

The Week Ahead: Fed to hike with dovish guidance for 2019

► **US: Dot plot likely to be lowered to two rate hikes for 2019**

The Fed is widely expected to raise the FFTR by 25 bps to the 2.25-2.5% range at its 18-19 December meeting. The interest rate on excess reserves (IOER) is forecast to increase by 20 bps, as outlined by the Fed in the November FOMC meeting minutes. There will be particular focus on the communication with the market expecting meaningful changes to the policy statement, new economic projections and the Fed Chair's post-meeting press conference. The tone of the meeting is expected to turn dovish, consistent with recent communication from FOMC members. The median dot plot is likely to be revised down to indicate two 25 bps hikes for 2019 (three currently) and one in 2020 (two currently). Consensus also envisages some marked language changes in the policy statement with the committee likely highlighting a shift to data dependency from its autopilot rate-hiking stance in 2018. The bond market is pricing in just one 25 bps hike in 2019, which looks pessimistic in our view given the ongoing above-trend economic expansion and still healthy labour market conditions. We continue to see two additional 25 bps FFTR hikes in 2019 after the December hike with the rate-hiking cycle likely coming to an end thereafter. Following the FOMC meeting, the market's attention will be on the potential government shutdown, with the 21 December deadline for agreeing a spending bill.

► **GCC: Central banks largely set to follow Fed in raising rates**

We expect most GCC central banks to raise their benchmark rates in line with the Fed. The Central Bank of the UAE is expected to increase its repo rate (lending rate) by 25 bps to 2.75%. In Saudi Arabia, SAMA is also likely to hike by the same magnitude, maintaining the 50 bps spread between its repo rate and the FFTR (upper bound). Three-month Saibor is trading at just an 11 bps premium to US Libor, from a wider differential of c.32 bps in September. However, we envisage that Qatar will again keep its lending rate steady at 5%, afforded by the margin with the FFTR, to limit upside pressure on the market lending rate. We envisage a similar move in Kuwait with the benchmark deposit rate being raised, though the lending rate will likely be kept on hold at 3%.

► **UK: Brexit uncertainty to continue; BoE and BoJ on hold**

Political uncertainty continues to remain elevated in the UK due to the dwindling likelihood of parliamentary approval for the government's Brexit bill (vote has to take place before 21 January). There are also increasing calls from politicians for a second referendum on Brexit, whilst the risk of a no-deal Brexit has also increased following the EU's rejection of any re-negotiation of the deal. Given this uncertainty, the BoE meeting scheduled for 20 December is likely to be a non-event with the central bank keeping the benchmark policy rate at 0.75%. We expect GBP to remain volatile until there is more clarity on Brexit. Elsewhere, the BoJ is also expected to leave its monetary policy unchanged at its policy meeting, including interest rates and asset purchases.

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I. Recent Events and Data Releases

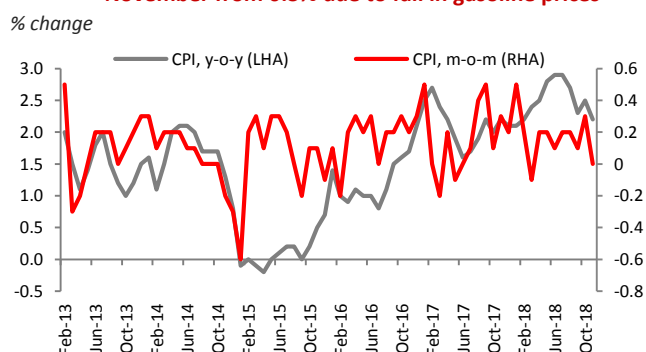
A. G4 Economies

US: November CPI inflation report in line with expectations

The inflation report for November had no major surprises that could affect the Fed's expected 25 bps rate hike at its upcoming December policy meeting. Headline inflation decelerated to 0% m-o-m (October: 0.3%), taking the y-o-y print to 2.2% (from 2.5%). This was largely due to the contraction in energy prices (-4.1% m-o-m), reflecting the recent moderation in global crude oil prices. Meanwhile, core inflation growth remained steady at 0.2% m-o-m, taking the y-o-y print to 2.2% (2.1% previously). Nevertheless, there were signs of stronger core service price growth, driven by a solid increase in the shelter (both rents and OER) and healthcare components. Moreover, the rise in these segments likely boosted core PCE inflation to 0.2% m-o-m in November from 0.1% in October. Overall, the inflation report supported our expectation of another 25 bps rate hike in December followed by two additional hikes in 2019 (March and June). We also envisage that the Fed will have more flexibility regarding the exact timing of rate hikes in 2019 given that the FOMC will hold press conferences following every meeting.

