The Week Ahead: BoE and RBI to remain on hold, guidance to take centre stage

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Global: BoE meeting, Fed speeches and financial markets

The initial focus of the week will be on the degree of contagion on global markets following last week's sharp selloff in US equities and 10-year treasuries. The US market moves were in part a response to a stronger-than-expected labour market report for January (page 5), especially wages, which raised concerns of a potentially stronger inflation and interest rate outlook. We now expect a Fed rate hike in March of 25 bps, bringing forward our June rate call, following the labour market data and moderately more hawkish tone of the January FOMC meeting (page 4). A number of Fed members have speaking engagements this week and attention will be on forward guidance particularly. Despite the robust labour report, we expect Fed speakers to reiterate their gradual rate-increase stance and the need to see greater signs of inflation in the data. Meanwhile, the BoE is expected to keep interest rates on hold on 8 February. We believe that the bank will air its concern about the recent sharp appreciation in the GBP, in line with the ECB. The BoE will also release its inflation report and new economic projections. We see a chance of downward revisions to the inflation projections, reducing the risk of any interest rate hikes in 2018. We expect the BoE to remain on hold in 2018, albeit highlighting data-dependence.

India: RBI on hold, though guidance likely more hawkish

We expect the RBI to keep monetary policy steady at its February meeting. The tone of the meeting could be moderately hawkish given the outlook for fiscal loosening in FY2018-19 (Apr.-Mar.) and high crude oil prices. Moreover, the CPI inflation reports released since the December policy meeting have surprised to the upside. Headline inflation accelerated to 5.2% y-o-y in December, pushing inflation into the RBI's upper target range (4% with +/-2% deviation). We remain particularly concerned about the high crude oil prices, which could also dampen domestic demand. However, we see food and housing prices decelerating sharply in 1Q2018, providing some space for the RBI to remain on hold while monitoring crude prices and the pass through of fiscal policy, especially on rural inflation (page 7).

China: Watch January inflation and trade data

The key data releases this week will be the trade balance (due 8 February) and inflation (9 February) for January. The consensus estimates headline CPI inflation decelerated to 1.5% y-o-y in January from 1.8% in December. The moderation is expected mainly due to the late Lunar New Year holiday season in 2018, which likely kept travel- and food-related spending relatively subdued. However, the unusually cold weather, which led to a sharp pick-up in vegetable prices in December, is expected to have continued to impact prices in January. Meanwhile, consensus believes export growth accelerated to 11.3% y-o-y in January from 10.9% in December, on the back of strong global demand. Finally, we highlight that January data should be viewed with caution, given the timing of the Lunar New Year.

I. Recent Events and Data Releases

A. MENA Economies

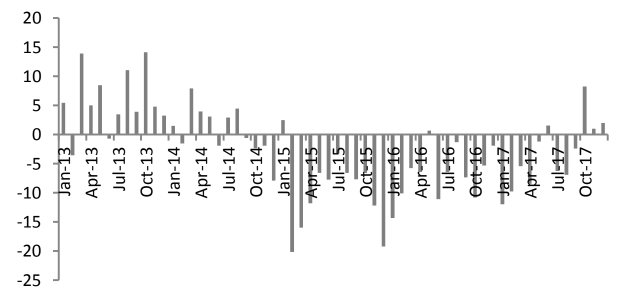
Saudi Arabia: SAMA's net foreign assets rise for third month in row

Dividends from SAMA and PIF likely supported the rise in government deposits in December

The monetary data for December showed that SAMA's net foreign assets (NFAs) rose for a third consecutive month, by USD2 billion to USD488.9 billion. The increase was supported by a USD3.2 billion rise in government deposits with the central bank. The increase was driven by the current account growing USD8.8 billion in December, which we see as likely reflecting year-end transfers of dividends from SAMA and the Public Investment Fund (PIF). Indeed, there has been a rise in the government's current account with SAMA in every December since 2015. However, there were still indications of fiscal deficit funding, with the government's reserve account falling by USD5.6 billion. Despite the increase in 4Q2017, SAMA's NFAs were down by 7.5% in 2017, falling by USD39.7 billion. However, the pace of the fall moderated sharply, reducing from a USD80.3 billion decline in 2016, reflecting the higher oil price and ongoing foreign borrowing.

