The Week Ahead: Fed's Powell testifies to Congress; UK inflation and labour data

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Contents

US: Powell's comments on trade tensions in focus

Fed Chair Jerome Powell delivers his semi-annual testimony to the Senate Banking Committee (17 July) and the House Financial Services Committee (18 July) this week. The markets will particularly examine his comments on trade tariffs and their potential impact on the growth and inflation outlooks. Powell has warned that changes in trade policy could lead to the current outlook being questioned. Attention will also be on his views on the flattening treasury yield curve and the likelihood of a recession in the near term. Despite these increasing uncertainties, we expect Powell to reiterate his confidence on the economy and the steady interest rate hiking stance, given the solid momentum, tightening labour market and rising inflation (page 2). The key US data releases this week are June retail sales, industrial production and housing starts. Consensus forecasts headline retail sales grew by a solid 0.5% m-o-m in June (May: 0.8%), driven by auto and gasoline spending. The retail sales control group, which feeds into GDP growth, is estimated to have grown at a healthy pace of 0.4% m-o-m in June, albeit moderating from 0.5% in the previous month.

UK: Inflation and labour data likely to support August rate hike

This week will also feature important UK releases, including inflation, retail sales and jobs data. We believe that the markets will closely scrutinise these releases to gauge the likelihood of an August rate hike. Consensus estimates headline inflation accelerated to 2.6% y-o-y in June (May: 2.4%), largely driven by energy prices. However, core inflation is expected to have remained steady at 2.1% y-o-y in June. On the labour market front, wage growth is also forecast to have remained stable at 2.5% 3M y-o-y in June. The incoming data published so far, including May monthly GDP growth, indicate a strengthening in pace in 2Q after the sharp deceleration in 1Q. Recent comments by BoE members remain on the hawkish side, with Governor Mark Carney suggesting that domestic demand is "growing at rates slightly above those of supply and domestic cost pressures [are] building". Thus, we expect the BoE to raise its policy rate by 25 bps at its August meeting, with the market also pricing in a 81% probability of a hike. Nevertheless, political uncertainty surrounding Brexit remains a key risk in our view (page 3).

Asia: Japan inflation and China's 2Q GDP growth

Japan's CPI inflation is expected to have picked up marginally to 0.8% y-o-y in June (May: 0.7%), likely boosted by higher oil prices and JPY depreciation. However, this is well below the BoJ's inflation target of 2%. Despite tight labour market conditions, there have been no meaningful signs of a pick-up in wage growth. Thus, we believe that the BoJ will again have to lower its inflation projections at its 30-31 July meeting. The BoJ forecasts headline and core inflation will reach 2.3% and 1.8% y-o-y respectively in FY2019 (April-March). Separately, China's 2Q GDP data released earlier today showed that growth has moderated slightly to 6.7% y-o-y from 6.8% in 1Q, driven by softer fixed investment growth.

I. Recent Events and Data Releases

A. G4 Economies

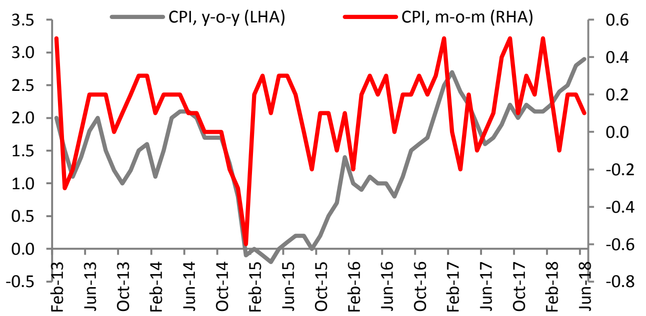
US: Annual core and headline CPI accelerate further in June

Core inflation strengthens to 2.3% y-o-y in June, remaining above Fed's 2% target