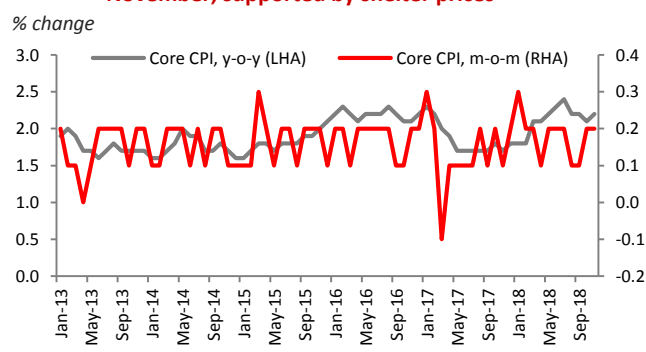
Core CPI inflation steady at 0.2% m-o-m in November

Fig. 1. US: Headline inflation decelerates to 0% m-o-m in November from 0.3% due to fall in gasoline prices



Source: Bureau of Labor statistics

Fig. 2. US: Monthly core inflation steady at 0.2% m-o-m in November, supported by shelter prices



Source: Bureau of Labor statistics

Eurozone: ECB to end asset purchases in December as planned

The ECB kept its monetary policy unchanged at its December meeting, in line with our and market expectations. The Governing Council (GC) reaffirmed that it will end its quantitative easing (QE) programme by the end of December and updated its forward guidance on the reinvestment programme. The ECB stated that it will continue to reinvest the principal payments from maturing securities purchased under the QE programme "for an extended period of time past the date when it starts raising the key ECB interest rates, and in any case as long as necessary". ECB President Mario Draghi also highlighted that the GC did not discuss any specific time frame for reinvestments, suggesting that the ECB prefers an open-ended time frame to remain flexible and adjust it based on evolving economic conditions. The capital key will continue to be the reference point for sovereign bond purchases, with portfolio allocation adjusted to bring the stock of public sector purchase programme (PSPP) holdings more in line with the new capital key.

ECB's reinvestment programme to remain open ended, with no time frame discussed at this point

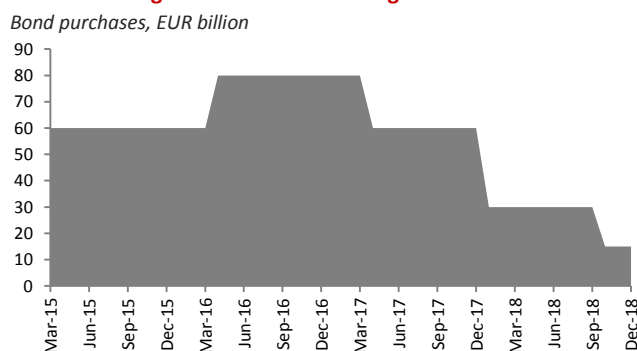
The forward guidance on interest rates was kept unchanged with the ECB reiterating that benchmark policy rates would “remain at their present levels at least through the summer of 2019”. The notable highlight of the post-meeting press conference was that Draghi acknowledged that there had been some discussion on TLTROs (targeted longer-term refinancing operations) during the meeting. Consensus believes that the ECB will extend the TLTRO in 1Q2019 to maintain favourable liquidity conditions in the banking sector.

No change to interest rate forward guidance

On the economic outlook, the tone of the ECB meeting was relatively dovish, with Draghi acknowledging that the balance of risks to the growth outlook was moving to the downside. Indeed, the ECB lowered its GDP growth projections for both 2018 (1.9% from 2% in September) and 2019 (1.7% from 1.8% previously). The ECB also reduced its inflation projection for 2019 to 1.6% from 1.7% in the September estimate. Despite the downward revisions, the ECB stated that underlying inflation is expected to increase over the medium term, supported by loose monetary policy conditions and rising wage growth.

