The Week Ahead: Busy data week, further rate cut by Central Bank of Egypt

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Global: US retail sales and Japan 1Q GDP data

Fed vice chair nominee Richard Clarida and Fed governor nominee Michelle Bowman will appear before the Senate Banking Committee for their confirmation hearings this week. We expect both nominees' views to broadly reflect the FOMC's current gradual interest rate hike stance. Despite that, markets will be watching Clarida's views on neutral interest rates and the inflation outlook closely, given the prominence of the Fed vice chair role. Key US data releases this week will be April retail sales, industrial production and housing. Consensus estimates retail sales (ex-autos) growth to have accelerated to 0.5% m-o-m in April (March: 0.2%), with a pick-up in consumer spending after a soft 1Q. However, weak auto transactions are likely to drag on headline retail sales. Outside the US, the focus will be on Japan's 1Q GDP growth, which is projected to have slowed to 0% q-o-q SAAR (4Q: 1.6%) due to a combination of weather-related softness in private consumption, weakening export momentum and a reversal of previous inventory build-up. UK labour (Mar. /Apr.) and EU GDP data (second print) are also due this week.

EM: India inflation, China IP and retail sales

Market attention will also be on the India CPI data given the rising upside risks to the inflation outlook from higher crude oil prices and INR depreciation. Consensus estimates headline inflation accelerated marginally to 4.4% y-o-y in April from 4.3% in March. We see upside risks to the RBI's short-term inflation outlook, which could shift the RBI's current neutral monetary policy stance to a more hawkish one in the upcoming policy meetings. Meanwhile, China will release its April industrial production and retail sales data this week. We expect its high frequency data to confirm solid economic activity in April heading into 2Q. Consensus forecasts industrial production growth strengthened to 6.4% y-o-y in April (March: 6%) on the back of robust manufacturing activity.

Egypt: Further 100 bps rate cut expected, weaker conviction

We expect the Central Bank of Egypt (CBE) to reduce benchmark interest rates by a further 100 bps at the MPC's 17 May meeting. This will be a repeat of its actions at the February and March meetings. Thus, we see the overnight lending rate being lowered to 16.75% and the deposit rate to 15.75%. Our conviction for a rate cut is weaker for this meeting than in the previous two given the monthly rise in April inflation. Nevertheless, we believe that the CBE will take advantage of the narrow window ahead of the government plans to lower subsidies in mid-2018. We expect the post-meeting communication to remain cautious, highlighting potential upside risks to inflation, including from subsidy reforms and higher oil prices. Following our expected May rate cut, we expect a pause in the interest rate-cutting cycle as the central bank assesses the impact of the subsidy reforms on inflation alongside factors such as the effect of the rate cuts on portfolio inflows. This is especially as the Fed is likely to hike again at its June meeting. Please see page 2 for further details on inflation developments and our interest rate outlook for Egypt.

I. Recent Events and Data Releases

A. MENA Economies

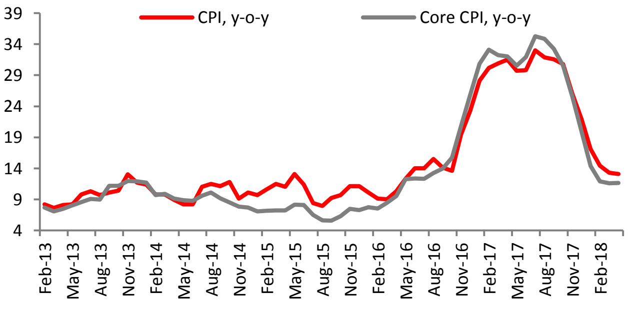
Egypt: Consumer inflation decelerates further to 13.1% y-o-y in April

Headline inflation continues to soften y-o-y but rises on m-o-m basis

Headline inflation softened further in April to 13.1% y-o-y from 13.3% in March and down from a recent peak of 33% y-o-y in July 2017. The ongoing disinflation continues in large part to reflect the favourable base with the EGP devaluation and fiscal reforms (subsidy reforms and introduction and increase in the VAT rate) falling out of the yearly data. The April headline CPI reading was the weakest pace of growth seen since May 2016 and well within the central bank's year-end inflation target of 13% (±3 ppt). The main driver behind the further y-o-y softening in the inflation rate was the food component, which accounts for c.40% of the CPI basket. Food prices decelerated to 11.1% y-o-y in April from 11.9% the previous month. We highlight some caution as the pace of easing in headline inflation has moderated and we believe that the support from the high inflation base is close to ending. Moreover, monthly inflation accelerated to 1.5% in April – its strongest growth since August 2017 and up from 1% m-o-m in March. There was a m-o-m rise in most components of the inflation basket, including food. We see this monthly rise as likely due to higher Easter demand and increased spending ahead of the holy month of Ramadan, especially on food. Clothing and footwear prices rose by 4.6% m-o-m.

