

## The Week Ahead: Powell's semi-annual testimony in spotlight

### ► **US: Central bank comments and PCE inflation data in focus**

The key event this week will be Fed Chair Jerome Powell's first semi-annual monetary policy testimony to Congress (27 and 28 February). Attention will particularly be on the Q&A session, which could provide some insight into his views and priorities on inflation and his interest rate outlook. We believe that the speech will be in line with the Fed's semi-annual monetary policy report and FOMC minutes released last week (page 3), highlighting continued gradual monetary tightening. We expect Powell's comments to still suggest three rate hikes this year, whilst expressing increasing confidence in the US growth outlook. There will be particular interest in any comments on the impact of fiscal stimulus on the economy and financial conditions following the recent market selloff. Important US data releases this week will be PCE inflation, durable goods orders (both for January), 4Q GDP (second print) and February's ISM manufacturing. Core PCE inflation is expected to have accelerated to 0.3% m-o-m in January (December: 0.2%), driven by healthcare, apparel and transportation services. Personal spending growth likely decelerated to 0.2% m-o-m in January, partly reflecting weaker retail sales post the holiday season.

### ► **Italy: Polls see no clear winner but Berlusconi holds the cards**

Italian voters head to the polls on 4 March to elect both houses of parliament. The latest polls suggest that none of the parties will secure a majority with both the centre-right and centre-left coalitions falling short. The anti-establishment party, Five Star Movement, is likely to receive the highest individual share of the vote though no other major party is likely to form a coalition with it. Political commentators were expecting a grand coalition between Silvio Berlusconi's Forza Italia (FI) and Matteo Renzi's Democratic Party (PD). However, both Berlusconi and Renzi ruled out any such alignment last week, creating more uncertainty over the outcome. The other possibility will be a centre-right coalition, including FI and North League (NL). However, this coalition also faced a severe roadblock last week with Berlusconi and Matteo Salvini (NL leader) skipping a unity rally due to their differences over the nomination for prime minister. Given Berlusconi's ban on running for public office before 2019, the vote share of the PD, FI and NL will remain critical to the formation of any new government.

### ► **Global: Draghi speech and India's 4Q GDP data**

Focus will also be on ECB President Mario Draghi's comments at the European Parliament and Luis de Guindos' hearing for the ECB vice president role. We expect Draghi's comments to be on the moderately bearish side, in line with the tone of the ECB's January meeting released last week (page 5). We expect Draghi to reiterate the need for patience until there are more meaningful signs of inflationary pressure. Meanwhile, the consensus expects Eurozone inflation to have moderated to 1.2% y-o-y in February (January: 1.3%), with lower energy prices and food price related base effect. Separately, India will release its 4Q GDP data, which is forecast to have accelerated to 6.9% y-o-y, from 6.3% in 3Q, reflecting the fading effects of GST implementation.

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# I. Recent Events and Data Releases

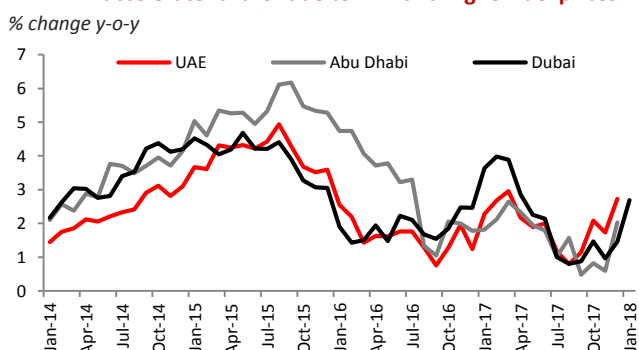
## A. MENA Economies

### UAE: Dubai inflation accelerates in January on VAT introduction

Dubai’s consumer price inflation accelerated in both monthly and yearly terms in January, reflecting the introduction of VAT and higher fuel prices. The CPI rose by 2.7% y-o-y in January (December: 1.5%) and by 2% m-o-m (December: 0.4%). The components driving the rise in inflation reflected the sectors where the 5% VAT rate was introduced. This included food (up 3.4% m-o-m, 6% y-o-y in January) and clothing (up 3% m-o-m, 7.6% y-o-y). The strengthening in clothing prices likely also reflected the weaker USD, which would have resulted in higher imported inflation. Moreover, transportation inflation strengthened by 5.6% m-o-m (10.7% y-o-y) with the higher crude oil prices feeding into domestic pump prices.