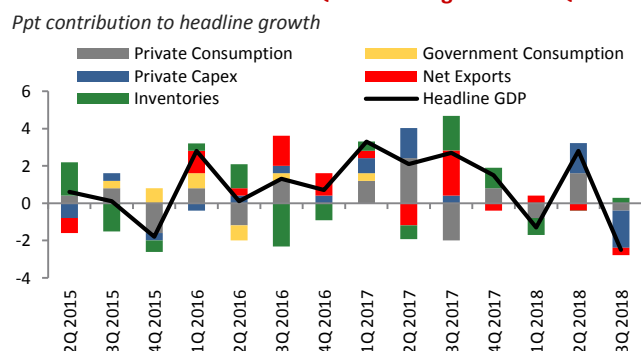
GDP growth forecasts reduced for 2018 and 2019

Fig. 3. Eurozone: ECB to end QE net purchases in December, though will reinvest maturing securities



Source: ECB

Fig. 4. Japan: Real GDP growth contracts by 2.5% q-o-q on annualised basis in 3Q from 2.8% growth in 2Q



Source: Economic and Social Research Institute Japan

Japan: 3Q GDP data revised down sharply in second estimate

Real GDP growth for 3Q was revised down sharply to -2.5% q-o-q saar in the second estimate (consensus: -2%) from -1.2% in the first estimate. This was largely due to a further contraction in capex spending, which was lowered to -2.8% q-o-q saar from -1.8% in the first estimate. Personal consumption and net exports also contributed negatively to GDP growth. The fall in growth was mainly due to disruptive weather conditions in the quarter, including widespread flooding (July), a nationwide heat wave (July/August), and typhoon and earthquake damage (September). However, we believe that the economy is likely to bounce back in 4Q to record positive growth, though we expect export growth to remain somewhat weak on the back of ongoing global trade tensions.

3Q GDP growth revision largely due to deepening capex spending contraction

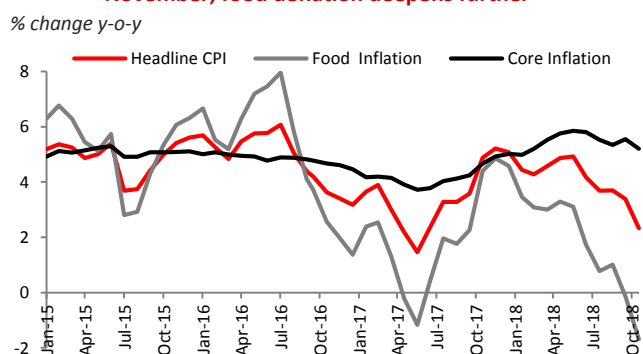
B. Emerging Market Economies

India: New RBI governor strikes dovish tone citing soft inflation

The Indian government appointed Shaktikanta Das as the new governor of the RBI following the unexpected resignation of Urjit Patel on 10 December. Das addressed the media after the appointment and highlighted that his priority will be to uphold “the autonomy, the integrity and credibility” of the central bank. On monetary policy, he underlined that the outlook for inflation remains “benign” and also emphasised that there is a need to support economic growth. We believe that these comments were relatively dovish compared to the MPC’s current monetary policy guidance of a “calibrated tightening” outlook. Indeed, we now expect the RBI to revert back to a “neutral” stance at its 6 February policy meeting.

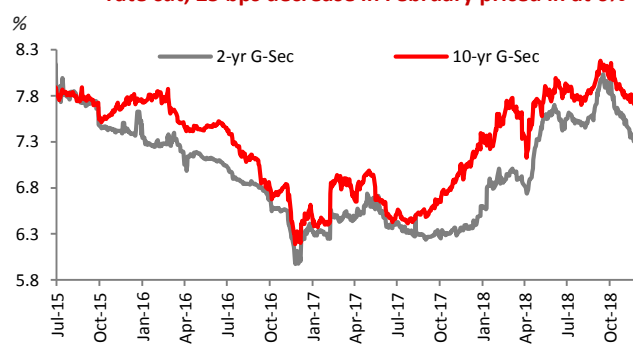
Shaktikanta Das appointed as new RBI governor