Fig. 1. Egypt: Pace of headline disinflation slows in April, whilst core inflation rises moderately

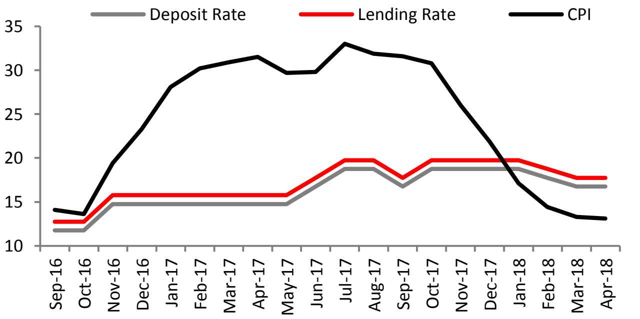
% change y-o-y



Source: CAPMAS

Fig. 2. Egypt: Real interest rates rise due to drop in headline inflation; monetary conditions still tight

% (interest rates); % change y-o-y (CPI)



Source: Central Bank of Egypt, CAPMAS, ADCB calculations

Rates likely to be cut by 100 bps this week – but with cautious communication

We see the Central Bank of Egypt (CBE) reducing benchmark interest rates again by 100 bps this week – the same magnitude of cuts as at the February and March meetings. Our conviction about a rate cut is less than in the previous two meetings due to the monthly rise in headline inflation in April. Nevertheless, we still believe that the central bank will look to take advantage of the window ahead of the planned reduction in fuel subsidies in mid-2018. Despite some signs of a tentative pick-up in domestic demand, underlying private sector (consumption and investment) activity remains weak and monetary policy tight. Real interest rates have continued to rise with the yearly disinflation trend since mid-2017. We believe that the communication from the CBE will remain cautious, in line with the March meeting. The Monetary Policy Committee (MPC) highlighted upside risks to the inflation outlook including the "timing and magnitude of potential subsidy-reform measures". Demand-pull factors and a higher oil price outlook were also highlighted. The government outlined plans in its draft budget to reduce fuel subsidies by 26.3% and electricity prices by 46.7% at the beginning of the fiscal year (starting in July). Following this week's meeting, we expect the CBE to pause its interest rate easing cycle until it can assess the impact of the subsidy reforms on inflation, alongside factors such as the effect of the rate cuts on portfolio inflows, especially as the Fed continues to raise rates. We do not expect a spike in the y-o-y inflation rate following the subsidy reductions given i) the smaller planned percentage rise in fuel and electricity prices than in mid-2017; and ii) the similar timing of reforms last year. These factors should keep the yearly rate broadly steady, in our view. We see the potential for a further 100 bps rate cut at end-2018 if inflationary pressure remains contained.

B. G4 Economies

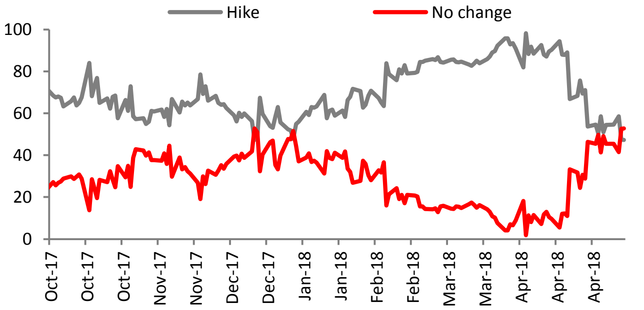
UK: BoE on hold with return to limited tightening guidance

BoE highlights data dependency in its interest rate outlook guidance – slightly more bearish tone

