

The Week Ahead: Central banks in focus - Fed minutes and Carney's testimony

► **US: January FOMC minutes and Fed speakers**

Focus this week will be on the FOMC minutes and speeches by key Fed members, including William Dudley, Randal Quarles and John Williams. The tone of the speakers will be particularly important after last week's surprise pick-up in January CPI inflation. We expect Fed members to continue to suggest a steady pace of monetary tightening, albeit expressing confidence that inflation will gradually accelerate especially given the expansionary fiscal policy. The January FOMC minutes will also likely reflect the rising confidence on inflation expectations, similar to the tweaks in the language seen in the January meeting statement that pointed to a more moderately hawkish tone. The minutes will also likely outline the solid economic momentum and tight labour market conditions. A discussion on alternative monetary policy, such as nominal GDP targeting, is also likely given the increasing focus of some FOMC members on the topic. On Friday the Fed publishes its semi-annual monetary policy report to congress, the first under Jerome Powell.

► **Europe: Carney's testimony, UK labour data and ECB minutes**

BoE Governor Mark Carney is to testify to Parliament's Treasury Committee on 21 February, alongside Deputy Governor Ben Broadbent and Chief Economist Andy Haldane. We expect the testimonies to reflect the recent more hawkish tone of the BoE, including the need to increase interest rates at a faster pace than envisaged especially given the tight labour market conditions. Thus, labour market data for December (released on 21 February), particularly wage growth, will be scrutinised closely. Consensus is expecting a broadly steady trend for December, with weekly earnings growth expected to have remained stable at 2.5% y-o-y and unemployment remaining at 4.3%. The UK will also release the second print of 4Q GDP growth, which is expected to have remained at 0.5% q-o-q, the same as the first estimate. Meanwhile, the ECB will publish its January meeting minutes on 22 February. We expect the bank to express concern over the recent EUR appreciation and its impact on the medium-term inflation outlook, as highlighted by ECB President Mario Draghi during the press conference. We envisage limited changes to forward guidance at this point, but rather expect adjustments in March with the release of new economic forecasts.

► **Egypt: CBE starts easing cycle by cutting rates by 100 bps**

The CBE started its interest rate easing cycle at its monetary policy meeting on 15 February, lowering benchmark interest rates by 100 bps. The central bank's overnight deposit rate now stands at 17.75% and the overnight lending rate at 18.75%. We continue to expect a further 200-300 bps of rate cuts by the CBE in 2018, supported by a further moderation of inflation. We see the next rate cut likely at the 29 March meeting, again by 100 bps, which should give the bank sufficient time to gauge the impact of this rate cuts on portfolio flows. We believe that portfolio flows will be key to the pace and depth of the easing cycle, alongside inflation and further fiscal reforms.

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Contents

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

I. Recent Events and Data Releases

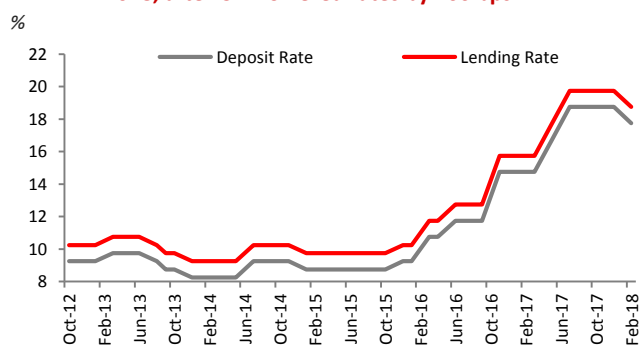
A. MENA Economies

Egypt: CBE starts easing cycle by cutting rates by 100 bps

The CBE started its interest rate easing cycle at its monetary policy meeting on 15 February, lowering benchmark interest rates by 100 bps. This was in line with our expectations. The central bank's overnight deposit rate now stands at 17.75% and the overnight lending rate at 18.75%. This was the first step to normalise interest rates, after the CBE raised benchmark rates by 700 bps between November 2016 and mid-2017, to reduce a secondary buildup in inflationary pressure following the EGP devaluation and increases in administered prices. In its post-meeting statement, the central bank noted that the rate cut was supported by the moderation in underlying inflationary pressure. However, the statement still highlighted the need for "tight real monetary conditions; a necessary requirement to achieve the inflation target of 13% (± 3 percent) in 4Q2018 and single digits thereafter". From a growth perspective, we see the rate cut as a positive signal on the start of the easing cycle. However, at this stage, we do not expect a boost to economic activity as interest rates remain high. Deeper cuts to rates will be required, in our view. We continue to expect a further 200-300 bps of rate cuts by the CBE in 2018, supported by a further moderation of inflation. We see the next rate cut likely at the 29 March meeting, again by 100 bps, which should give the bank sufficient time to gauge the impact of this rate cuts on portfolio flows.