Fig. 1. Saudi Arabia: SAMA's net foreign assets rose by USD2 billion in December

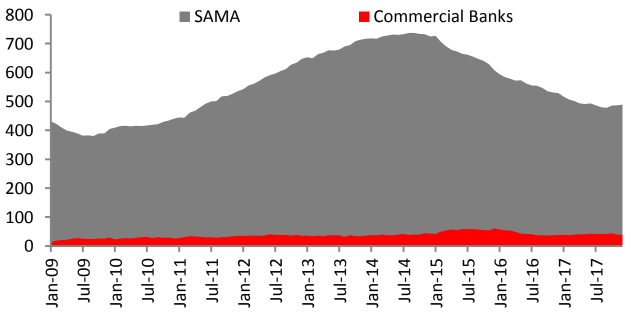
Monthly change, USD billion



Source: SAMA, ADCB calculations

Fig. 2. Saudi Arabia: Pace of drawdown of SAMA's NFAs moderated sharply in 2017 versus 2016

USD billion



Source: SAMA< ADCB calculations

No signs of private sector capital outflows in 4Q2017

The data also pointed to a continued easing in banking sector liquidity conditions, which has been a central factor in the narrowing of the spread between the Saibor and US Libor. The loan-to-deposit ratio improved slightly to 85.6% at end-2017 from 86.9% in December 2016. We see limited potential for further narrowing given the compression seen in 2017. Total deposits in the banking sector rose by 1.2% m-o-m in December, led by government deposits, though private sector deposits also increased. The latter showed no signs of capital outflows in 4Q2017 following the corruption probe that started in early November. Total banking sector deposits were up just 0.1% y-o-y in December and were broadly flat for the year as a whole. Meanwhile, gross loan growth was down 1% m-o-m in December, with private sector credit growth contracting by 1.5% m-o-m. On a yearly basis, total loan growth grew by 3.8% in the final month of the year, driven by credit extended to the government, which was up 42.6% y-o-y. We see the government segment continuing to drive credit growth in 2018 to help fund the fiscal deficit.

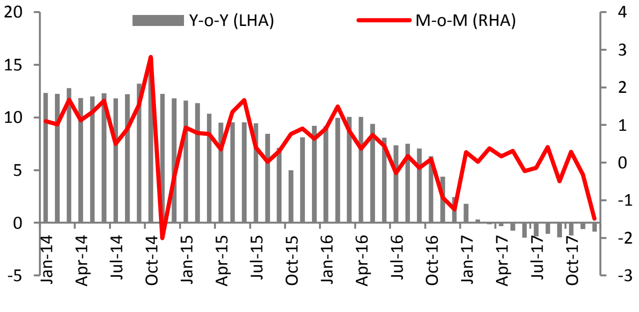
Front-loading of household expenditure visible in December ahead of VAT introduction

The proxy economic indicators continued to show weak economic activity overall. Letters of credit for private sector imports fell by 6.8% m-o-m, for example. However, the data points to a front-loading of government expenditure ahead of the introduction of VAT.

Point-of-sale transactions rose by 20.1% m-o-m in value terms, taking the y-o-y rate to 28.1% (November: 10.1 % y-o-y). The first payment from the citizen account programme to low- and middle-income families at end-December could also have supported the rise in spending.

Fig. 3. Saudi Arabia: Private sector credit growth fell by 0.8% in 2017, highlighting weak economic backdrop

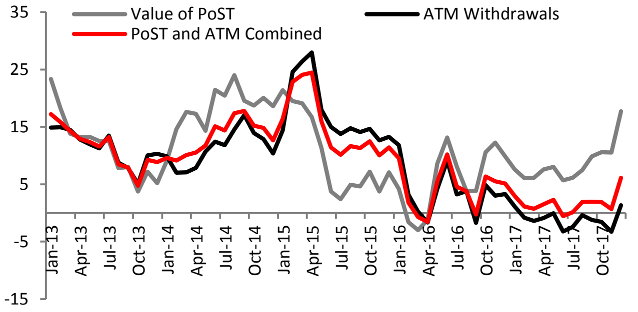
% change



Source: SAMA, ADCB calculations

Fig. 4. Saudi Arabia: Sharp rise in indicators of private consumption ahead of VAT introduction