The BoE left its policy rate unchanged at 0.5% at its May meeting, in line with the recently lowered market expectations. Asset purchases and corporate bond holdings were also kept steady at GBP435 billion and GBP10 billion respectively. On balance, the tone of the meeting was moderately less hawkish with a reduction in the inflation outlook and by implying the need for a more gradual rate hiking cycle. However, the BoE continued to highlight the need for further monetary tightening and downplayed the weak 1Q GDP data. The MPC voted with a majority of 7 to 2 to keep the bank rate steady at 0.5%, again in line with the consensus expectation, with Ian McCafferty and Michael Saunders voting for a 25 bps hike. The key argument that the MPC put forward for keeping the policy rate on hold was that "the costs to waiting for additional information were likely to be modest, given the need for only limited tightening over the forecast period". The committee highlighted that it wants to see how the incoming data evolves in the coming months to understand whether the slowdown in economic activity will persist. Regarding forward guidance, the BoE toned down the hawkish stance of its February communication which highlighted that monetary tightening was required "somewhat earlier and by a somewhat greater extent". However, the bank still stressed that it would be appropriate to continue with an "ongoing tightening of monetary policy over the forecast period".

Fig. 3. UK: Market sees chance of 25 bps rate hike in August at 47% at end of last week

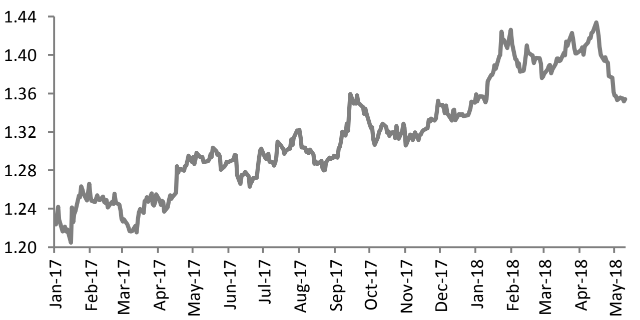
% probability of 25 bps rate hike at August meeting



Source: Bloomberg

Fig. 4. UK: GBP remains weak as market expectations of interest rate hikes in 2018 decline sharply

GBP:USD



Source: Bloomberg

BoE lowered both its GDP growth and inflation forecasts for 2018 – still optimistic in our view

The BoE downplayed the economic slowdown in 1Q arguing that it was mainly due to one-off bad weather conditions, and expects an upwards revisions to the growth figure to 0.3% q-o-q from 0.1% (first print). Nevertheless, the BoE lowered its 2018 growth forecast to 1.4% (1.8% previously) given the weakening in 1Q activity. The BoE's growth outlook for 2019 and 2020 was unchanged at 1.7% for both years. Its GDP growth and inflation forecasts remain optimistic in our view – thus, we expect some further downside revisions going forward. The bank lowered its inflation forecasts for each of the three years in the outlook period – to 2.2% for 2018 (from 2.4%), 2.1% for 2019 (2.2% earlier) and 2% for 2020 (2.1% previously). The main reason for the adjustments was the moderating pass through of the GBP devaluation. However, the committee's view on the underlying inflation outlook has not changed and they stated that domestic cost pressures "are firming gradually, broadly as expected", given the very limited slack in the economy and wage growth. The BoE estimates that wage growth will accelerate to 3.25% in 2019 and 3.5% in 2020.

We expect no interest rate hikes in 2018

The BoE's guidance suggests one 25 bps hike in each of 2018, 2019 and 2020, thus keeping its option open for raising rates this year. However, the chance of a rate hike in August look uncertain at this point, with markets pricing in a 47% probability for a 25 bps increase in the policy rate. The probability rises to 63% by the November meeting. Our base case is for no hikes in 2018, given the limited progress made in the Brexit negotiations and weak underlying economic fundamentals.

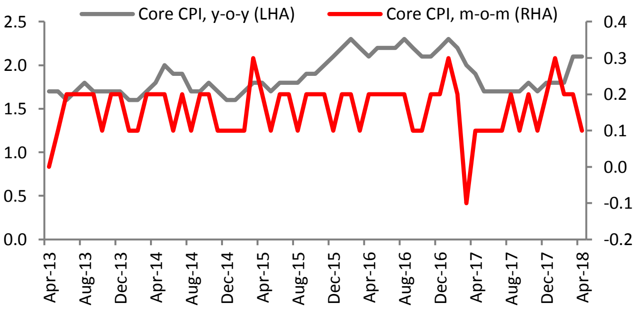
US: Core CPI inflation softer than expected in April

