerated to 5.2% y-o-y in December, driven by food prices and rents

We believe that the December inflation print has increased the chances of the RBI becoming more hawkish on the interest rate outlook, from a neutral stance currently. The recent speculation that the government is likely to miss its fiscal target is also likely to remain a critical factor for the RBI. We believe the RBI will also wait for the new fiscal budget to be announced in February, to gauge the additional price pressures. However, we do not see the RBI raising interest rates in 1Q2018, though we now see the potential of two 25 bps rate hikes in 2018, one each in mid and end-2018.

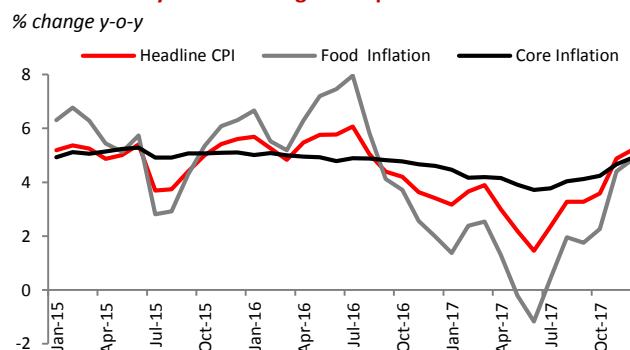
We expect RBI to change its neutral interest rate tone to hawkish in upcoming meetings

Fig. 5. China: Headline inflation accelerates marginally to 1.8% y-o-y in December, driven by food prices



Source: National Bureau of Statistics

Fig. 6. India: Inflation accelerates to 5.2% y-o-y in December, led by rents and vegetable prices



Source: India Central Statistical Organisation

China: CPI inflation accelerates marginally in December

China's consumer price inflation picked up slightly to 1.8% y-o-y in December (November: 1.7%) but came in below the consensus estimate of 1.9%. The increase was mainly driven by a narrowing deflation in food prices, which printed at -0.4% y-o-y for the month (November: -1.1%). The extreme cold weather caused fresh vegetable, fruit and pork prices to rise sharply on a monthly basis. However, core inflation eased to 2.2% y-o-y in December after remaining steady at 2.3% for the previous three months. We expect inflation to pick up further in the coming months, as weather-related effects and the upcoming Chinese holiday season are likely to strengthen price pressures. Nonetheless, we think that headline inflation will remain manageable, coming in under the PBoC's target, which is likely to remain at c.3% in 2018.

CPI inflation accelerated to 0.3% m-o-m in December, driven by food prices

We believe that the PBoC will increase interest rates in line with the Fed's policy of normalisation in order to limit capital outflows. We believe that the PBoC is more likely to control leveraging activity using macro-prudential regulations, whilst keeping monetary policy guidance steady. Meanwhile, we expect China's GDP growth to decelerate to 6.5% in 2018, as the government is likely to continue its deleveraging process and introduce further environmental restrictions to curb pollution.

We expect PBoC to follow Fed's rate hike path to stem capital outflows

II. Economic Calendar

Fig. 7. The week ahead

Time*	Country	Event	Period	Prior	Consensus
EM data					
	UAE	M2 Money Supply, m-o-m	Dec	0.4%	
	UAE	CPI, y-o-y	Dec	1.7%	
	UAE	Central Bank Foreign Assets	Dec	330.3B	
	Saudi Arabia	CPI, y-o-y	Dec	0.1%	
	Bahrain	CPI, y-o-y	Dec	2.9%	
	Bahrain	M2 Money Supply, y-o-y	Nov	3.3%	
	Oman	Nominal GDP YTD, y-o-y	3Q	12.3%	
	Qatar	CPI, y-o-y	Dec	0.2%	
	Egypt	Production Index, m-o-m	Nov	-1.2%	
	Egypt	Trade Balance	Dec	-3214M	
	India	Exports, y-o-y	Dec	30.6%	
	India	Wholesale Prices, y-o-y	Dec	3.9%	4%
Monday, 15 Jan					
3:50	Japan	Money Stock M2, y-o-y	Dec	4%	4%
22:15	UK	BOE's Tenreyro Speaks on Productivity at Event in London			
Tuesday, 16 Jan					
3:50	Japan	PPI, y-o-y	Dec	3.5%	3.2%
8:30	Japan	Tertiary Industry Index, m-o-m	Nov	0.3%	0.3%
13:30	UK	CPI, m-o-m	Dec	0.3%	0.4%
13:30	UK	CPI, y-o-y	Dec	3.1%	3%
13:30	UK	CPI Core, y-o-y	Dec	2.7%	2.6%
13:30	UK	PPI Output NSA, y-o-y	Dec	3%	0.2%
17:30	US	Empire Manufacturing	Jan	18	19
Wednesday, 17 Jan					
3:50	Japan	Core Machine Orders, m-o-m	Nov	5%	-1.2%
12:55	Eurozone	ECB's Nowotny Speaks at Euromoney CEE Conference			
14:00	Eurozone	CPI, y-o-y	Dec F	1.5%	1.4%
18:15	US	Industrial Production, m-o-m	Dec	0.2%	0.4%
23:00	US	US Federal Reserve Releases Beige Book			
Thursday, 18 Jan					
0:00	US	Fed's Evans Speaks on Economy and Monetary Policy			
1:30	US	Fed's Mester Discusses Monetary Policy Communication			
6:00	China	GDP, y-o-y	4Q	6.8%	6.7%
6:00	China	Retail Sales, y-o-y	Dec	10.2%	10.2%
6:00	China	Industrial Production, y-o-y	Dec	6.1%	6.1%
8:30	Japan	Industrial Production, m-o-m	Nov F	0.6%	
12:15	Eurozone	Bundesbank President Weidmann speaks in Frankfurt			
17:30	US	Housing Starts	Dec	1297K	1275K
17:30	US	Building Permits	Dec	1303K	1290K
18:30	Eurozone	ECB's Coeure speaks on a panel in Frankfurt			
Friday, 19 Jan					
13:30	UK	Retail Sales, inc-Auto Fuel, m-o-m	Dec	1.1%	-0.9%
13:30	UK	Retail Sales, inc-Auto Fuel, y-o-y	Dec	1.6%	2.6%
13:30	UK	Retail Sales, ex-Auto Fuel, m-o-m	Dec	1.2%	-1%
13:30	UK	Retail Sales, ex-Auto Fuel, y-o-y	Dec	1.5%	2.6%
19:00	US	University of Michigan Sentiment	Jan P	95.9	97

* 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.