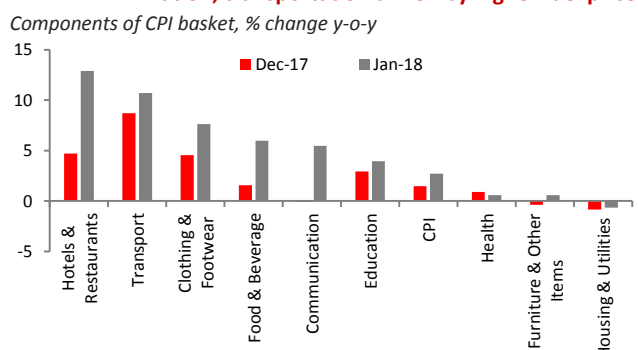
*Headline inflation strengthened to 2.7% y-o-y in January, up from 1.5% in December*

**Fig. 1. UAE: Inflation already rising at end-2017 and to accelerate further due to VAT and higher fuel prices**



Source: Federal Competitiveness and Statistics Authority, Statistics Centre of Abu Dhabi, Dubai Statistics Center, ADCB calculations

**Fig. 2. Dubai: Components where VAT introduced saw jump in inflation; transportation driven by higher fuel price**



Source: Dubai Statistics Center

The rise in inflation was limited by the fact that a number of key sectors in the economy were either exempt or zero rated – including areas such as residential rents, transportation, education, and healthcare. We believe that this reflects the government’s aim of balancing raising government revenue with supporting key sectors of the economy. The continued fall in rental prices is also limiting the rise in inflation. However, the introduction of VAT (or increase in the rate) in other countries shows that it can take a few months for inflation to feed into prices, especially given the weak demand following the introduction of the tax. We take this into account for our UAE-wide annual average inflation forecast of 3.4% in 2018, up from 2% in 2017. We expect the stronger inflation rate in 2018 and higher interest rates to dampen consumer demand in 2018. We see the Central Bank of the UAE to follow the Fed by raising its benchmark repo rate three times this year.

*Higher inflation and rate hikes to dampen consumer demand in 2018*

## B. G4 Economies

### US: FOMC minutes highlight rising confidence in economic outlook

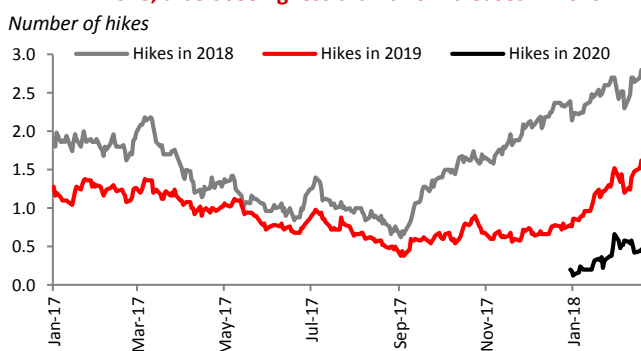
The minutes of the FOMC's January meeting suggest that several members are increasingly confident that the economic momentum is solid, with tax cuts expected to provide additional support. The FOMC members also agreed that "the strengthening in the near-term economic outlook increased the likelihood that a gradual upward trajectory of the federal funds rate would be appropriate". Reflecting the greater confidence, the phrase "further gradual increases" was added to the post-meeting statement. We believe this supports a 25 bps FFTR hike in March. However, we do not see that "further" implies faster rate hikes in 2018 and continue to see three 25 bps rate hikes for the year (as in 2017). We also expect comments by new Fed Chair Jerome Powell to suggest three rate hikes for 2018 during his first testimony to Congress this week. Indeed, the Fed's semi-annual monetary policy report released on 23 February, was in line with the FOMC's communication. The report will serve as the basis for Powell's congressional testimony. The report highlighted the solid economic momentum in 2H2017, though noted that inflation remained below the Fed's target.