Core CPI inflation remained steady at 0.2% m-o-m in June, in line with market expectations. Nevertheless, annual core inflation accelerated to 2.3% y-o-y in June, from 2.2% in the previous month. The key drivers of monthly core inflation were medical services, new and used vehicles, primary and owners' equivalent rent and transportation services. However, the rise in these components was offset by a contraction in apparel prices and a drop in lodging-away-from-home prices. Headline inflation decelerated to 0.1% m-o-m in June (May: 0.2%), below the consensus expectation of 0.2%. The lower-than expected headline inflation was largely due to a surprise drop in energy prices, which contracted by 0.3% m-o-m in June (May: 0.9%). Despite the monthly moderation in headline inflation, the annual reading strengthened to 2.9% in June (May: 2.8%), in line with market expectations. Overall, the June inflation report supports our view that the Fed will continue to hike rates steadily in 2H, with a 25 bps FFTR hike in each of September and December.

Fig. 1. US: Headline inflation softens to 0.1% m-o-m in June, from 0.2% in May, due to surprise fall in gasoline price

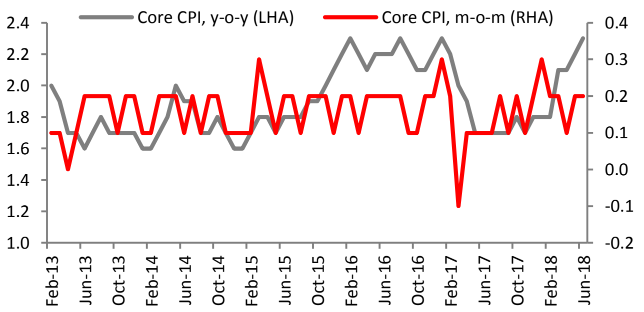
% change



Source: Bureau of Labor Statistics

Fig. 2. US: Core inflation in June in line with consensus estimate, remaining steady at 0.2% m-o-m

% change



Source: Bureau of Labor Statistics

Fed's monetary report consistent with two further rate hikes in 2H2018

Semi-annual monetary policy report: The Fed released its semi-annual monetary policy report to the congress last week. The report highlighted that further gradual increases in the FFTR rate will be consistent "with a sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective over the medium term". The report also underlined that higher oil prices will have less drag on the US economy now as compared to the past, due to rising US shale oil production.

US releases new list of potential Chinese goods for 10% import tariff

Tariffs on Chinese imports: The US released the details of the Chinese goods that are under consideration for a 10% tariff, worth USD200 billion. The list includes consumer goods such as air conditioners, apparel and electric vehicle batteries amongst others. The report highlighted that the implementation of these tariffs will be undertaken only after the conclusion of the public consultation process, which ends on 30 August. Thus the implementation of tariffs on these goods is only likely to occur in mid-September, at the earliest.

UK: Brexit white paper released – no major surprises

UK proposal looks to keep key benefit for its economy – maintaining most advantageous aspects

The UK government published its much awaited white paper on its vision for the future relationship between the UK and the EU. The plans elaborated in the paper were largely in line with the 12-point strategy agreed during the Chequers summit. The key takeaways are: i) establishment of free trade area for goods and agri-business between the UK and EU, though not services, ii) introduction of new "facilitated" customs agreement (such as no customs checks), iii) a new framework for labour movement though allowing UK and EU citizens to travel to each other's countries. The proposal of a free trade area for goods solves the hard border issue between Northern Ireland and Ireland. The UK government will look to agree new trade arrangements for the services sector – which accounts for c.80% of the UK economy. Thus, the free trade area for goods plan does not practically imply a soft Brexit, in our view. We believe that a much softer Brexit deal also looks very unlikely at this point, given the resignations of David Davis and Boris Johnson from the cabinet. Moreover, we expect the EU to push for further concessions during the negotiations, which could increase political uncertainty in the UK in the upcoming months. Even if the EU agrees Prime Minster Theresa May's proposals as presented, it remains to be seen how she will garner a majority of votes in the parliament for the deal, given the slim majority for the coalition government and dissenting pro-Brexit hardliners in the Conservative Party.