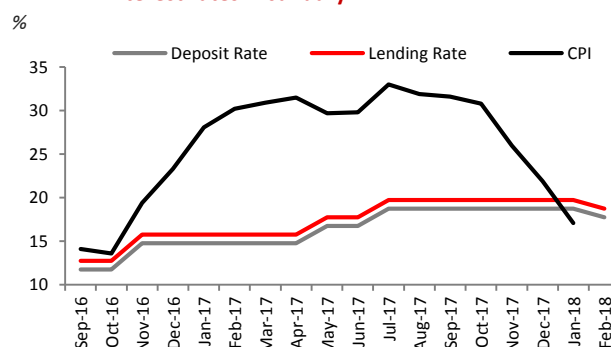
Deeper cuts to rates required to boost economic activity

Fig. 1. Egypt: We expect further 200-300 bps of rate cuts in 2018, after CBE lowered rates by 100 bps



Source: Central Bank of Egypt

Fig. 2. Egypt: Monetary policy remains tight with positive real interest rates in January



Source: Central Bank of Egypt, CAPMAS

A further moderation in inflation should support more rate cuts. We expect inflation to continue to decelerate as previous fiscal reforms and EGP devaluation continue to work out of the data. Moreover, we see ample spare capacity in the economy and expect still tight monetary policy to keep the build-up in price pressure contained. Indeed, real interest rates returned to positive territory in January (Fig. 2) due to the fall in inflation. Meanwhile, we believe that a relatively stable EGP rate against the USD should help to contain imported inflation. The government's international bond issuance plans will likely support Egypt's FX reserve position, and in turn the EGP, even if there is some volatility in portfolio inflows due to the expected rate cuts. Earlier last week, the government issued USD4 billion of international bonds, a sale that was oversubscribed by three times. Moreover, only a part of portfolio inflows into Egypt were included in official FX reserves, with the remainder kept separately as other foreign currency assets.

Portfolio flows will also be key factor in determining pace of interest rate cuts

This reduces any potential volatility in capital inflows feeding into the EGP. Nevertheless, we believe that the portfolio flows will be central to the pace and depth of the easing cycle, alongside inflation and further fiscal reforms. We believe that the still substantial interest rate differential should be supportive for foreign T-bill investors. This is especially as we do not expect the CBE to unwind the full 700 bps of rate hikes seen between November 2016 and mid-2017. Meanwhile, we expect further increases in fuel prices in 2H2018.

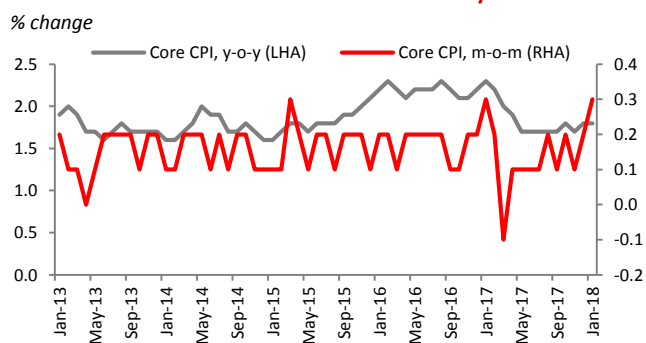
B. G4 Economies

US: January inflation surprises to upside but retail sales contract

Both headline and core inflation surprised to the upside in January. Headline inflation accelerated to 0.5% m-o-m in January (December: 0.2%), beating the consensus expectations of 0.3%. Core inflation also picked up to 0.3% m-o-m in January (unrounded: 0.349%; December and consensus: 0.2%). Despite the monthly rise in headline and core inflation, the yearly rate remained stable at 2.1% y-o-y and 1.8% respectively. The acceleration in monthly inflation was largely broad-based with notable increases in apparel, shelter, gasoline, transportation and medical services prices. The monthly rise was mainly due to the residual seasonality bias in January, which in our view is very unlikely to be sustained in the coming months. Nevertheless, we still believe that core CPI inflation will pick up meaningfully from March on a yearly basis, as the one-off decline in wireless telephone prices drops out of the calculation. We also expect core goods inflation to increase in 2018 as the falling USD is likely to push up import costs. However, we do not see inflation overshooting the Fed’s target of 2% significantly in 2018.