% change y-o-y, 3M moving average



Source: SAMA, ADCB calculations

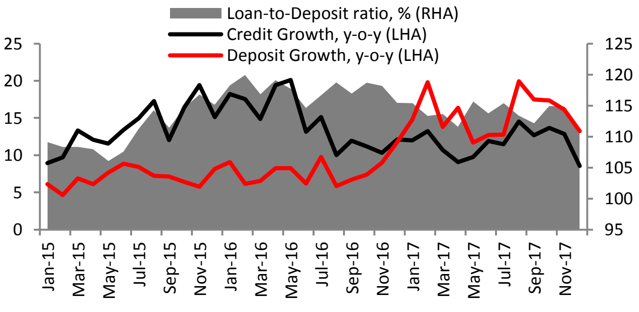
Qatar: Banking sector foreign liabilities increase in end-2017

Non-resident deposits in banking sector rose in December

The banking sector data for December continued to show signs of stabilisation, with an increase in foreign liabilities of commercial banks and a rise in the FX reserves of the central bank. However, both of these remain markedly below the levels of May 2017 before the regional dispute. Qatari banks' foreign liabilities rose for a second consecutive month in December, with the increase more pronounced than in November. Notably, non-resident deposits saw a first monthly increase since May, rising by USD0.6 billion in December and up 1.6% m-o-m. The data likely indicate that deposits from the regional countries involved in the ongoing dispute have largely left the banking system. Nevertheless, non-resident deposits were down 25.2% y-o-y in December 2017, resulting in their share of deposits falling to 16.7% of the total from 25.2% at end-2016. Total banking sector deposits rose by a solid 2.6% m-o-m in December on higher public sector (USD2 billion increase) and private sector (USD3.1 billion) deposits. Government deposits in the banking sector were up 69.4% in 2017, with most of the rise occurring in 2H2017.

Fig. 5. Qatar: L-to-D ratio fell to a multi-year low in 2017 on strong deposit growth

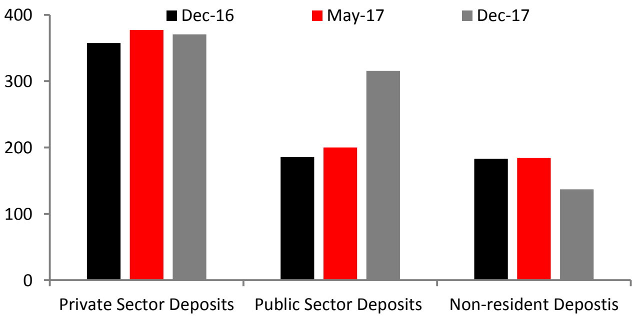
% change y-o-y (LHA); loan-to deposit ratio (RHA)



Source: Qatar Central Bank, ADCB calculations

Fig. 6. Qatar: Total deposit growth driven by sharp rise in government deposits

QAR billion



Source: Qatar Central Bank, ADCB calculations

The strong deposit growth contributed to the loan-to-deposit ratio moderating to 111% at end-2017, down from 115% in December 2016 and the lowest level since June 2015. Total credit growth continued to slow in December, falling to 8.6% y-o-y (end-2016: 12.1%), which we believe reflected the slowdown in non-hydrocarbon activity since 2Q2017 and a more cautious approach to projects from the government. Separately, the Central Bank of Qatar's FX reserves rose to USD37.6 billion in December (November: USD36.9 billion), albeit still down from USD46.1 billion in May 2017. We see the rise from the recent low in September as being supported by higher hydrocarbon revenues despite signs of import levels normalising.