B. Emerging Market Economies

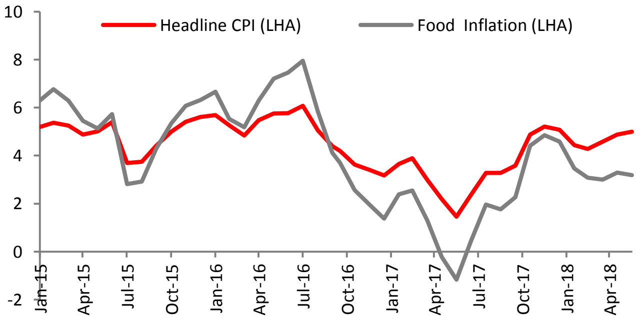
India: Headline inflation softer than expectations in June

Food inflation softens in June, partly offsetting rise in energy inflation

Headline inflation accelerated to 5% y-o-y in June (May: 4.9%), albeit below the consensus expectation of 5.3%. The lower-than-expected print was largely due to a deceleration in food inflation, which dipped to 3.2% y-o-y in June, from 3.3% in May. However, other major sub categories either remained sticky or strengthened further. Energy inflation increased sharply to 7.1% y-o-y (May: 5.8%) led by crude oil prices. The government fully passed through the higher oil prices to consumers in June, after keeping prices steady during the Karnataka state election (mid-April to mid-May). We believe that the central government will retain its fuel deregulation policy – given the upside risks to the current account and fiscal deficits. Core inflation (ex-food, fuel) also strengthened in June to 6.4% y-o-y from 6.2% in May. This was largely due to increased prices for educational services, household goods and services, and recreation.

Fig. 3. India: Headline inflation strengthens further in June, but comes in below market expectations

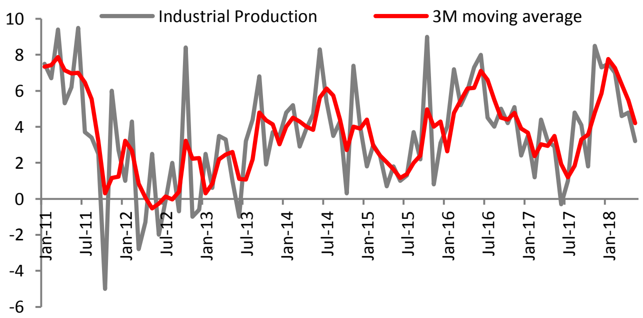
% change, y-o-y



Source: India Central Statistical Organisation

Fig. 4. India: Industrial production growth weakens in June, raising concerns about growth

% change, y-o-y



Source: India Central Statistical Organisation

We believe that the risks to the inflation outlook are skewed to the upside due to the INR's further depreciation and increase in minimum support prices for agricultural crops. Moreover, increased government spending ahead of the general elections in mid-2019 and the farm-loan waiver announced in Karnataka are expected to increase inflationary pressures in 2H2018 and early 2019. We expect the RBI to increase its repo rate by another 25 bps at its October meeting, as the MPC will have additional information related to the government's procurement policy for agricultural goods, monsoons and crude price developments (including the possibility of exemption from US sanctions on Iran). However, we cannot rule out an earlier and pre-emptive rate hike by the RBI at its August meeting.

