The Week Ahead: UK Parliament Brexit vote to take centre stage

Economics Team

Monica Malik, Ph.D.
Chief Economist
+971 (0)2 696 8458
Monica.Malik@adcb.com

Thirumalai Nagesh
Economist
+971 (0)2 696 2704
Thirumalainagesh.Venkatesh@adcb.com

Contents

UK: Prime Minister's Brexit plan unlikely to pass

The UK Parliament is set to vote on Prime Minister Theresa May's Brexit plan on 15 January (rescheduled from December) with expectations widespread that it will be rejected. Brexit supporters within the Conservative Party have continued to express opposition to the Withdrawal Agreement, with Labour members potentially looking to break the impasse with a second referendum or general election (Jeremy Corbyn's preferred option). Our core view remains that the UK is unlikely to leave the EU without a deal, though this would require an extension of Article 50 beyond 29 March, and substantial uncertainties remain regarding political developments. Recent events suggest that Parliament is looking to take greater control of Brexit and there is broad-based support to avoid a chaotic exit from the EU. In December, MPs voted to allow Parliament to seize control of Brexit if the House of Commons were to vote down May's deal. Moreover, last week the government lost two Brexit votes: i) limiting the government's financial powers in the event of a no-deal exit; and ii) forcing the PM to announce new plans within three days if her deal fails to pass in the Commons. The latter stops the government trying to run down the clock towards a 'no-deal' Brexit to garner support for its proposal. If May's deal does not pass next week, a second referendum or no confidence motion against the government could increase the likelihood of a general election.

US: Government shutdown reduces chances of March rate hike

The government shutdown and dovish Fed reduce the chances of a March rate hike. The shutdown has exceeded the previous 21-day record (in 1995-96) and there is no end in sight. This will distort key macroeconomic data points including employment, alongside result in delays to data releases. Indeed, December retail sales data (due 16 January) is likely to be delayed. Some 800K federal workers were not paid last Friday and a protracted shutdown could result in a meaningful drag on growth. Moreover, the recent Fed communication remained bearish with patience highlighted, especially as upside inflationary pressure remains contained (page 3). A number of FOMC members have speaking engagements this week and we expect the cautious tone to continue, especially given the government shutdown. We continue to see two hikes in 2019 with the timing shifted to June and December, though with risk to the downside (page 4).

Turkey: CBRT expected to remain on hold

We expect the CBRT to keep key benchmark interest rates steady at its 16 January meeting, including the one-week repo rate at 24%. Steady rates are important to anchor the TRY and inflation expectations. Headline inflation decelerated to 20.3% y-o-y in December from a peak of 25.2% in October. The extension of tax cuts and the fall in global oil prices should lead to a further gradual deceleration in headline inflation in 1Q2019, possibly prompting the start of a gradual rate-easing cycle. Elsewhere, CPI prints for December are expected this week including from India, Japan and the UK.

I. Recent Events and Data Releases

A. MENA Economies

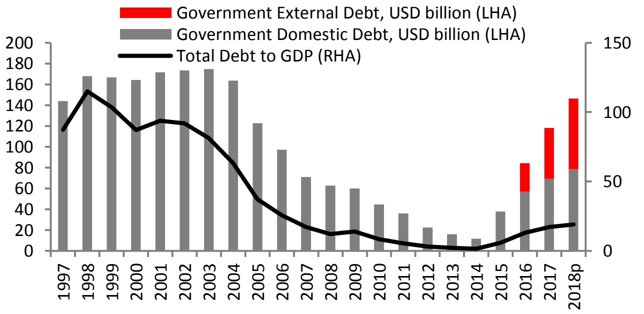
Saudi Arabia: Government raises USD7.5 billion in international debt

Attractive pricing, improving market conditions and index inclusion support demand

The Saudi government returned to the international debt market last week, marking its first international issuance since geopolitical uncertainties increased in October. The paper was split into two tranches: i) a USD4 billion 10-year note at 175 bps over US Treasuries; and ii) a USD3.5 billion 31-year note at 230 bps over US Treasuries. Over USD27 billion in orders was received for the dual-tranche paper with a number of factors likely supporting the demand. These include the attractive pricing at around 20-25 bps over the existing curve. Saudi Arabia initially marketed the spreads at around a 40 bps premium. The price of the longer-dated maturity was particularly generous, especially given Saudi Arabia's debt ratings. Favourable market conditions, such as ample market liquidity for primary debt and rising emerging market sentiment, were also factors supporting demand, alongside inclusion in the JP Morgan government bond indices.