Fig. 5. India: Both headline and core inflation decelerate in November; food deflation deepens further



Source: India Central Statistical Organisation

Fig. 6. India: Bond market now expects RBI’s next move to be rate cut; 25 bps decrease in February priced in at 6%



Source: Bloomberg

In line with the dovish comments expressed by the new governor, November CPI inflation surprised to the downside and decelerated to 2.3% y-o-y (consensus: 2.6%) from the upwardly revised figure of 3.4% in October. This is the fourth consecutive month of headline inflation undershooting the RBI’s medium target of 4% (+/-2%), though it is still hovering within the lower target range. The moderation in headline inflation in November was largely due to deepening food deflation (-1.7% y-o-y) and some moderation in fuel prices. Core inflation (ex-food, tobacco and fuel) also softened to 5.7% y-o-y in November from 6.2% in October, supported by the housing and transportation components. We expect headline inflation to remain benign on the back of the recent drop in the global crude oil price and the arrival of fresh seasonal crops, which is expected to deepen food deflation further.

November inflation surprises to downside with deepening food deflation

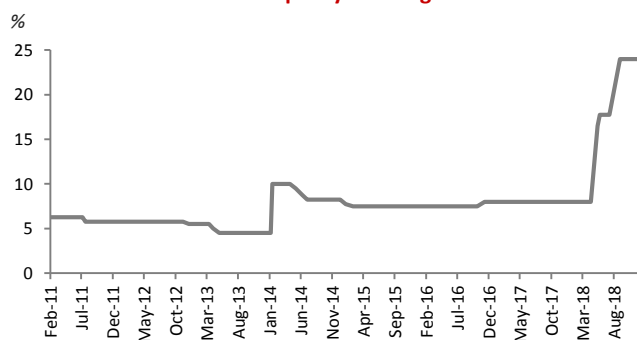
Turkey: CBRT on hold with no major change in forward guidance

The CBRT kept its one-week repo rate steady at 24% at its 13 December monetary policy meeting, in line with our and the market’s expectations. The tone of the meeting was slightly dovish with the removal of the word “decisively” from the statement. The message now is that the tight monetary policy stance “will be maintained until [the] inflation outlook displays significant improvement”. The other notable change in the statement was the acknowledgement of some improvement in the inflation data in November although the MPC did reiterate that there remain some upside risks to the

CBRT reiterates tight monetary policy stance albeit with dovish tone

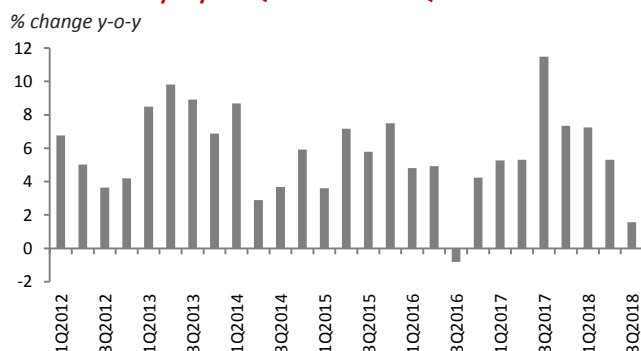
inflation outlook. We believe that the changes in the statement do not materially alter the CBRT’s current monetary policy guidance. However, the CBRT looks increasingly comfortable with the current outlook, especially given the TRY’s appreciation since early September, the moderation in inflation in November and the improvement in the current account balance. Moreover, the sharp slowdown in GDP growth in 3Q to 1.6% y-o-y (2Q:5.8%) also indicates that weakening domestic demand will provide some further support to rein in inflation, albeit only gradually. Overall, we expect the CBRT to remain on hold in 1Q2019 with a wait and watch stance before committing to any changes in the future path of rates.