Core inflation softened to 0.1% m-o-m in April from 0.2% in March

Headline inflation accelerated to 0.2% m-o-m in April (March: -0.1), though came in below the consensus estimate of 0.3%. The rise was due to an increase in food and energy prices, which both strengthened from a contraction in March. However, core inflation decelerated to a four-month low of 0.1% m-o-m in April – lower than both the consensus expectation and the March print of 0.2%. This kept annual core inflation unchanged at 2.1% y-o-y in April (consensus: 2.2%). The monthly moderation in core inflation was mainly due to airfares and car prices contracting. As we have highlighted earlier, the fall in car prices was due to increased supply from off-lease vehicles entering the market. However, on the positive side, shelter prices remained strong, with rent for primary residences posting its strongest gain since early-2007. Notably, medical services prices continued to accelerate, which has a larger weighting in PCE inflation than in CPI. Thus, we believe that core PCE inflation (y-o-y and m-o-m) could strengthen in April. Despite the weak core CPI inflation, we believe that the Fed will retain its gradual interest rate hike stance. The Fed will also have the April PCE inflation report and May CPI print before its June FOMC meeting. We continue to expect another 25 bps Fed fund rate hike in June.

Fig. 5. US: Core inflation decelerated unexpectedly to 0.1% m-o-m in April, from 0.2% in March

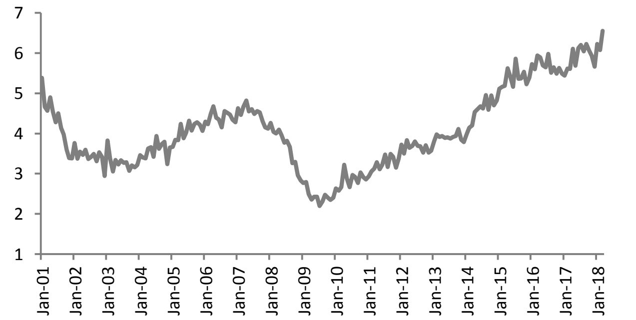
% change



Source: Bureau of Labor statistics

Fig. 6. US: Job openings reach record high of 6.55 million in March, from 6.1 million in February

Million, seasonally adjusted



Source: Bureau of Labour Statistics

US: March JOLTS data echoes resilient labour market

The JOLTS data for March continued to reflect healthy and tightening labour market conditions. Job openings rose to a historical high of 6.55 million, beating the consensus expectation of 6.1. The sectors driving job openings were broad-based with the largest increases seen in professional and business services (112K), trade, transportation and utilities (99K) and construction (68K). Similarly, education and the federal government saw a rise in available jobs. However, openings in manufacturing and financial activities fell in April. Despite rising job openings, the hiring rate remained steady at 3.7% for a second consecutive month in March. We believe that increasing job openings alongside a steady hiring rate suggests a shortage of skilled workers in a number of key sectors.

Job openings reached a record high of 6,550K in March, reflecting broad-based job creation

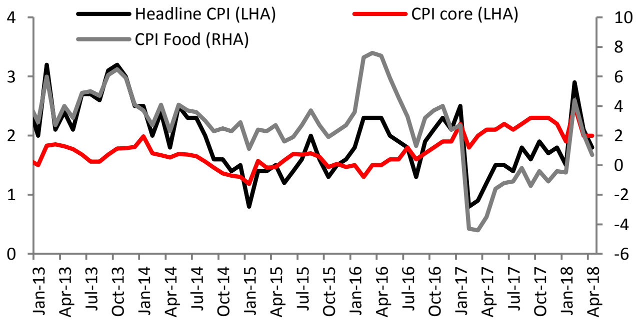
C. Emerging Market Economies

China: CPI inflation softens in April; export growth picks up

Headline CPI inflation decelerated to 1.8% y-o-y in April (March: 2.1%) – lower than the consensus expectation of 1.9%. This was mainly due to softening food inflation. Meanwhile, core and non-food inflation remained steady at 2% and 2.1% respectively in April. We believe that there were few signs of inflationary pressure at this point, though the rise in the crude price poses an upside risk to headline inflation in the upcoming months. The rise in oil prices has already started to feed into producer prices with PPI inflation in April rising to 3.4% y-o-y, (March: 3.1%). We think the pass-through from producer prices to consumer prices will have some lag effect but do not see headline CPI inflation breaching the government's 3% inflation target in 2018. Thus, we expect the PBoC to maintain its neutral monetary policy stance. We think the recent reserve requirement ratio cut by the PBoC was largely to support SME lending growth without altering its stance on inflation and ongoing deleveraging activity.