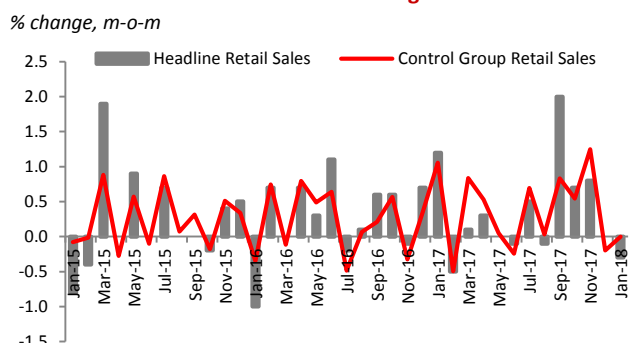
Core inflation accelerated to 0.3% m-o-m in January

Fig. 3. US: Monthly rise in core inflation largely driven by residual and one-off factors in January



Source: Bureau of Labor statistics

Fig. 4. US: Headline retails sales contract in January, mainly due to fall in autos and building materials



Source: US Census Bureau

The reaction of global markets to the higher-than-expected inflation print was muted due to the weak retail sales data for January, which was released on the same day. Meanwhile, retail sales contracted by 0.3% m-o-m in January (consensus: 0.2%) after remaining flat in December. The soft report was a surprise given the strong economic fundamentals. The retail sales control group, which feeds into the GDP data, came in at 0% m-o-m, likely impacting economic growth in 1Q2018. Notably, motor vehicles, construction materials and furniture sales declined whilst electronics, clothing and general merchandise sales increased. We believe that the Fed will remain cautious in how it interprets the softer retail sales and higher inflation report in January, whilst it

Retail sales unexpectedly fell in January

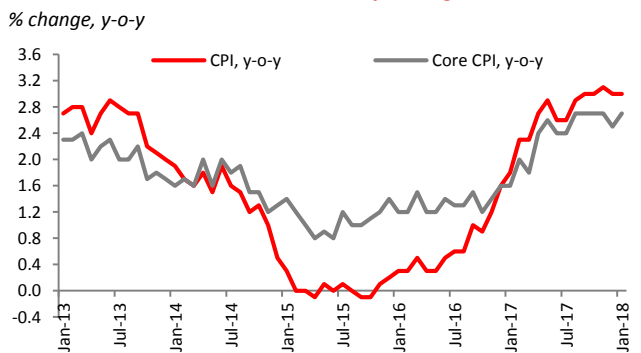
awaits more data points. Thus, we do not expect any changes in the Fed's guidance at this point and expect three 25 bps FFTR hikes in 2018 (March, June and December).

UK: Core inflation beats expectations in January

Headline inflation remained unchanged at 3% y-o-y in January, surprising the market, which had expected a moderation to 2.9%. This is the fifth consecutive reading of headline inflation at or above 3%. Moreover, core inflation accelerated to 2.7% y-o-y in January (December: 2.5%; consensus: 2.6%) driven by volatile airfare costs and recreational prices. We believe that these temporary factors are likely to fade in the coming months. Moreover, there were no major signs of a pick-up in domestic inflationary pressure, as reflected in rental prices remaining weak. Moreover, we expect inflation to ease gradually on the back of the fading GBP pass-through effect and lower energy prices (in GBP terms). We see headline inflation decelerating towards the BoE's 2% target by the end of 2018.