Fig. 7. Turkey: CBRT leaves one-week repo rate unchanged at 24% at December policy meeting



Source: CBRT

Fig. 8. Turkey: Real GDP growth moderates significantly to 1.6% y-o-y in 3Q from 5.3% in 2Q



Source: Turkish Statistical Institute

II. Economic Calendar

Fig. 9. The week ahead

Time*	Country	Event	Period	Prior	Consensus
Expected this week					
	UAE	M2 Money Supply, m-o-m	Nov	-2%	
	UAE	Central Bank Foreign Assets	Nov	327.1B	
	UAE	CPI, y-o-y	Nov	1.6%	
	Saudi Arabia	CPI, y-o-y	Nov	2.4%	
	Saudi Arabia	Non-Oil Exports, y-o-y	Oct	40.6%	
	Bahrain	CPI, y-o-y	Nov	0.5%	
	Bahrain	GDP Constant Prices, y-o-y	3Q	2.4%	
	Kuwait	CPI, y-o-y	Nov	0.2%	
Monday, 17 December					
11:00	Turkey	Industrial Production, m-o-m	Oct	-2.7%	-4.3%
11:00	Turkey	Unemployment Rate	Sep	11.1%	11.6%
14:00	Eurozone	CPI, y-o-y	Nov F	2.2%	2%
17:30	US	Empire Manufacturing	Dec	23.3	20
Tuesday, 18 December					
13:00	Germany	IFO Business Climate	Dec	102	101.7
17:30	US	Housing Starts	Nov	1228K	1230K
Wednesday, 19 December					
13:30	UK	CPI, m-o-m	Nov	0.1%	0.2%
13:30	UK	CPI, y-o-y	Nov	2.4%	2.3%
13:30	UK	CPI Core, y-o-y	Nov	1.9%	1.8%
17:30	US	Current Account Balance	3Q	-\$101.5B	-\$124.8B
19:00	US	Existing Home Sales	Nov	5.22M	5.2M
23:00	US	FOMC Rate Decision (Upper Bound)	19-Dec	2.25%	2.5%
23:00	US	FOMC Rate Decision (Lower Bound)	19-Dec	2%	2.25%
23:00	US	Interest Rate on Excess Reserves	20-Dec	2.2%	2.4%
23:30	US	Fed's Powell Holds Press Conference After FOMC Decision			
Thursday, 20 December					
8:30	Japan	All Industry Activity Index, m-o-m	Oct	-0.9%	2%
13:30	UK	Retail Sales, inc-Auto Fuel, m-o-m	Nov	-0.5%	0.3%
13:30	UK	Retail Sales, inc-Auto Fuel, y-o-y	Nov	2.2%	2%
16:00	UK	Bank of England Bank Rate	20-Dec	0.75%	0.75%
16:00	UK	BOE Asset Purchase Target	Dec	435B	435B
19:00	US	Leading Index	Nov	0.1%	0.1%
	Japan	BOJ Policy Balance Rate	20-Dec	-0.1%	-0.1%
	Japan	BOJ 10-Year Yield Target	20-Dec	0%	0%
Friday, 21 December					
3:30	Japan	National CPI, y-o-y	Nov	1.4%	0.8%
3:30	Japan	National CPI, ex-Fresh Food, y-o-y	Nov	1%	1%
13:30	UK	GDP, q-o-q	3Q F	0.6%	0.6%
13:30	UK	GDP, y-o-y	3Q F	1.5%	1.5%
17:30	US	GDP Annualized, q-o-q	3Q T	3.5%	3.5%
17:30	US	Personal Consumption	3Q T	3.6%	3.6%
17:30	US	Durable Goods Orders	Nov P	-4.3%	1.7%
17:30	US	Durables, ex Transportation	Nov P	0.2%	0.3%
17:30	US	Cap Goods Shipments, Non-defence ex-Air	Nov P	0.3%	0.2%
19:00	Eurozone	Consumer Confidence	Dec A	-3.9	-4.3
19:00	US	Personal Income	Nov	0.5%	0.3%
19:00	US	Personal Spending	Nov	0.6%	0.3%
19:00	US	PCE Core, m-o-m	Nov	0.1%	0.2%
19:00	US	PCE Core, y-o-y	Nov	1.8%	1.9%
19:00	US	University of Michigan Sentiment	Dec F	97.5	97.5