We expect next 25 bps repo rate hike in October, rather than August

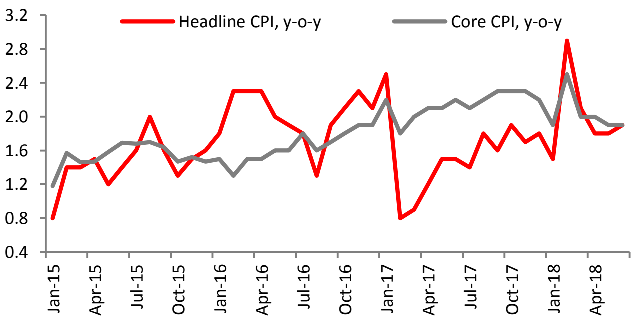
China: Headline CPI inflation rose marginally in June, led by food prices

CPI inflation accelerated to 1.9% y-o-y in June from 1.8% in May, in line with the consensus estimate. The increase in inflation was due to food and consumer goods prices. However, non-food price inflation remained steady at 2.2% y-o-y in June, with the rise in energy prices offset by a moderation in education and healthcare prices. Core CPI inflation also remained unchanged at 1.9% y-o-y. Importantly, producer price inflation (PPI) strengthened sharply to 4.7% y-o-y from 4.1% in May, beating the consensus estimate of 4.5%. The rise in PPI inflation was broad-based, with a sharp acceleration seen in mining & quarrying and raw material prices. The impact of trade tariffs is likely to push both consumer and producer prices slightly higher in the coming months, starting from July. In addition, the recent CNY depreciation against the dollar is expected to add further upside pressure to inflation in the near term. Despite the forecast contained uptick in prices due to tariffs and CNY depreciation, we expect headline CPI inflation to stay well below the PBoC's official target of 3% in 2018. Thus, we expect the PBoC to retain its "neutral and prudent" monetary policy stance while gradually reducing the reserve requirement ratio to support key industries.

Producer price inflation strengthened sharply in June to 4.7% y-o-y from 4.1% in May

Fig. 5. China: Headline inflation accelerated to 1.9% y-o-y in June from 1.8% in May, driven by food prices

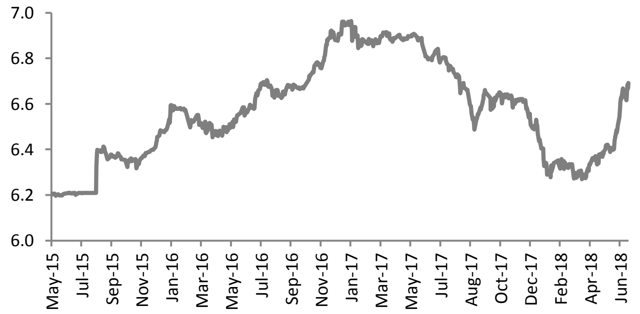
% change, y-o-y



Source: National Bureau of Statistics of China

Fig. 6. China: CNY weakened against dollar, as trade tensions escalate further

USD:CNY



Source: Bloomberg

Turkey: New cabinet ministers announced; central bank law amended

Recep Erdoğan announced his new cabinet ministers last week after being sworn in as president. Under the new presidential system, the cabinet has been reduced to 16 ministers from 26 in the previous government. The major surprise was the appointment of Erdogan's son-in-law Berat Albayrak as treasury and finance minister. The market's reaction was negative, with equity markets selling off and the TRY weakening. Concerns

Erdogan's son-in-law Berat Albayrak appointed as new treasury and finance minister related to central bank independence also flared up last week following the passage of a presidential decree to change the central bank law. According to the new rules: i) the CBRT governor's term will be reduced to four years, ii) the CBRT governor will have no say in appointing the deputy governor, and iii) deputy governors need not necessarily have a minimum of 10 years' experience in the field. Moreover, the president will have the power to appoint the heads of key institutions, including the central bank. We believe that the amended rules will reduce the autonomy of the central bank. We expect the CBRT to further hike its policy rate at its 24 July meeting and in 2H2018, while reiterating its intention to keep monetary conditions tight.