Fig. 1. Saudi Arabia: Total government debt at c.19.1% of GDP at end of 2018

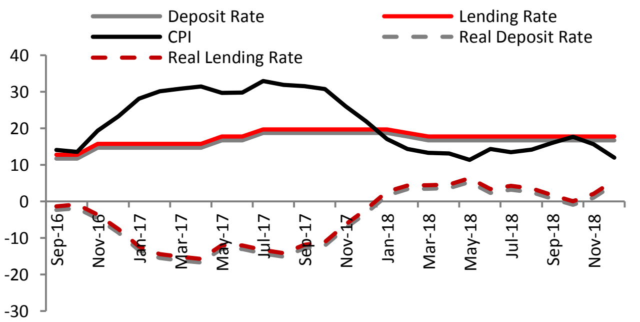
USD billion (LHA); % of GDP (RHA)



Source: Ministry of Finance, ADCB estimates

Fig. 2. Egypt: CBE may look for higher real interest rates than in 1Q2018 before resuming interest rate cuts

%



Source: CAPMA, Central Bank of Egypt, ADCB calculations

Saudi government expected to issue further debt as funding requirements increase in 2019

We see the early move in issuing the debt as positive as it removes some uncertainties related to geopolitical issues. We expect further debt to be issued by the Saudi government to fund the fiscal deficit, which is expected to widen in 2019 due to a lower annual average oil price and a rise in government spending. For further details, please see our note – **Saudi Arabia 2019 Budget: Sentiment boosting budget, deficit expected to widen**, published on 19 December 2018. The official budget projects a deficit of SAR131 billion (USD34.9 billion) in 2019 with government spending slated to rise by 7.4% from actual spending in 2018. We see the potential for a larger deficit of above USD60 billion as the oil revenue assumptions in the budget look optimistic. We think that a significant part of the deficit will be covered by debt, which will also help to reduce the pace of drawdowns from official FX reserves. Saudi Arabia's government debt stood at around 19.1% of GDP at end-2018, highlighting the space to issue further debt. We also expect GREs to raise further debt to support Saudi Arabia's wider transformation plan. Energy Minister Khalid al-Falih indicated that Saudi Aramco will issue around USD10 billion in bonds in 2Q2019 to help part-finance its planned acquisition of a controlling stake in petrochemical maker SABIC from the PIF (along with loans). This in turn would provide the PIF with funds to progress with key development projects.

Egypt: Sharp deceleration in headline inflation, CBE to remain cautious

CBE expected to take cautious approach, though lower inflation opens door to 1H rate cut

Egypt's headline inflation slowed markedly in December, decelerating to 12% y-o-y from 15.7% in November and 17.7% in October. The December print was the lowest since May and meant that inflation hit the CBE's year-end inflation target of 13% ±3%. Moreover, inflation is just within the end-2019 target range of 9% ±3%. The softening in headline inflation was largely due to the normalisation in food prices following the spike in 4Q2018. Food inflation (which accounts for 40% of the CPI basket) decelerated to 11.2% y-o-y in December from 18.7% in November, after contracting 6.7% m-o-m. This alone shaved some 3 percentage points off the headline rate. Meanwhile, non-food inflation remains contained, rising by 0.2% m-o-m in December. We expect a further gradual moderation in headline inflation in January. This should help the CBE resume its easing cycle in 1H2019, though we believe a cut is unlikely at the February meeting. We believe that the CBE will want to see further prints to ensure that the downward trajectory of inflation is established. Stability in global markets and capital flows to EM will also be a key factor for the central banks given the reduction in foreign holdings of Egyptian treasuries. As such, the monetary policymakers are likely to want to keep a larger real interest rate buffer than in 1Q2018 during the last interest rate cutting cycle. Oil price developments will play a more important role in the inflation outlook from April, as the government recently announced a new fuel indexation mechanism.

B. G4 Economies

US: Fed highlights patient approach in December minutes

Communication points to more nuanced approach as Fed reaches end of cycle

The minutes of the Fed's December FOMC meeting confirmed the recent more dovish stance of US policymakers. The minutes continued to emphasise the committee's shift to a more data-dependent approach in 2019 as the Fed approaches the end of its hiking cycle, whilst the subdued inflation allows officials to remain patient regarding any further rate hikes. We continue to see two hikes in 2019, albeit with more downside than upside risk, and with the timing pushed back until market and domestic uncertainties subside. The minutes also noted that recent developments such as financial market volatility and increased concerns about global growth "made the appropriate extent and timing of future policy firming less clear than earlier". Nevertheless, the FOMC did not see material changes in the economic outlook as yet and noted the dichotomy between strong economic data and volatility in the financial markets. The minutes stressed that consumer spending remains the backbone of economic growth, whilst largely dismissing the recent slowdown in business investment as likely temporary. The minutes also outlined some of the rationale behind the changes in the December post-meeting statement. Notably, the change to "some further gradual increases" is aimed at indicating that "a relatively limited amount of additional tightening likely would be appropriate".