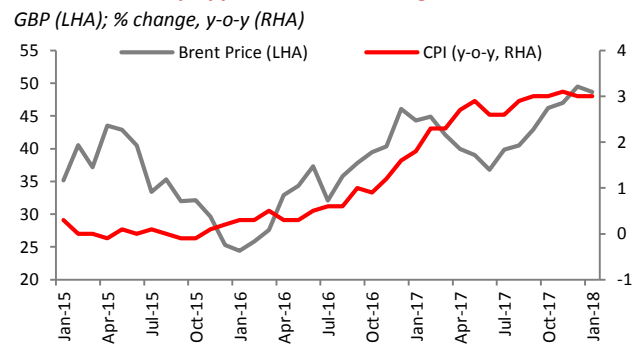
Core inflation accelerated in January, supporting BoE's hawkish tone

Fig. 5. UK: January rise in core inflation supportive of 25bps benchmark rate hike in May or August



Source: UK Office for National Statistics

Fig. 6. UK: Brent price in GBP terms declines in January due to sharp appreciation of sterling



Source: Bloomberg, UK Office for National Statistics

We believe that the January inflation report will further strengthen the BoE's hawkish stance. Headline inflation is expected to remain above the 2% inflation target despite expectations of a gradual deceleration going forward, supporting interest rate hikes in either May or August. The recent communication from MPC members also suggests that interest rate hikes could come at a faster pace than market expectations. Thus, we now expect the BoE to hike interest rates gradually with one 25 bps hike in 2018 and two in 2019. However, we believe that the outcome of the Brexit negotiations and the UK's level of access to the EU during the transition period will remain crucial in gauging the inflation and growth outlook.

We expect 25bps interest rate hike in May or August

Japan: GDP growth softens in 4Q but outlook remains firm

Japan's GDP growth slowed to 0.1% q-o-q in 4Q, lower than the consensus estimate of 0.2% and 3Q's 0.6%. Despite this moderation, real GDP growth has now expanded for an eighth consecutive quarter, marking the longest period of economic expansion in Japan in almost three decades. The growth in 4Q was mainly driven by consumption activity, which rebounded from a contraction in 3Q. Investment activity also remained firm, particularly non-residential investments. The deceleration in q-o-q GDP growth was

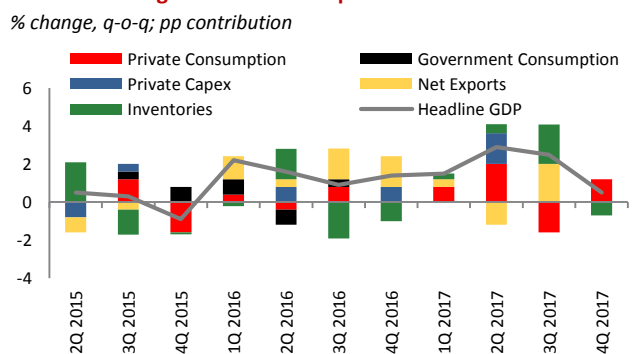
Japanese economy moderated in 4Q, though remains in expansionary zone

mainly due to a negligible contribution net exports and a drag from inventories. Imports grew at a slightly faster pace than exports, though this reflected the pickup in household spending, higher fuel imports and a favourable base effect. Moreover, the drawdown in inventories in 4Q2017 could be supportive of GDP growth in early 2018, especially if there is momentum building in domestic and external demand.

On an annual basis, real GDP growth accelerated to 1.6% in 2017 (2016: 0.9%) with broad-based drivers. Household consumption was strengthened in 2017, whilst synchronised global growth further boosting exports and non-residential investment. We believe that this positive growth momentum will likely continue into 2018 as both fiscal and monetary policy remain accommodative. The passage of an additional spending bill (JPY2.7 trillion) on 1 February will further boost public demand in 2018. Despite Japan’s growth outlook, underlying inflationary pressures remain subdued and are only likely to pick up gradually, in our view. Thus, we expect the BoJ to keep its monetary policy unchanged until at least 3Q2018 with any change in yield curve control or forward guidance only likely after the government announces the end of deflation. The reappointment of BoJ Governor Haruhiko Kuroda for another term last week also suggests continuation of accommodative monetary policy, in our view.