* UAE time

Source: Bloomberg

Fig. 10. Last week's data

Time*	Country	Event	Period	Prior	Consensus	Actual
EM Countries						
	UAE	Dubai Economy Tracker SA	Nov	52.5		55.3
	Oman	CPI, y-o-y	Nov	1%		1.1%
	Egypt	Urban CPI, y-o-y	Nov	17.7%		15.7%
	China	Money Supply M2, y-o-y	Nov	8%	8%	8%
	China	New Yuan Loans CNY	Nov	697B	1150B	1250B
Monday, 10 December						
3:50	Japan	GDP SA, q-o-q	3Q F	-0.3%	-0.5%	-0.6%
3:50	Japan	GDP Annualized SA, q-o-q	3Q F	-1.2%	-2%	-2.5%
11:00	Turkey	GDP, y-o-y	3Q	5.2%	2.2%	1.6%
13:30	UK	Trade Balance	Oct	£2331M	£1267M	£3300M
13:30	UK	Industrial Production, y-o-y	Oct	0%	-0.1%	-0.8%
13:30	UK	Monthly GDP, 3M/3M Change	Oct	0.6%	0.4%	0.4%
19:00	US	JOLTS Job Openings	Oct	6960	7100	7079
Tuesday, 11 December						
3:50	Japan	Money Stock M2, y-o-y	Nov	2.7%	2.6%	2.3%
11:00	Turkey	Current Account Balance	Oct	1.81B	2.5B	2.8B
13:30	UK	Average Weekly Earnings, 3M/y-o-y	Oct	3.1%	3%	3.3%
13:30	UK	Weekly Earnings, ex-Bonus, 3M/y-o-y	Oct	3.2%	3.2%	3.3%
13:30	UK	ILO Unemployment Rate, 3M	Oct	4.1%	4.1%	4.1%
17:30	US	PPI Final Demand, y-o-y	Nov	2.9%	2.5%	2.5%
Wednesday, 12 December						
8:30	Japan	Tertiary Industry Index, m-o-m	Oct	-1.2%	0.8%	1.9%
16:00	India	CPI, y-o-y	Nov	3.4%	2.6%	2.3%
16:00	India	Industrial Production, y-o-y	Oct	4.5%	6%	8.1%
17:30	US	CPI, m-o-m	Nov	0.3%	0%	0%
17:30	US	CPI, y-o-y	Nov	2.5%	2.2%	2.2%
17:30	US	CPI, ex-Food and Energy, m-o-m	Nov	0.2%	0.2%	0.2%
17:30	US	CPI, ex-Food and Energy, y-o-y	Nov	2.1%	2.2%	2.2%
Thursday, 13 December						
15:00	Turkey	One-Week Repo Rate	13-Dec	24%	24%	24%
16:45	Eurozone	ECB Main Refinancing Rate	13-Dec	0%	0%	0%
16:45	Eurozone	ECB Marginal Lending Facility	13-Dec	0.25%	0.25%	0.25%
16:45	Eurozone	ECB Deposit Facility Rate	13-Dec	-0.4%	-0.4%	-0.4%
17:30	US	Import Price Index, m-o-m	Nov	0.5%	-1%	-1.6%
Friday, 14 December						
3:50	Japan	Tankan Large Manufacturing Index	4Q	19	18	19
3:50	Japan	Tankan Large Manufacturing Outlook	4Q	19	17	15
3:50	Japan	Tankan Large Non-Manufacturing Index	4Q	22	21	24
3:50	Japan	Tankan Large Non-Manufacturing Outlook	4Q	22	20	20
6:00	China	Retail Sales, y-o-y	Nov	8.6%	8.8%	8.1%
6:00	China	Industrial Production, y-o-y	Nov	5.9%	5.9%	5.4%
12:30	Eurozone	Markit Eurozone Manufacturing PMI	Dec P	51.8	51.8	51.4
17:17	India	Exports, y-o-y	Nov	17.9%		0.8%
17:30	US	Retail Sales Advance, m-o-m	Nov	1.1%	0.1%	0.2%
17:30	US	Retail Sales, ex-Auto, m-o-m	Nov	1%	0.2%	0.2%
17:30	US	Retail Sales, ex-Auto and Gas, m-o-m	Nov	0.7%	0.4%	0.5%
17:30	US	Retail Sales Control Group	Nov	0.7%	0.4%	0.9%
18:15	US	Industrial Production, m-o-m	Nov	-0.2%	0.3%	0.6%
18:45	US	Markit US Manufacturing PMI	Dec P	55.3	55	53.9

* UAE time

Source: Bloomberg

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