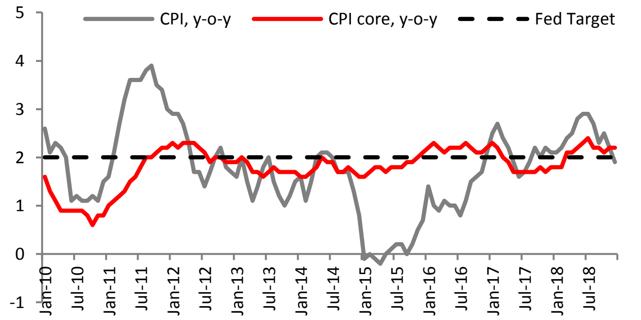
More uncertainty over March rate hike due to government shutdown

The minutes are in line with other recent communications from key Fed members, which point to a more patient and wait-and-see approach until there is greater clarity on global growth, US financial conditions and the underlying momentum of the US economy. A further easing in financial conditions, as happened at the start of the year, and US growth staying strong will be critical for any 1H2019 rate hikes. However, the government shutdown makes assessing the state of the economy more difficult, which has raised further uncertainty around a March hike. A protracted shutdown could be a meaningful drag on growth, alongside delaying economic data releases from the Census Bureau and Bureau of Economic Analysis. Key data releases, such as retail sales and GDP, are likely to be delayed whilst labour data is likely to be distorted. We now expect the rate hikes in June and December rather than our earlier assumption of March and June earlier.

December CPI: Printed in line with consensus expectations, with headline inflation moderating due to softer energy prices and core inflation remaining stable and just above the Fed's target. Headline inflation slowed to 1.9% y-o-y (November: 2.2%), after energy prices contracted by 7.4% m-o-m. Core CPI remained steady both on a y-o-y basis (at 2.2%) and a m-o-m basis (0.2%). Both core goods (0.1%) and services (0.3%) inflation rose m-o-m.

Fig. 3. US: Headline inflation moderates on softer energy prices, core inflation remains steady

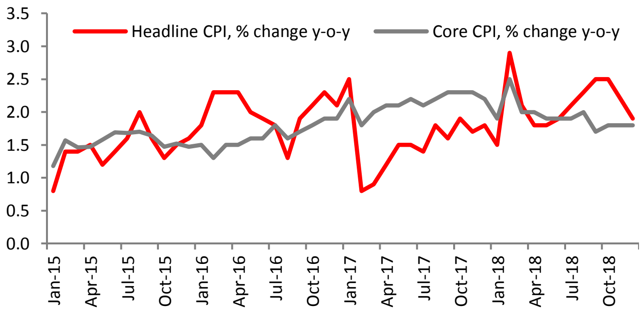
% change y-o-y



Source: Bureau of Labor Statistics

Fig. 4. China: Domestic inflationary pressure remains contained and reflected in core inflation

% change y-o-y



Source: National Bureau of Statistics of China

C. Emerging Market Economies

China: Benign inflation backdrop provides space for further easing

Core inflationary pressure remains muted with soft domestic demand

China's headline consumer price inflation slowed to 1.9% y-o-y in December – weaker than expected (2.1%) and down from 2.2% in November. On a monthly basis, prices were flat, i.e. 0% m-o-m, highlighting the weak inflation backdrop. The deceleration in annual inflation was largely due to the easing in global energy prices. Indeed, the deflation in fuel prices was particularly notable, as they contracted by 0.5% y-o-y in December versus growth of 12.6% in November. Core CPI (ex-food and energy) remained steady at 1.8% y-o-y for a third consecutive month. We expect a further softening in China's headline inflation this year due to the lower oil price. Moreover, the lacklustre domestic demand is also keeping core inflation muted.

We expect further targeted monetary and fiscal easing

As such, we see further space for an easing of monetary policy, including selective credit easing for private sector firms in certain sectors. Indeed, we expect additional cuts to the RRR in 2019 after the 100 bps broad-based reduction on 4 January, which we believe was primarily aimed at supporting lending to the private sector. The government has also reiterated its commitment to bolstering domestic demand through fiscal policy, including tax cuts.