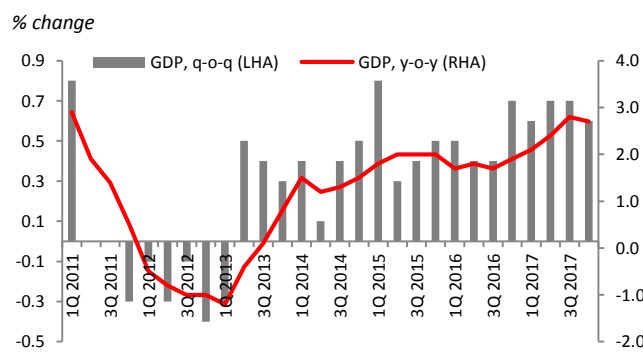
Kuroda’s reappointment as BoJ governor suggests continuation in expansionary monetary policy

Fig. 7. Japan: GDP growth moderates in 4Q albeit expanding for eighth consecutive quarter



Source: Economic and Social Research Institute Japan

Fig. 8. Eurozone: Headline GDP solid in 4Q, despite regional variations



Source: Eurostat

Eurozone: 4Q GDP data suggests growth momentum remains steady

Eurozone 4Q GDP growth was unrevised at 0.6% q-o-q in the second estimate, albeit with some regional variations. This was slightly weaker than the previous two quarters’ growth of 0.7% q-o-q as German and Italian economic growth moderated marginally from 3Q. However, France, the Netherlands and Portugal recorded stronger growth in 4Q, suggesting that the drivers were broad-based. We believe that this solid economic momentum will continue to feed positively into the 2018 figures. Meanwhile, the detailed breakdown of GDP by expenditure will be available on 7 March.

Eurozone growth remains solid, with pick-up in peripheral economies

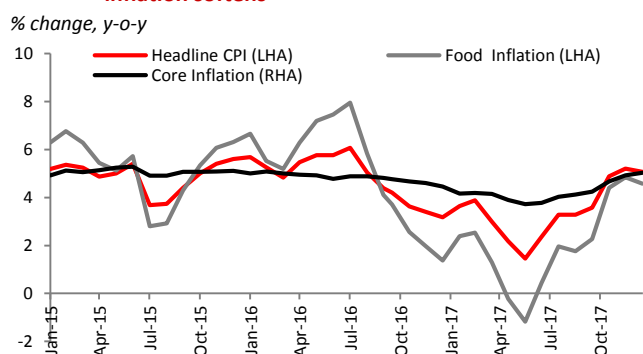
C. Emerging Market Economies

India: Inflation eases marginally in January, driven by soft food prices

India's inflation showed initial signs of moderation in January with headline inflation easing to 5.1% y-o-y from 5.2% in December. This is the first deceleration since July 2017 and in line with the consensus estimate. The softening in inflation was mainly due to food price inflation, which decelerated to 4.6% y-o-y in January from 4.9% in December. We expect food inflation to ease further in February with the arrival of a new harvest, which is likely to ease vegetable prices. However, fuel price inflation remained elevated at 7.7% in January (December: 7.9%) on the back of higher crude prices. Meanwhile, core inflation remained steady at 5.3% in January, driven by the positive contribution from the government's house rent allowances.

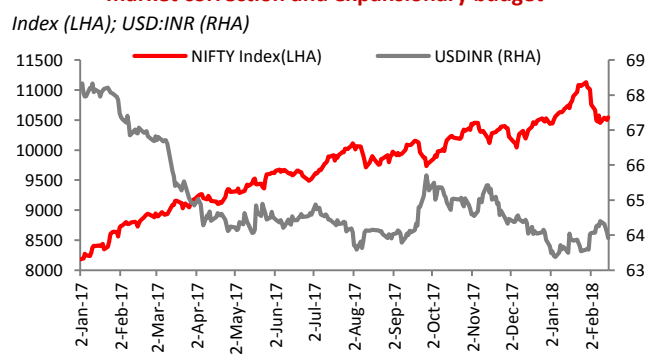
Headline inflation moderated in January, in line with expectations

Fig. 9. India: Headline inflation moderates in January as food inflation softens



Source: India Central Statistical Organisation

Fig. 10. India: INR remains broadly stable despite equity market correction and expansionary budget



Source: Bloomberg

Despite the moderation in food prices expected in the coming months, the inflation outlook is surrounded by a number of uncertainties, in our view. The government's proposal to increase the minimum support price for agricultural goods and its expansionary fiscal policy, as well as volatile crude prices and an increase in house rent allowances, are likely to feed inflationary pressures in 1H2018. On the downside, the reduction of GST rates on approximately 200 items could weaken core inflation, although this largely depends on producers passing through the benefits to consumers. Overall, we expect the RBI to remain on hold in 1H2018 with inflation projected to remain elevated in the range of 5.1-5.6%.