II. Economic Calendar

Fig. 7. The week ahead

Time*	Country	Event	Period	Prior	Consensus
Expected this week					
	UAE	M2 Money Supply, m-o-m	Jun	-0.7%	
	UAE	Central Bank Foreign Assets	Jun	326.6B	
	UAE	CPI, y-o-y	Jun	3.5%	
	Saudi Arabia	CPI, y-o-y	Jun	2.3%	
	Saudi Arabia	Non-Oil Exports, y-o-y	May	26.5%	
	Bahrain	CPI, y-o-y	Jun	2.8%	
	Qatar	CPI, y-o-y	Jun	0.5%	
	Egypt	Trade Balance	May	-3315M	
	Oman	Budget Balance Month	May	-56.9M	
	Kuwait	CPI, y-o-y	Jun	0.4%	
Monday, 16 July					
6:00	China	GDP, y-o-y	2Q	6.8%	6.7%
6:00	China	GDP SA, q-o-q	2Q	1.4%	1.6%
6:00	China	Retail Sales, y-o-y	Jun	8.5%	8.9%
6:00	China	Industrial Production, y-o-y	Jun	6.8%	6.5%
10:30	India	Wholesale Prices, y-o-y	Jun	4.4%	5.2%
16:30	US	Retail Sales Advance, m-o-m	Jun	0.8%	0.5%
16:30	US	Retail Sales Control Group	Jun	0.5%	0.4%
16:30	US	Empire Manufacturing	Jul	25	21
Tuesday, 17 July					
12:00	UK	BOE's Carney, Cunliffe, Stheeman Speak on Financial Stability			
12:30	UK	Claimant Count Rate	Jun	2.5%	
12:30	UK	Jobless Claims Change	Jun	-7.7K	
12:30	UK	Average Weekly Earnings, 3M/y-o-y	May	2.5%	2.5%
12:30	UK	Weekly Earnings ex-Bonus, 3M/y-o-y	May	2.8%	2.7%
12:30	UK	ILO Unemployment Rate, 3M	May	4.2%	4.2%
17:15	US	Industrial Production, m-o-m	Jun	-0.1%	0.5%
17:15	US	Capacity Utilization	Jun	77.9%	78.2%
18:00	US	Powell to Deliver Semi-Annual Testimony Before Senate Panel			
Wednesday, 18 July					
12:30	UK	CPI, m-o-m	Jun	0.4%	0.2%
12:30	UK	CPI, y-o-y	Jun	2.4%	2.6%
12:30	UK	CPI Core, y-o-y	Jun	2.1%	2.1%
13:00	Eurozone	CPI, y-o-y	Jun F	1.9%	2%
16:30	US	Housing Starts	Jun	1350K	1320K
18:00	US	Fed Chairman Powell Appears Before House Panel			
22:00	US	U.S. Federal Reserve Releases Beige Book			
Thursday, 19 July					
3:50	Japan	Trade Balance	Jun	-¥580.5B	¥531.2B
12:30	UK	Retail Sales, ex-Auto Fuel, m-o-m	Jun	1.3%	0.2%
12:30	UK	Retail Sales, ex-Auto Fuel, y-o-y	Jun	4.4%	3.7%
12:30	UK	Retail Sales, inc-Auto Fuel, m-o-m	Jun	1.3%	0.1%
12:30	UK	Retail Sales, inc-Auto Fuel, y-o-y	Jun	3.9%	3.5%
16:30	US	Philadelphia Fed Business Outlook	Jul	19.9	21.5
17:00	US	Fed's Quarles Speaks on Alternative Reference Rates			
18:00	US	Leading Index	Jun	0.2%	0.5%
Friday, 20 July					
3:30	Japan	National CPI, y-o-y	Jun	0.7%	0.8%
3:30	Japan	National CPI, ex-Fresh Food, y-o-y	Jun	0.7%	0.8%
8:30	Japan	All Industry Activity Index, m-o-m	May	1%	0%
16:00	US	Fed's Bullard Speaks on Economy and Monetary Policy			