II. Economic Calendar

Fig. 5. The week ahead

Time*	Country	Event	Period	Prior	Consensus
Expected this week					
	UAE	CPI, y-o-y	Dec	1.34%	--
	UAE	Central Bank Foreign Assets	Dec	346.3B	
	Saudi Arabia	CPI, y-o-y	Dec	2.8%	--
	China	Foreign Direct Investment, y-o-y CNY	Dec	-26.3%	--
	China	New Yuan Loans, CNY	Dec	1250B	850B
Monday 14 January					
16:00	India	CPI, y-o-y	Dec	2.3%	2.2%
	China	Trade Balance	Dec	$44.7B	$51.6B
	China	Exports, y-o-y	Dec	5.4%	2%
	China	Imports, y-o-y	Dec	3%	4.5%
Tuesday 15 January					
17:30	US	Empire Manufacturing	Jan	10.9	11.3
17:30	US	PPI Final Demand, m-o-m	Dec	0.1%	-0.1%
19:00	Eurozone	ECB's Draghi Presents 2017 Annual Report in Strasbourg			
20:30	US	Fed's Kashkari Speaks on Regional Economy in Minnesota			
22:00	US	Fed's George Speaks on Economy and Monetary Policy Outlook			
22:00	US	Fed's Kaplan Speaks in Plano, Texas			
	India	Trade Balance	Dec	-$16670.7M	-$14300M
	India	Exports, y-o-y	Dec	0.8%	--
	India	Imports, y-o-y	Dec	4.3%	--
Wednesday 16 January					
8:15	UAE	Dubai Economy Tracker SA	Dec	55.3	--
13:15	UK	BOE Governor Carney Testifies on Financial Stability Report			
13:30	UK	CPI, m-o-m	Dec	0.2%	0.2%
13:30	UK	CPI, y-o-y	Dec	2.3%	2.1%
13:30	UK	CPI Core, y-o-y	Dec	1.8%	1.8%
16:00	US	MBA Mortgage Applications	11-Jan	23.5%	--
17:30	US	Retail Sales Advance, m-o-m	Dec	0.2%	0.1%
17:30	US	Retail Sales, ex-Auto and Gas, m-o-m	Dec	0.5%	0.4%
17:30	US	Retail Sales Control Group, m-o-m	Dec	0.9%	0.4%
23:00	US	US Federal Reserve Releases Beige Book			
Thursday 17 January					
3:30	US	Fed's Kashkari Speaks on Panel About Financial Crisis			
4:00	Japan	BOJ Kuroda and Amamiya make a speech at G20 Symposium			
13:30	UK	Bank of England Credit Conditions & Bank Liabilities Surveys			
15:00	Eurozone	ECB's Lautenschlaeger Speaks in Dublin			
17:30	US	Housing Starts	Dec	1256K	1253K
17:30	US	Initial Jobless Claims	12-Jan	216K	220K
19:45	US	Fed's Quarles Speaks at Insurance Industry Forum			
Friday 18 January					
3:30	Japan	Natl CPI, y-o-y	Dec	0.8%	0.3%
3:30	Japan	Natl CPI, ex- Fresh Food, y-o-y	Dec	0.9%	0.8%
13:30	UK	Retail Sales, ex-Auto Fuel, m-o-m	Dec	1.2%	-0.8%
13:30	UK	Retail Sales, ex-Auto Fuel, y-o-y	Dec	3.8%	3.8%
13:30	UK	Retail Sales, inc. Auto Fuel, m-o-m	Dec	1.4%	-0.8%
13:30	UK	Retail Sales, inc. Auto Fuel, y-o-y	Dec	3.6%	3.6%
18:05	US	Fed's Williams Speaks on Economic Outlook and Monetary Policy			
19:00	US	U. of Mich. Sentiment	Jan P	98.3	96.8
19:00	US	U. of Mich. Expectations	Jan P	87	--

* UAE time

Source: Bloomberg

This report is intended for general information purposes only. It should not be construed as an offer, recommendation or solicitation to purchase or dispose of any securities or to enter in any transaction or adopt any hedging, trading or investment strategy. Neither this report nor anything contained herein shall form the basis of any contract or commitment whatsoever. Distribution of this report does not oblige Abu Dhabi Commercial Bank PJSC ("ADCB") to enter into any transaction.

The content of this report should not be considered legal, regulatory, credit, tax or accounting advice. Anyone proposing to rely on or use the information contained in the report should independently verify and check the accuracy, completeness, reliability and suitability of the information and should obtain independent and specific advice from appropriate professionals or experts regarding information contained in this report.

Information contained herein is based on various sources, including but not limited to public information, annual reports and statistical data that ADCB considers accurate and reliable. However, ADCB makes no representation or warranty as to the accuracy or completeness of any statement made in or in connection with this report and accepts no responsibility whatsoever for any loss or damage caused by any act or omission taken as a result of the information contained in this report.

Charts, graphs and related data or information provided in this report are intended to serve for illustrative purposes only. The information contained in this report is prepared as of a particular date and time and will not reflect subsequent changes in the market or changes in any other factors relevant to their determination. All statements as to future matters are not guaranteed to be accurate. ADCB expressly disclaims any obligation to update or revise any forward looking statements to reflect new information, events or circumstances after the date of this publication or to reflect the occurrence of unanticipated events.

This report is being furnished to you solely for your information and neither it nor any part of it may be used, forwarded, disclosed, distributed or delivered to anyone else. You may not copy, reproduce, display, modify or create derivative works from any data or information contained in this report.