RBI to remain on hold in 1H2018

II. Economic Calendar

Fig. 11. The week ahead

Time*	Country	Event	Period	Prior	Consensus
MENA data					
	UAE	M2 Money Supply, m-o-m	Jan	2.2%	
	UAE	Central Bank Foreign Assets	Jan	347.7B	
	UAE	CPI, y-o-y	Jan	2.7%	
	UAE	CPI, m-o-m	Jan	0.7%	
	Saudi Arabia	CPI, y-o-y	Jan	0.4%	
	Saudi Arabia	Non-Oil Exports, y-o-y	Dec	18.2%	
	Bahrain	M2 Money Supply, y-o-y	Dec	2.8%	
	Bahrain	CPI, y-o-y	Jan	1.4%	
	Oman	Oil Output, y-o-y	Jan	-1.2%	
	Oman	Budget Balance Month	Dec	-97.5M	
	Kuwait	CPI, y-o-y	Jan	1.1%	
	Egypt	Trade Balance	Dec	-2856M	
	Egypt	Production Index, m-o-m	Jan	-1.8%	
Monday, 19 Feb					
3:50	Japan	Trade Balance	Jan	¥359B	-¥1020.3B
13:00	Eurozone	ECB Current Account SA	Dec	32.5B	
Tuesday, 20 Feb					
14:00	Germany	ZEW Survey Current Situation	Feb	95.2	94
19:00	Eurozone	Consumer Confidence	Feb A	1.3	1
Wednesday, 21 Feb					
8:30	Japan	All Industry Activity Index, m-o-m	Dec	1%	0.4%
13:00	Eurozone	Markit Eurozone Manufacturing PMI	Feb P	59.6	59.2
13:30	UK	Claimant Count Rate	Jan	2.4%	
13:30	UK	Jobless Claims Change	Jan	8.6K	
13:30	UK	Average Weekly Earnings, 3M/y-o-y	Dec	2.5%	2.5%
13:30	UK	Weekly Earnings, ex-bonus, 3M/y-o-y	Dec	2.4%	2.4%
13:30	UK	ILO Unemployment Rate, 3M	Dec	4.3%	4.3%
13:30	UK	Employment Change, 3M/3M	Dec	102K	180K
18:00	US	Fed's Harker Speaks on the Economic Outlook			
18:15	UK	BOE's Carney, Broadbent, Haldane and Tenreyro Speaks			
18:45	US	Markit US Manufacturing PMI	Feb P	55.5	55.5
19:00	US	Existing Home Sales	Jan	5.6M	5.6M
23:00	US	FOMC Meeting Minutes	31-Jan		
Thursday, 22 Feb					
09:15	US	Fed's Quarles to Speak on Global Economy			
13:00	Germany	IFO Business Climate	Feb	117.6	117
13:30	UK	GDP, q-o-q	4Q P	0.5%	0.5%
13:30	UK	GDP, y-o-y	4Q P	1.5%	1.5%
19:00	US	Leading Index	Jan	0.6%	0.7%
19:00	US	Fed's Dudley to Speak at New York Fed Briefing			
21:10	US	Fed's Bostic Speaks at Banking Conference in Atlanta			
Friday, 23 Feb					
3:30	Japan	National CPI, y-o-y	Jan	1%	1.3%
3:30	Japan	National CPI, ex-fresh food, y-o-y	Jan	0.9%	0.8%
11:00	Germany	GDP SA, q-o-q	4Q F	0.6%	0.6%
14:00	Eurozone	CPI Core, y-o-y	Jan F	1%	1%
14:00	Eurozone	CPI, y-o-y	Jan F	1.4%	1.3%
19:15	US	Fed's Dudley and Rosengren speak on Fed Balance Sheet			
21:10	US	Fed's releases February Monetary Policy report to Congress			