Deceleration in credit growth reflects softer economic momentum from mid-2017

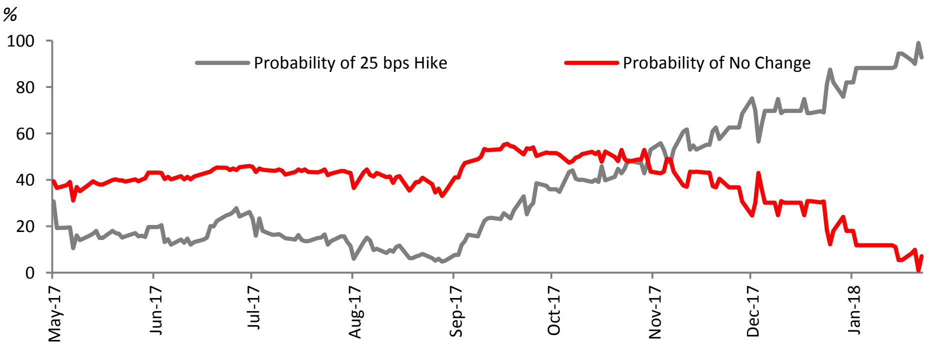
B. G4 Economies

US: January Fed meeting highlights increasing confidence over inflation

The FOMC kept the FFTR range unchanged at 1.25-1.5% at its 30-31 January meeting, in line with our and the market's expectation. The tone of the meeting was slightly hawkish, with the Fed seeing a rise in inflation expectations in recent months, albeit they remained low. Moreover, the committee added the word "further" to its forward guidance, noting that economic conditions are expected to evolve in a manner that "will warrant further gradual increases in the federal funds rate." The solid economic momentum, tight labour market conditions and favourable financial market conditions lead us to believe that the Fed will likely frontload its interest rate hikes in 2018. We now expect a 25bps rate hike in March versus our previous call for a June rate hike. We also now see a greater risk of an additional hike in 2018, compared to our current expectation of two 25bps rate hikes in 2018. However, we believe that the Fed will likely need to see greater signs of inflation this year and we also await to see forward guidance from the FOMC as its composition changes. The market is currently pricing a 93% probability of a 25bp rate hike in March.

We now expect 25bps rate hike in March

Fig. 7. US: March rate hike probability hovering above 90% level



Source: Bloomberg

The FOMC maintained that the near-term risks to the economy "appear roughly balanced", though economic activity and the labour market are seen strengthening at a solid pace. However, the language on inflation was modestly upgraded, suggesting greater confidence that inflation will gradually move higher. The FOMC highlighted that it expects inflation on a 12-month basis to "move up this year" and stabilise around the 2% inflation target over the medium term. Notably, it removed the phrase that inflation

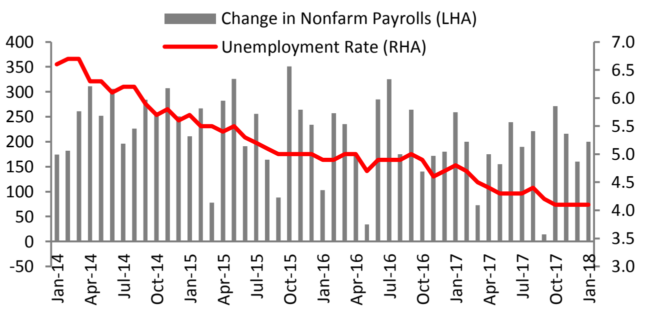
FOMC upgraded its language on inflation modestly will "remain somewhat below 2 percent in the near term" from the December statement. However, there was no mention of fiscal policy, particularly regarding the potential impact of the tax reform and infrastructure spending proposed by President Trump.

New Fed chair Jerome Powell will be sworn in on 5 February

In addition, the FOMC during its annual organisational meeting reaffirmed its "Statement on Longer-Run Goals and Monetary Policy Strategy." The committee also updated its reference to the median of participants' estimates of the longer-run normal rate of unemployment, shifting it to 4.6% from 4.8% in January 2017. Moreover, recent Fed member speeches suggest that there has been growing discussion of alternative monetary policy frameworks. We believe that this could be a major development in 2018 that would likely have long-term implications for markets. Separately, the FOMC unanimously selected Jerome Powell to serve as its chairman, effective from 5 February.

Fig. 8. US: January gains in employment were broad-based, though unemployment remains steady at 4.1%

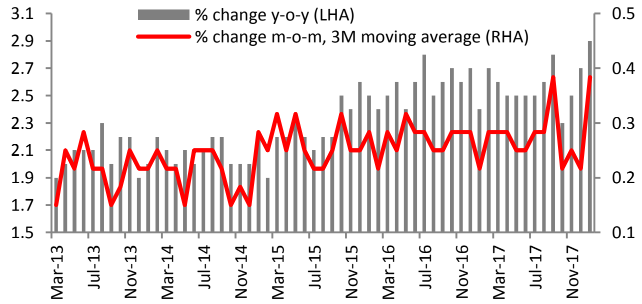
'000 (LHA); % (RHA)