*January minutes support outlook for 25 bps rate hike in March 2018*

Despite the confidence over the near-term economic outlook, the minutes highlighted continuing differences over the inflation outlook within the FOMC. Several members observed that "they saw both upside and downside risks to the inflation outlook, and members agreed to continue to monitor inflation developments closely". This clearly suggests that Fed members are still not very confident about the inflation outlook. Nevertheless, the FOMC's language on inflation in its January minutes predates both the stronger-than-expected wage inflation and CPI readings for January, thus this calls for some caution in reading between the lines. Moreover, the minutes were published prior to the announcement of the infrastructure spending plans, which could add greater stimulus to the US economy. We believe that the pick-up in inflation in January was driven by one-off factors and therefore only expect a meaningful increase from March as the base effect of wireless telephone services fades from the calculation.

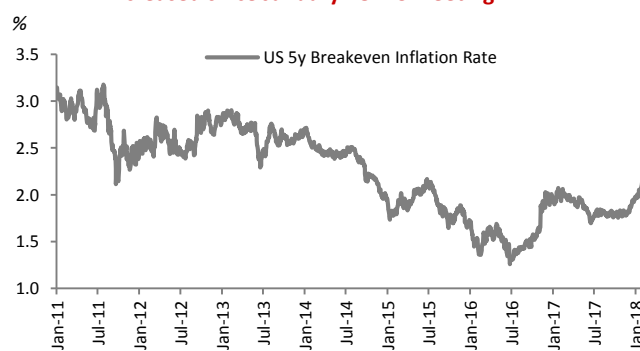
*FOMC divided over inflation outlook with some members expressing risk of undershooting*

**Fig. 3. US: Market has almost priced in three 25 bps hikes in 2018, albeit seeing less than two increases in 2019**



Source: Bloomberg; ADCB estimates

**Fig. 4. US: Market-based inflation expectations have increased since January FOMC meeting**



Source: Bloomberg

At the January meeting, Fed economists presented various briefings on inflation analysis and forecasting. The staff highlighted that several factors beyond those captured in the models appeared to have put downwards pressure on prices in recent years, including structural changes and idiosyncratic price shocks. Following the presentations, FOMC participants engaged in a detailed discussion on inflation frameworks, with a number of

*Fed still sees usefulness in Phillips curve-type inflation framework*

members highlighting the importance of the underlying 2% inflation objective as a symmetric target. The FOMC members also mostly agreed that a “Phillips curve-type of inflation framework” remained useful in understanding inflation dynamics.

### UK: Unemployment rises in December

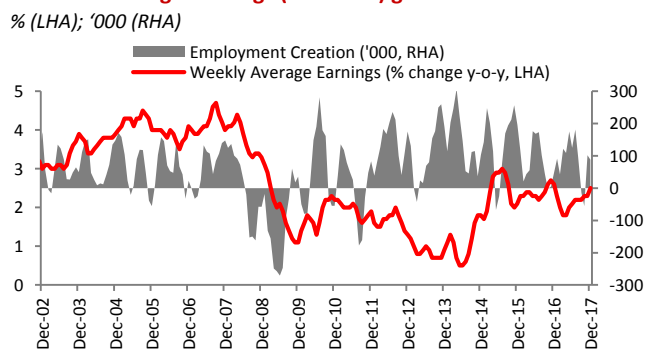
UK labour market data for December provided no signs of a pick-up in wage growth, at this point. This was particularly important as the BoE cited tight labour market conditions as a primary reason for calling for a faster pace of interest rate hikes at its February meeting. In a surprise development, the headline unemployment rate rose to 4.4% in the three months to December, above the consensus estimate and November print of 4.3%. This was the first increase in the headline rate since August 2016 and the biggest rise since 2013. The pick-up in the unemployment rate was mainly due to an increased participation rate. Nevertheless, employment gains continued in December, albeit at a slower pace of 88K (November: 102K; consensus: 165K). Average weekly earnings growth was steady at 2.5% 3M/3M y-o-y in December whilst wage growth ex-bonuses accelerated to 2.5% y-o-y (November: 2.3%; consensus: 2.4%).