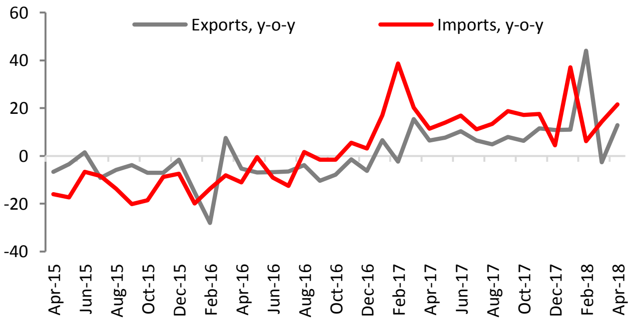
Headline CPI inflation softens in April but producer prices increase due to rising crude oil prices

Fig. 7. China: Headline inflation moderates in April, driven by food prices; core inflation steady



Source: National Bureau of Statistics of China

Fig. 8. China: Both export and import growth remain solid in April



Source: Customs General Administration PRC

The Chinese economy continued to expand at a steady pace in early-2018. Trade data released last week suggested that both exports and imports gained further momentum in April with exports growing by a solid 12.9% y-o-y in April (March: -2.7%) – higher than the consensus estimate of 8%. This suggests that the earlier trade tensions between the US and China had little impact on external trade. The recent and ongoing trade

Both exports and imports accelerate in April, suggesting solid external and local demand discussions between the US and China are a positive sign though the chance of further escalation remains a key risk, in our view. Meanwhile, imports also grew by a solid 21.5% y-o-y in April (March: 14.4%), indicating strong domestic demand.

II. Economic Calendar

Fig. 9. The week ahead

Time*	Country	Event	Period	Prior	Consensus
GCC Economies					
	UAE	M2 Money Supply m-o-m	Apr	0.7%	
	UAE	CPI y-o-y	Apr	3.4%	
	Saudi Arabia	CPI y-o-y	Apr	2.8%	
	Oman	CPI y-o-y	Apr	0.1%	
	Qatar	CPI y-o-y	Apr	0.4%	
	Egypt	Trade Balance	Mar	-3279M	
	Egypt	Lending Rate	17-May	17.75%	
	Egypt	Deposit Rate	17-May	16.75%	15.75%
Monday, 14 May					
3:50	Japan	PPI y-o-y	Apr	2.1%	2%
10:00	Japan	Machine Tool Orders y-o-y	Apr P	28.1%	
10:30	India	Wholesale Prices y-o-y	Apr	2.5%	2.9%
10:45	Eurozone	Fed's Mester, ECB's Villeroy Speak in Paris			
15:45	Eurozone	ECB's Praet Speaks in London			
16:00	India	CPI y-o-y	Apr	4.3%	4.4%
21:45	Eurozone	ECB's Coeure Speaks in Geneva			
Tuesday, 15 May					
6:00	China	Retail Sales y-o-y	Apr	10.1%	10%
6:00	China	Industrial Production y-o-y	Apr	6%	6.4%
8:30	Japan	Tertiary Industry Index m-o-m	Mar	0%	-0.2%
10:00	Germany	GDP SA q-o-q	1Q P	0.6%	0.4%
12:30	UK	Claimant Count Rate	Apr	2.4%	
12:30	UK	Jobless Claims Change	Apr	11.6K	
12:30	UK	Average Weekly Earnings, 3M/y-o-y	Mar	2.8%	2.6%
12:30	UK	Weekly Earnings, ex-Bonus 3M/y-o-y	Mar	2.8%	2.9%
12:30	UK	ILO Unemployment Rate, 3M	Mar	4.2%	4.2%
13:00	Eurozone	GDP SA q-o-q	1Q P	0.4%	0.4%
13:00	Eurozone	GDP SA y-o-y	1Q P	2.5%	2.5%
16:30	US	Empire Manufacturing	May	15.8	15
16:30	US	Retail Sales Advance m-o-m	Apr	0.6%	0.3%
16:30	US	Retail Sales Control Group	Apr	0.4%	0.4%
18:00	US	Fed Nominees Clarida and Bowman Testify Before Senate Panel			
21:00	US	Fed's Williams to Speak at Economic Club of Minnesota			
	India	Exports y-o-y	Apr	-0.7%	
Wednesday, 16 May					
3:50	Japan	GDP SA q-o-q	1Q P	0.4%	0%
3:50	Japan	GDP Annualized SA q-o-q	1Q P	1.6%	-0.1%
8:30	Japan	Industrial Production m-o-m	Mar F	1.2%	
13:00	Eurozone	CPI y-o-y	Apr F	1.3%	1.2%
16:00	Eurozone	ECB President Draghi Speaks in Frankfurt			
16:30	US	Fed's Bostic to Give Economic Update			
16:30	US	Housing Starts	Apr	1319K	1310K
17:15	US	Industrial Production m-o-m	Apr	0.5%	0.6%
Thursday, 17 May					
3:50	Japan	Core Machine Orders m-o-m	Mar	2.1%	-2.8%
18:00	US	Leading Index	Apr	0.3%	0.4%
20:00	UK	BOE Chief Economist Haldane Speaks in London			
Friday, 18 May					
3:30	Japan	National CPI y-o-y	Apr	1.1%	0.7%
11:00	US	Fed's Mester Speaks on Macro prudential, Monetary Policy			