Source: Bureau of Labor Statistics

Fig. 9. US: Wage growth picks up in January, with upward revisions to December figures

% change



Source: Bureau of Labor Statistics

US: Strong January labour report; solid rise in wage growth

Average hourly earnings accelerated to 2.9% y-o-y in January, from 2.7% in December

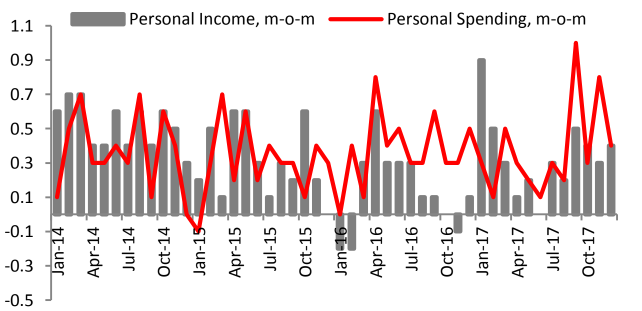
The January labour market report was robust, with signs of wage growth acceleration and strong hiring activity. Non-farm payrolls rose by 200K in January, versus the market expectation of 180K. December jobs growth was also revised up to 160K, from 148K reported previously. The jobs growth was broad-based sector wise, particularly driven by rises in construction (36K), food services (31K), health care (21K), and manufacturing (15K). Arguably, the most positive development was the pick-up in monthly wage growth, which accelerated for a second consecutive month. Average hourly earnings rose by 0.3% m-o-m in January, beating consensus expectation of 0.2%, albeit this was lower than the upwardly revised December print of 0.4% m-o-m. January wage growth was driven by professional and business services (0.6%), education and health services (0.4%) and retail trade (0.4%). The wage increases were likely supported by mandatory minimum wage hikes announced in 18 states, with a number of corporates also announcing pay hikes following the corporate tax cuts. On an annual basis, wage growth accelerated to 2.9% y-o-y in January (December: 2.7%), the highest reading since mid-2009. We believe that the Fed will look for sustainable wage growth in the upcoming months to see if it needs to make any changes to its current policy stance (gradual interest rate hikes) and communication. Meanwhile, the unemployment rate remained steady at 4.1% in January, with the participation rate also unchanged at 62.7% for the fourth consecutive month.

Personal spending and PCE data: December personal spending was solid, supported by robust holiday season spending and auto sales. Personal spending grew by a healthy 0.4% m-o-m in December (consensus: 0.4%), albeit moderating from an upwardly revised 0.8% in November (0.6% previously). The other notable development was in the savings rate, which weakened to a 12-year low of 2.4% in December (November: 2.5%). Meanwhile, core PCE inflation accelerated to 0.2% m-o-m in December (November: 0.1%), in line with the consensus expectation. We expect headline PCE inflation to accelerate further from March 2018 as the effect of the one-off factors seen in 2017 starts receding. Core inflation is also expected to rise gradually from March and move closer to 2% by 3Q2018, mainly driven by rent and the healthcare sector.

We expect inflation to pick up more meaningfully from March as one-off factors fade

Fig. 10. US: Personal spending remained solid in December, driven by auto sales and holiday spending