*Unemployment rate increased to 4.4% in December*

After the weak labour report, BoE Governor Mark Carney testified before parliament and reiterated that the BoE now anticipates rate hikes to be somewhat greater and somewhat sooner than they had expected in November. However, Carney refused to disclose the exact timing of the next rate hike and kept options open for a 25 bps hike either in May or in August. We expect the BoE to proceed with one rate hike in 2018, though believe that it will require the data to reflect some pickup in wages. Meanwhile, BoE Chief Economist Andrew Haldane highlighted a “slow build-up” in underlying price pressures but added that economic slack is close to being absorbed. He also added that the BoE expects wage growth to accelerate to 3% y-o-y by the end of 1Q2018 (due to base effects) with a “pretty slow” increase from that level thereafter. We expect wage growth to remain subdued until there is further clarity on any Brexit deal.

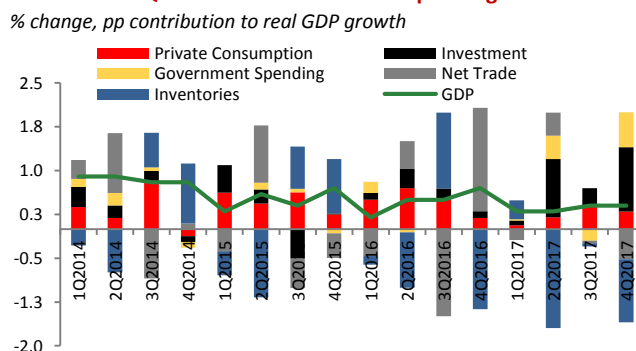
*BoE likely to proceed with 25 bps rate hike in either May or August*

**Fig. 5. UK: Employment gains slowed in December whilst average earnings (ex-bonus) growth was muted**



Source: UK Office for National Statistics

**Fig. 6. UK: Quarterly GDP growth revised down to 0.4% q-o-q in 4Q due to softer household spending**



Source: UK Office for National Statistics

**GDP growth:** The UK’s 4Q GDP growth was revised down to 0.4% q-o-q from 0.5% in the first estimate. This was mainly due to a weaker reading for household spending, which decelerated to 0.3% q-o-q in 4Q from 0.4% in 3Q. This brought the annual growth rate down to 1.7% from 1.8% in the previous estimate. We expect household spending to remain subdued in 2018 given the existing uncertainty over the Brexit negotiations.

*GDP growth revised down to 0.4% q-o-q in 4Q in second print, from 0.5%*

Gross fixed capital formation (GFCF) accelerated to 1.1% q-o-q in 4Q (3Q: 0.7%), driven by government spending and the private dwelling sector. However, total business investment was flat in the quarter, suggesting that corporates remain sceptical over the UK's relationship with the EU after it leaves. Net exports contributed negatively to headline growth, in part due to lower volumes of fuel exports.

### Eurozone: ECB minutes highlight concern over EUR appreciation

The minutes of the ECB's 24-25 January meeting were broadly in line with the post-meeting statement and the press conference. The two key takeaways from the minutes of the meeting were i) increasing concern over rapid EUR appreciation and ii) still no clear sign of an uptrend in underlying inflation. The communication on the EUR appreciation was much stronger than before, with the Governing Council (GC) expressing increasing concern over FX pass-through effects dampening the medium-term inflation outlook. GC members also highlighted that there were no convincing signs of a sustained upward trend in underlying inflation despite the robust economic expansion seen in 2017. The minutes were also consistent with gradual adjustments to the forward guidance, with hints that the first tweak would be to remove the reference of an increase in the asset purchase programme in terms of 'size'.

*ECB minutes highlight increasing concerns over stronger EUR and its pass-through effect on inflation*

We expect the ECB to amend its forward guidance on asset purchases in the March meeting, when the central bank will have new economic projections based on the higher EUR exchange rate assumptions. We believe that low underlying inflation is likely to mean the ECB continues to tighten monetary policy in a gradual and limited manner. The ECB policy outlook will likely continue to reflect patience and persistence, as consistently outlined by Draghi. Looking ahead, we expect asset purchases to be extended for at least another three months until December, albeit at a slower pace, with any interest rate hikes only likely by mid-2019.