* UAE time
Source: Bloomberg

Fig. 10. Last week's data

Time *	Country	Event	Period	Prior	Consensus	Actual
GCC Countries						
	UAE	Dubai Economy Tracker SA	Apr	55.3		53.9
	Egypt	Urban CPI, y-o-y	Apr	13.3%		13.1%
	Egypt	CPI Core, y-o-y	Apr	11.6%		11.6%
Monday, 7 May						
10:00	Germany	Factory Orders, m-o-m	Mar	-0.2%	0.5%	-0.9%
	China	Foreign Reserves	Apr	$3142.8B	$3131B	$3124.8B
Tuesday, 8 May						
10:00	Germany	Industrial Production SA, m-o-m	Mar	-1.7%	0.8%	1%
11:30	UK	Halifax House Prices, m-o-m	Apr	1.6%	-0.2%	-3.1%
18:00	US	JOLTS Job Openings	Mar	6078	6100	6550
	China	Trade Balance	Apr	-$5B	$27.8B	$28.8B
	China	Imports, y-o-y	Apr	14.4%	16%	21.5%
	China	Exports, y-o-y	Apr	-2.7%	7%	12.9%
Wednesday, 9 May						
9:00	Japan	Leading Index	Mar P	105.9	105.1	105
16:30	US	PPI Final Demand, m-o-m	Apr	0.3%	0.2%	0.1%
16:30	US	PPI Final Demand, y-o-y	Apr	3.0%	2.8%	2.6%
18:00	US	Wholesale Inventories, m-o-m	Mar F	0.5%	0.5%	0.3%
Thursday, 10 May						
3:50	Japan	BoP Current Account Balance	Mar	¥2076B	¥2929.3B	¥3122.3
5:30	China	PPI, y-o-y	Apr	3.1%	3.4%	3.4%
5:30	China	CPI, y-o-y	Apr	2.1%	1.9%	1.8%
12:30	UK	Trade Balance	Mar	-£1176	-£2000	-£3091
12:30	UK	Industrial Production, m-o-m	Mar	0.1%	0.2%	0.1%
12:30	UK	Manufacturing Production, m-o-m	Mar	-0.2%	-0.2%	-0.1%
15:00	UK	Bank of England Bank Rate	10-May	0.5%	0.5%	0.5%
15:00	UK	BOE Asset Purchase Target	May	435B	435B	435B
15:00	UK	BOE Corporate Bond Target	May	10B	10B	10B
16:30	US	CPI, m-o-m	Apr	-0.1%	0.3%	0.2%
16:30	US	CPI, y-o-y	Apr	2.4%	2.5%	2.5%
16:30	US	CPI, ex-Food and Energy, m-o-m	Apr	0.2%	0.2%	0.1%
16:30	US	CPI, ex-Food and Energy, y-o-y	Apr	2.1%	2.2%	2.1%
22:00	US	Monthly Budget Statement	Apr	-$208.7B	$212B	$214.3B
Friday, 11 May						
3:50	Japan	Money Stock M2, y-o-y	Apr	3.2%	3.2%	3.3%
16:00	India	Industrial Production, y-o-y	Mar	7%	6.2%	4.4%
16:30	US	Import Price Index, m-o-m	Apr	-0.2%	0.5%	0.3%
18:00	US	Univ. of Michigan Sentiment	May P	98.8	98.3	98.8
	China	Money Supply M2, y-o-y	Apr	8.2%	8.5%	8.3%
	China	New Yuan Loans CNY	Apr	1120B	1100B	1180B

* UAE time

Source: Bloomberg

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