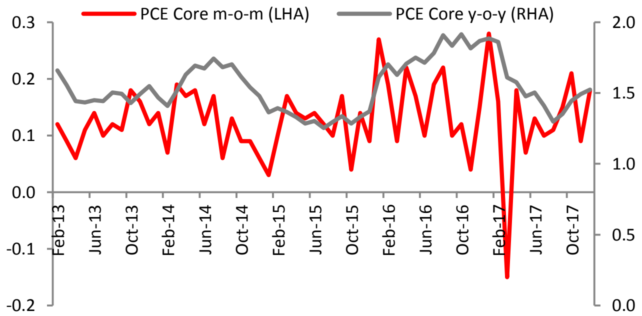
% change m-o-m



Source: Bureau of Economic Analysis

Fig. 11. US: Core PCE inflation accelerated by 0.2% m-o-m in December

% change



Source: Bureau of Economic Analysis

Eurozone: 4Q GDP growth solid but inflation subdued in December

Eurozone GDP grew by 0.6% q-o-q in 4Q2017, in line with the consensus expectation but marginally lower than the upwardly revised 3Q growth of 0.7%. The recent high frequency data continues to suggest that economic growth remains solid and broad-based in early 2018. The key development has been a pick-up in investment activity in many Eurozone economies, in our view. The detailed breakdown of GDP by component will be available on 7 March (final estimate), whilst the second estimate with more comprehensive country data will be available on 14 February. GDP growth in France surprised to the upside and accelerated to 2.4% y-o-y in 4Q2018 from 2.3% in 3Q. On an annual basis, it accelerated to 1.9% in 2017 from 1.1% in 2016, driven by robust fixed capital formation. Ongoing structural reforms and positive business sentiment in France are likely to remain supportive, in our view. We expect the Eurozone economy to grow by 2.6% in 2018, from 2.3% in 2017.

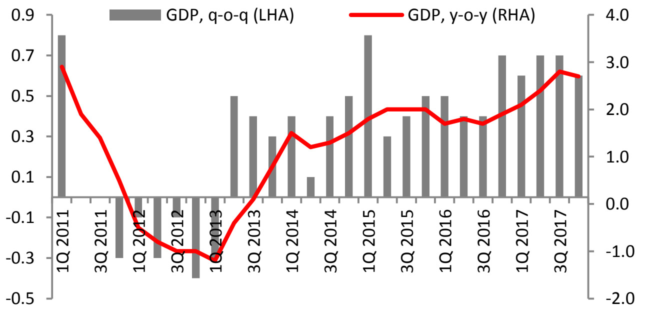
Eurozone GDP solid in 4Q, growing by 0.6% q-o-q

Eurozone Inflation: Headline inflation decelerated to 1.3% y-o-y (December: 1.4%), though marginally above the consensus estimate of 1.2%. The yearly deceleration was mainly due to energy and food prices. However, core inflation accelerated to 1% y-o-y in January (December: 0.9%), led by non-energy industrial goods and steady services inflation. We believe that underlying price pressures will be subdued in 1H2018, though should see some support in 2H2018 from the low base effect. We believe that rapid strengthening of the EUR will also have a pass-through effect on inflation and will dampen the impact of higher oil prices on Eurozone inflation (i.e. oil in EUR terms). Overall, we see a risk that the strong EUR could further delay its progress toward the 2% target. Recent comments by ECB chief economist Peter Praet suggest that the central

We expect headline inflation to remain subdued in 1H2018 bank is still "some distance" from seeing a "sustained adjustment in the path of inflation", which is broadly in line with our view on inflation.

Fig. 12. Eurozone: 4Q GDP growth remains healthy, likely driven by capital expenditure and external demand

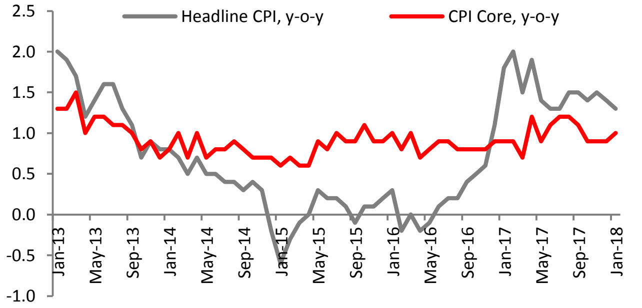
% change



Source: Eurostat

Fig. 13. Eurozone: Headline inflation moderated in January, while core inflation rose modestly

% change y-o-y



Source: Eurostat

C. Emerging Market Economies

India: Expansionary budget announced for FY2019

FY2019 fiscal deficit projected at 3.3% of GDP

The Indian government announced an expansionary budget for FY2019 (April-March), whilst reiterating its medium-term fiscal consolidation path. The fiscal deficit for FY2019 is projected at 3.3% of GDP, marginally higher than the consensus expectation of 3.2%, with a primary focus on rural and infrastructure investment. The increased allocation to railways capital expenditure was a positive surprise, but focus on the roads, rural and social sectors was largely in line with market expectations. The finance minister also increased the minimum support price (MSP) for Kharif crops (cultivated between April-October), in a likely move to strengthen the rural vote base ahead of 2019 elections. Also in line with expectations, Finance Minister Arun Jaitley slashed the corporate tax rate to 25% for micro, small and medium enterprises (MSMEs) to support growth and employment. However, in a move to raise government revenue, he levied a long-term capital gains tax of 10% on all equity capital gains from 1 February 2018. Overall, we believe that the expansionary fiscal policy along with the increase in MSP will put upward pressure on consumer prices. We expect the RBI to remain on hold in 1H2018 and will watch for further developments on crude prices and the next monsoon rainfall.