*ECB to maintain tone of patience and persistence until inflation picks up meaningfully*

## C. Emerging Market Economies

### India: Slightly more hawkish tilt to February RBI minutes

The minutes of the RBI's 6-7 February meeting were moderately more hawkish than the post-meeting statement with all of the MPC members expressing concern over the country's inflation outlook. Notably, two out of six members argued for a change in stance from "neutral" to "withdrawal of accommodation". Higher crude oil prices were cited as the major upside risk to inflation alongside an expansionary budget. The fiscal slippage in FY2018-19 (April to March) also diminishes the chance of the central government absorbing the high crude oil prices. Despite the favourable base effects to headline inflation over the next three to four months, the chance of rate cuts has diminished markedly, in our view. We expect the RBI to remain on hold until 1H2018 with incoming data to remain crucial in deciding the central bank's next course of action.

*RBI to remain on hold in 1H2018*

## II. Economic Calendar

Fig. 7. The week ahead

Time*	Country	Event	Period	Prior	Consensus
<b>EM data</b>					
	UAE	CPI, y-o-y	Jan	2.7%	
	UAE	CPI, m-o-m	Jan	0.7%	
	UAE	M2 Money Supply, m-o-m	Jan	2.2%	
	UAE	Central Bank Foreign Assets	Jan	347.7B	
	Saudi Arabia	Non-Oil Exports, y-o-y	Dec	18.2%	
	Saudi Arabia	M2 Money Supply, y-o-y	Jan	-1%	
	Saudi Arabia	SAMA Net Foreign Assets SAR	Jan	1833.4B	
	Bahrain	M2 Money Supply, y-o-y	Dec	2.8%	
	Qatar	M2 Money Supply, y-o-y	Jan	21.3%	
	Egypt	Production Index, m-o-m	Jan	-1.8%	
	India	Eight Infrastructure Industries	Jan	4%	
	India	GVA, y-o-y	4Q	6.1%	6.6%
<b>Monday, 26 Feb</b>					
18:00	Eurozone	ECB President Draghi speaks in Brussels			
19:00	US	New Home Sales	Jan	625K	648K
22:00	UK	BOE's Cunliffe Speaks at Event at Warwick University			
<b>Tuesday, 27 Feb</b>					
13:00	Eurozone	M3 Money Supply, y-o-y	Jan	4.6%	4.6%
14:00	Eurozone	Bundesbank's Weidmann Presents Annual Report			
17:00	Germany	CPI EU Harmonized, y-o-y	Feb P	1.4%	1.3%
17:30	US	Durable Goods Orders	Jan P	2.8%	-2%
17:30	US	Durable goods, ex-Transportation	Jan P	0.7%	0.4%
17:30	US	Cap Goods Shipments, Non-defence, ex-Air	Jan P	0.4%	0.3%
19:00	US	Conference Board Consumer Confidence	Feb	125.4	126.4
19:00	US	Fed's Powell Testifies to House Financial Services Committee			
<b>Wednesday, 28 Feb</b>					
3:50	Japan	Retail Trade, y-o-y	Jan	3.6%	2.5%
3:50	Japan	Industrial Production, m-o-m	Jan P	2.9%	-4.2%
5:00	China	Manufacturing PMI	Feb	51.3	51.2
14:00	Eurozone	CPI Core, y-o-y	Feb A	1%	
14:00	Eurozone	CPI Estimate, y-o-y	Feb	1.3%	1.2%
17:30	US	GDP Annualized, q-o-q	4Q S	2.6%	2.5%
17:30	US	Personal Consumption	4Q S	3.8%	3.6%
19:00	US	Pending Home Sales, m-o-m	Jan	0.5%	0.5%
	US	Fed's Powell Testifies to Senate Banking Committee			
<b>Thursday, 1 Mar</b>					
5:45	China	Caixin China PMI Manufacturing	Feb	51.5	51.3
13:30	UK	Mortgage Approvals	Jan	61K	62K
13:30	UK	Markit UK PMI Manufacturing SA	Feb	55.3	55
14:00	Eurozone	Unemployment Rate	Jan	8.7%	8.6%
17:30	US	PCE Core, m-o-m	Jan	0.2%	0.3%
17:30	US	PCE Core, y-o-y	Jan	1.5%	1.5%
17:30	US	Personal Income	Jan	0.4%	0.3%
17:30	US	Personal Spending	Jan	0.4%	0.2%
17:30	US	Initial Jobless Claims	24-Feb	222K	226K
19:00	US	ISM Manufacturing	Feb	59.1	58.7
<b>Friday, 2 Mar</b>					
3:30	Japan	Jobless Rate	Jan	2.8%	2.8%
3:50	Japan	Monetary Base, y-o-y	Feb	9.7%	
4:00	UK	Carney Speaks at Economics Conference in Edinburgh			
19:00	US	University of Michigan. Sentiment	Feb F	99.9	99.5