* UAE time

Source: Bloomberg

Fig. 8. Last week's data

Time*	Country	Event	Period	Prior	Consensus	Actual
EM data						
	UAE	Dubai Airport Cargo Volume, y-o-y	May	-0.7%		-4.9%
	Bahrain	GDP Constant Prices, y-o-y	1Q	2.3%		-1.2%
	Oman	CPI, y-o-y	Jun	0.8%		1.4%
	Egypt	Urban CPI, y-o-y	Jun	11.4%		14.4%
	China	Money Supply M2, y-o-y	Jun	8.3%	8.4%	8%
	China	New Yuan Loans CNY	Jun	1150B	1535B	1840B
	India	Exports, y-o-y	Jun	20.2%		17.6%
Monday, 9 July						
3:50	Japan	BoP Current Account Balance	May	¥1845.1B	¥1266B	¥1938.3B
	China	Foreign Reserves	Jun	$3110.6B	$3101.8B	$3112.1B
Tuesday, 10 July						
3:50	Japan	Money Stock M2, y-o-y	Jun	3.2%	3.2%	3.2%
5:30	China	PPI, y-o-y	Jun	4.1%	4.5%	4.7%
5:30	China	CPI, y-o-y	Jun	1.8%	1.9%	1.9%
12:30	UK	Trade Balance	May	-£3087	-£3400	-£2790
12:30	UK	Industrial Production, m-o-m	May	-1.0%	0.5%	-0.4%
12:30	UK	Manufacturing Production, m-o-m	May	-1.3%	0.7%	0.4%
13:00	Eurozone	ZEW Survey Expectations	Jul	-12.6		-18.7
18:00	US	JOLTS Job Openings	May	6840	6620	6638
Wednesday, 11 July						
3:50	Japan	Core Machine Orders, m-o-m	May	10.1%	-5%	-3.7%
8:30	Japan	Tertiary Industry Index, m-o-m	May	1%	-0.3%	0.1%
16:30	US	PPI Final Demand, m-o-m	Jun	0.5%	0.2%	0.3%
16:30	US	PPI Final Demand, y-o-y	Jun	3.1%	3.1%	3.4%
18:00	US	Wholesale Inventories, m-o-m	May F	0.5%	0.5%	0.6%
Thursday, 12 July						
10:00	Germany	CPI EU Harmonized, y-o-y	Jun F	2.1%	2.1%	2.1%
13:00	Eurozone	Industrial Production SA, m-o-m	May	-0.8%	1.2%	1.3%
13:00	Eurozone	Industrial Production WDA, y-o-y	May	1.7%	2.4%	2.4%
16:00	India	CPI, y-o-y	Jun	4.9%	5.3%	5%
16:00	India	Industrial Production, y-o-y	May	4.8%	4.4%	3.2%
16:30	US	CPI, m-o-m	Jun	0.2%	0.2%	0.1%
16:30	US	CPI, y-o-y	Jun	2.8%	2.9%	2.9%
16:30	US	CPI, ex-Food and Energy, m-o-m	Jun	0.2%	0.2%	0.2%
16:30	US	CPI, ex-Food and Energy, y-o-y	Jun	2.2%	2.3%	2.3%
22:00	US	Monthly Budget Statement	Jun	-$146.8B	-$80B	-$74.9B
Friday, 13 July						
8:30	Japan	Industrial Production, m-o-m	May F	-0.2%		-0.2%
8:30	Japan	Capacity Utilization, m-o-m	May	1.8%		-2.1%
16:30	US	Import Price Index, m-o-m	Jun	0.9%	0.1%	-0.4%
18:00	US	University of Michigan Sentiment	Jul P	98.2	98	97.1
	China	Trade Balance	Jun	$24.2B	$27.2B	$41.6B
	China	Exports, y-o-y	Jun	12.2%	9.5%	11.3%
	China	Imports, y-o-y	Jun	26%	21.3%	14.1%

* UAE time
Source: Bloomberg

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