II. Economic Calendar

Fig. 14. The week ahead

Time*	Country	Event	Period	Prior	Consensus
EM data					
	UAE	Emirates NBD UAE PMI	Jan	57.7	--
	UAE	Dubai Airport Cargo Volume, y-o-y	Dec	0.4%	--
	Saudi Arabia	Non-Oil Exports, y-o-y	Nov	13.1%	--
	Saudi Arabia	Emirates NBD Saudi Arabia PMI	Jan	57.3	--
	Egypt	Gross Official Reserves	Jan	37B	--
	Egypt	Urban CPI, y-o-y	Jan	21.9%	--
	Egypt	Emirates NBD Egypt PMI	Jan	48.3	--
	India	Nikkei India PMI Composite	Jan	53	--
Monday, 5 Feb					
4:30	Japan	Nikkei Japan PMI Composite	Jan	52.2	--
5:45	China	Caixin China PMI Composite	Jan	53	--
13:00	Eurozone	Markit Eurozone Composite PMI	Jan F	58.6	58.6
13:30	UK	Official Reserves Changes	Jan	-$44M	--
13:30	UK	Markit/CIPS UK Composite PMI	Jan	54.9	54.6
14:00	Eurozone	Retail Sales, y-o-y	Dec	2.8%	1.9%
18:45	US	Markit US Composite PMI	Jan F	53.8	--
19:00	US	ISM Non-Manufacturing Composite	Jan	56	56.7
Tuesday, 6 Feb					
13:00	Eurozone	ECB's Weidmann, BIS's Carstens Speak in Frankfurt			
17:30	US	Trade Balance	Dec	-$50.5B	-$52B
17:50	US	Fed's Bullard Speaks on US Economy and Monetary Policy			
19:00	US	JOLTS Job Openings	Dec	5879	--
Wednesday, 7 Feb					
13:00	India	RBI Repurchase Rate	7-Feb	6%	6%
13:00	India	RBI Reverse Repo Rate	7-Feb	5.75%	5.75%
13:00	India	RBI Cash Reserve Ratio	7-Feb	4%	4%
14:00	Eurozone	European Commission Economic Forecasts			
17:30	US	Fed's Dudley Speaks in Moderated Q&A			
	China	Foreign Reserves	Jan	$3139.9B	$3170B
Thursday, 8 Feb					
2:20	US	Fed's Williams Speaks in Hawaii			
3:50	Japan	BoP Current Account Balance	Dec	¥1347.3B	¥1059B
13:00	Eurozone	ECB Publishes Economic Bulletin			
14:45	Eurozone	ECB's Praet Speaks in Frankfurt			
16:00	UK	Bank of England Bank Rate	8-Feb	0.5%	0.5%
16:00	UK	BOE Asset Purchase Target	Feb	435B	435B
16:00	UK	BOE Corporate Bond Target	Feb	10B	10B
16:00	UK	Bank of England Inflation Report			
	China	Trade Balance	Jan	$54.7K	$54.7B
	China	Imports, y-o-y	Jan	4.5%	11%
	China	Exports, y-o-y	Jan	10.9%	11.3%
Friday, 9 Feb					
3:50	Japan	Money Stock M2, y-o-y	Jan	3.6%	3.6%
5:30	China	PPI, y-o-y	Jan	4.9%	4.2%
5:30	China	CPI, y-o-y	Jan	1.8%	1.5%
8:30	Japan	Tertiary Industry Index, m-o-m	Dec	1.1%	0.1%
13:30	UK	Industrial Production, m-o-m	Dec	0.4%	-0.9%
13:30	UK	Manufacturing Production, m-o-m	Dec	0.4%	0.3%
13:30	UK	Trade Balance	Dec	-£2804	-£2400
19:00	US	Wholesale Inventories, m-o-m	Dec F	0.2%	0.2%