\* UAE time

Source: Bloomberg

Fig. 8. Last week's data

Time*	Country	Event	Period	Prior	Consensus	Actual
<b>MENA data</b>						
	Oman	Budget Balance Month	Dec	-97.5M		36.2M
	Bahrain	CPI, y-o-y	Jan	1.4%		2.8%
	Kuwait	CPI, y-o-y	Jan	1.1%		1%
	Egypt	Trade Balance	Dec	-2856M		-3294M
<b>Monday, 19 Feb</b>						
3:50	Japan	Trade Balance	Jan	¥359B	-¥1020.3B	-¥943.4B
13:00	Eurozone	ECB Current Account SA	Dec	35B		29.9B
<b>Tuesday, 20 Feb</b>						
14:00	Germany	ZEW Survey Current Situation	Feb	95.2	94	92.3
14:00	Germany	ZEW Survey Expectations	Feb	20.4	16	17.8
19:00	Eurozone	Consumer Confidence	Feb A	1.4	1	0.1
<b>Wednesday, 21 Feb</b>						
4:30	Japan	Nikkei Japan PMI Mfg	Feb P	54.8		54
8:30	Japan	All Industry Activity Index, m-o-m	Dec	1%	0.4%	0.5%
12:30	Germany	BME Germany Manufacturing PMI	Feb P	61.1	60.5	60.3
13:00	Eurozone	Markit Eurozone Manufacturing PMI	Feb P	59.6	59.2	58.5
13:30	UK	Claimant Count Rate	Jan	2.4%		2.3%
13:30	UK	Jobless Claims Change	Jan	6.2K		-7.2K
13:30	UK	Average Weekly Earnings, 3M/y-o-y	Dec	2.5%	2.5%	2.5%
13:30	UK	Weekly Earnings, ex-bonus, 3M/y-o-y	Dec	2.3%	2.4%	2.5%
13:30	UK	ILO Unemployment Rate, 3Mths	Dec	4.3%	4.3%	4.4%
13:30	UK	Employment Change, 3M/3M	Dec	102K	165K	88K
16:00	US	MBA Mortgage Applications	16-Feb	-4.1%		-6.6%
18:45	US	Markit US Manufacturing PMI	Feb P	55.5	55.5	55.9
19:00	US	Existing Home Sales	Jan	5.6M	5.6M	5.4M
<b>Thursday, 22 Feb</b>						
13:00	Germany	IFO Business Climate	Feb	117.6	117	115.4
13:30	UK	GDP, q-o-q	4Q P	0.5%	0.5%	0.4%
13:30	UK	GDP, y-o-y	4Q P	1.5%	1.5%	1.4%
19:00	US	Leading Index	Jan	0.6%	0.7%	1%
<b>Friday, 23 Feb</b>						
3:30	Japan	National CPI, y-o-y	Jan	1%	1.3%	1.4%
3:30	Japan	National CPI, ex-fresh food, y-o-y	Jan	0.9%	0.8%	0.9%
11:00	Germany	GDP SA, q-o-q	4Q F	0.6%	0.6%	0.6%
11:00	Germany	GDP NSA, y-o-y	4Q F	2.3%	2.3%	2.3%
14:00	Eurozone	CPI Core, y-o-y	Jan F	1%	1%	1%
14:00	Eurozone	CPI, y-o-y	Jan F	1.4%	1.3%	1.3%

\* UAE time

Source: Bloomberg

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