* UAE time

Source: Bloomberg

Fig. 12. Last week's data

Time*	Country	Event	Period	Prior	Consensus	Actual
EM data						
	Qatar	CPI, y-o-y	Jan	0.6%		0.9%
	Oman	CPI, y-o-y	Jan	1.7%		1.1%
	Egypt	Lending Rate	15-Feb	19.75%		18.75%
	Egypt	Deposit Rate	15-Feb	18.75%	17.75%	17.75%
	China	Money Supply M2, y-o-y	Jan	8.2%	8.2%	8.6%
	China	Aggregate Financing CNY	Jan	1139.8B	3150B	3060B
	China	New Yuan Loans CNY	Jan	584.4B	2050B	2900B
	India	CPI, y-o-y	Jan	5.2%	5.1%	5.1%
	India	Industrial Production, y-o-y	Dec	8.8%	6.0%	7.1%
	India	Exports, y-o-y	Jan	12.4%		9.1%
Monday, 12 Feb						
23:00	US	Monthly Budget Statement	Jan	\$51.3B	\$51B	\$49.2B
Tuesday, 13 Feb						
3:50	Japan	PPI, y-o-y	Jan	3%	2.8%	2.7%
13:30	UK	CPI, m-o-m	Jan	0.4%	-0.6%	-0.5%
13:30	UK	CPI, y-o-y	Jan	3%	2.9%	3%
13:30	UK	CPI Core, y-o-y	Jan	2.5%	2.6%	2.7%
13:30	UK	RPI, m-o-m	Jan	0.8%	-0.7%	-0.8%
13:30	UK	PPI Output NSA, m-o-m	Jan	0.4%	0.2%	0.1%
13:30	UK	PPI Output NSA, y-o-y	Jan	3.3%	3%	2.8%
15:00	US	NFIB Small Business Optimism	Jan	104.9	105.3	106.9
Wednesday, 14 Feb						
3:50	Japan	GDP SA, q-o-q	4Q P	0.6%	0.2%	0.1%
3:50	Japan	GDP Annualized SA, q-o-q	4Q P	2.2%	1%	0.5%
11:00	Germany	GDP SA, q-o-q	4Q P	0.8%	0.6%	0.6%
11:00	Germany	CPI EU Harmonized, y-o-y	Jan F	1.4%	1.4%	1.4%
14:00	Eurozone	Industrial Production SA, m-o-m	Dec	1.3%	0.1%	0.4%
14:00	Eurozone	GDP SA, q-o-q	4Q P	0.6%	0.6%	0.6%
14:00	Eurozone	GDP SA, y-o-y	4Q P	2.7%	2.7%	2.7%
17:30	US	CPI, m-o-m	Jan	0.2%	0.3%	0.5%
17:30	US	CPI, y-o-y	Jan	2.1%	1.9%	2.1%
17:30	US	CPI, ex-Food and Energy, m-o-m	Jan	0.2%	0.2%	0.3%
17:30	US	CPI, ex-Food and Energy, y-o-y	Jan	1.8%	1.7%	1.8%
17:30	US	Retail Sales Advance, m-o-m	Jan	0%	0.2%	-0.3%
17:30	US	Retail Sales, ex-auto, m-o-m	Jan	0.1%	0.5%	0%
17:30	US	Retail Sales Control Group	Jan	-0.2%	0.4%	0%
Thursday, 15 Feb						
3:50	Japan	Core Machine Orders, m-o-m	Dec	5.7%	-2%	-11.9%
8:30	Japan	Industrial Production, m-o-m	Dec F	2.7%		2.9%
14:00	Eurozone	Trade Balance SA	Dec	22B	22.3B	23.8B
17:30	US	Empire Manufacturing	Feb	17.7	18	13.1
17:30	US	PPI Final Demand, m-o-m	Jan	0.0%	0.4%	0.4%
17:30	US	PPI Final Demand, y-o-y	Jan	2.6%	2.4%	2.7%
18:15	US	Industrial Production, m-o-m	Jan	0.4%	0.2%	-0.1%
Friday, 16 Feb						
13:30	UK	Retail Sales, ex-auto fuel, m-o-m	Jan	-1.5%	0.6%	0.1%
13:30	UK	Retail Sales, inc-auto fuel, m-o-m	Jan	-1.4%	0.5%	0.1%
17:30	US	Import Price Index, m-o-m	Jan	0.2%	0.6%	1%
17:30	US	Housing Starts	Jan	1209K	1234K	1326K
17:30	US	Building Permits	Jan	1300K	1300K	1396K
19:00	US	University of Michigan Sentiment	Feb P	95.7	95.5	99.9

* UAE time

Source: Bloomberg

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