* UAE time
Source: Bloomberg

Fig. 15. Last week's data

Time*	Country	Event	Period	Prior	Consensus	Actual
EM data						
	UAE	M2 Money Supply, m-o-m	Dec	-0.3%	--	0.4%
	Qatar	M2 Money Supply, y-o-y	Dec	18.9%	--	21.3%
	India	Eight Infrastructure Industries	Dec	7.4%	--	4%
	India	GDP Annual Estimate, y-o-y	2017	8%	--	7.1%
Monday, 29 Jan						
17:30	US	Personal Income	Dec	0.3%	0.3%	0.4%
17:30	US	Personal Spending	Dec	0.8%	0.4%	0.4%
17:30	US	PCE Core, m-o-m	Dec	0.1%	0.2%	0.2%
17:30	US	PCE Core, y-o-y	Dec	1.5%	1.5%	1.5%
Tuesday, 30 Jan						
3:30	Japan	Jobless Rate	Dec	2.7%	2.7%	2.8%
3:50	Japan	Retail Trade, y-o-y	Dec	2.1%	2.2%	3.6%
13:30	UK	Mortgage Approvals	Dec	64.7K	63.5K	61K
13:30	UK	M4 Money Supply, y-o-y	Dec	3.8%	--	3.7%
14:00	Eurozone	GDP SA, q-o-q	4Q A	0.7%	0.6%	0.6%
14:00	Eurozone	GDP SA, y-o-y	4Q A	2.8%	2.7%	2.7%
14:00	Eurozone	Consumer Confidence	Jan F	1.3	1.3	1.3
17:00	Germany	CPI EU Harmonized, y-o-y	Jan P	1.6%	1.6%	1.4%
19:00	US	Conference Board Consumer Confidence	Jan	123.1	123	125.4
Wednesday, 31 Jan						
3:50	Japan	Industrial Production, m-o-m	Dec P	0.5%	1.5%	2.7%
4:01	UK	GfK Consumer Confidence	Jan	-13	-13	-9
5:00	China	Manufacturing PMI	Jan	51.6	51.6	51.3
14:00	Eurozone	Unemployment Rate	Dec	8.7%	8.7%	8.7%
14:00	Eurozone	CPI Core, y-o-y	Jan A	0.9%	1%	1%
14:00	Eurozone	CPI Estimate, y-o-y	Jan	1.4%	1.2%	1.3%
17:15	US	ADP Employment Change	Jan	242K	185K	234K
19:00	US	Pending Home Sales, m-o-m	Dec	0.3%	0.5%	0.5%
23:00	US	FOMC Rate Decision (Upper Bound)	31-Jan	1.5%	1.5%	1.5%
23:00	US	FOMC Rate Decision (Lower Bound)	31-Jan	1.25%	1.25%	1.25%
Thursday, 1 Feb						
5:45	China	Caixin China PMI Manufacturing	Jan	51.5	51.5	51.5
13:30	UK	Markit UK PMI Manufacturing SA	Jan	56.2	56.5	55.3
17:30	US	Nonfarm Productivity	4Q P	2.7%	0.7%	-0.1%
17:30	US	Unit Labor Costs	4Q P	-0.1%	0.9%	2%
19:00	US	ISM Manufacturing	Jan	59.3	58.6	59.1
19:00	US	ISM Prices Paid	Jan	68.3	68.8	72.7
Friday, 2 Feb						
3:50	Japan	Monetary Base, y-o-y	Jan	11.2%	--	9.7%
13:30	UK	Markit/CIPS UK Construction PMI	Jan	52.2	52	50.2
17:30	US	Change in Nonfarm Payrolls	Jan	160K	180K	200K
17:30	US	Change in Manufacturing Payrolls	Jan	21K	20K	15K
17:30	US	Unemployment Rate	Jan	4.1%	4.1%	4.1%
17:30	US	Average Hourly Earnings, m-o-m	Jan	0.4%	0.2%	0.3%
17:30	US	Labor Force Participation Rate	Jan	62.7%	--	62.7%
19:00	US	Factory Orders	Dec	1.7%	1.5%	1.7%
19:00	US	University of Michigan Sentiment	Jan F	94.4	95	95.7
19:00	US	Durable Goods Orders	Dec F	2.9%	--	2.8%

* UAE time
Source: Bloomberg

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