

The Week Ahead: Fed communication and UK labour market report

► **US: January FOMC minutes and Fed speeches**

The minutes from the FOMC's January meeting (due 20 February) will be the key release from the US this week. Focus will be particularly on the rationale behind the Fed's abrupt shift in stance to remain "patient" at its January meeting, after highlighting the need for additional rate hikes in December. We will be looking for any fresh insights into how the FOMC participants view the rate hiking cycle, i.e. whether it is close to completion and the expected degree of further rate hikes in the near-term. The discussion on the balance sheet adjustments will also be watched closely after Fed Chair Jerome Powell highlighted that the FOMC was evaluating the right timing to end the balance sheet run-off during his post-meeting press conference. A number of FOMC members, including John Williams, Randal Quarles and James Bullard, have speaking engagements this week. We expect their tone to remain cautious, highlighting a wait-and-see approach. We do not see the Fed hiking again until mid-2019, whilst the market is not pricing in any rate hike in 2019. On the data front, US durable goods orders (due 21 February) are expected to show solid activity in December, reflecting healthy aircraft orders. Consensus estimates that headline durable goods orders grew by a solid 1.8% m-o-m in December, from 0.7% in November.

► **Global: UK's labour data and Japan inflation in focus**

The UK will release its December labour market report on 19 February, with headline wage growth forecast to have strengthened for the sixth consecutive month to 3.5% 3M/y-o-y (November: 3.4%). However, given the weakening economic activity amidst Brexit uncertainty and the softening headline inflation, a solid report is unlikely to change the BoE's wait-and-see stance in our view. In the Eurozone, attention will be on the review of Italy's sovereign rating by Fitch (22 February) and political developments in Spain, after the Prime Minister Pedro Sánchez last week called for a snap election on 28 April. Elsewhere, Japan will release its inflation and trade balance data for January. Consensus estimates core CPI (ex-fresh food) accelerated marginally to 0.8% y-o-y in January driven by electricity charges, from 0.7% in December. Nevertheless, headline inflation is forecast to have moderated to 0.2% y-o-y in January (December: 0.3%) due to lower food and gasoline prices.

► **Egypt: CBE cuts benchmark rates by 100 bps**

The CBE lowered its benchmark interest rates by 100 bps at its 14 February meeting, in line with our expectation. The central bank noted that the "incoming data continued to confirm the moderation of underlying inflationary pressures". We expect further rate cuts by the CBE at its upcoming meetings, especially as real interest rates remain positive and relatively high as the inflation rate has moderated. However, any further easing will be contingent on a number of factors, including the further deceleration in headline inflation and stability in the EGP. The central bank might pause rates in times of subsidy and price reforms. Please see page 2 for further details.

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I. Recent Events and Data Releases

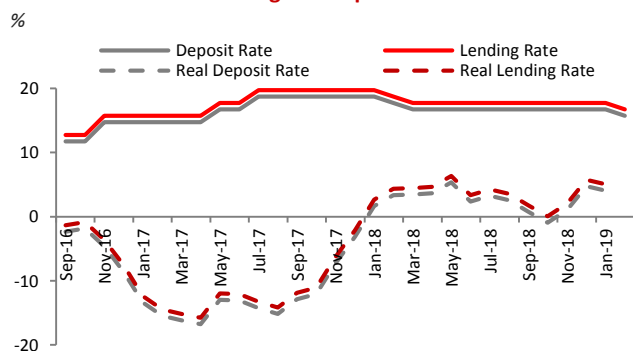
A. MENA Economies

Egypt: CBE cuts benchmark rates by 100 bps

The CBE lowered its benchmark interest rates by 100 bps at its 14 February meeting, taking the overnight deposit rate to 15.75% and the overnight lending rate to 16.75%. The cut was in line with our expectation, though consensus had forecast rates would remain on hold. This was the first rate cut since March 2018, when the easing cycle was interrupted by rising oil prices and the US rate hiking cycle, which resulted in emerging markets volatility and capital outflows. We had expected a rate cut by the CBE at its February meeting on: i) the improved external backdrop and signs of healthy capital inflows into Egypt (equity and debt); and ii) the deceleration in headline inflation due to the unwinding of the 2H2018 food price spike. Indeed, the central bank stated in its post-meeting statement that the “incoming data continued to confirm the moderation of underlying inflationary pressures”. Furthermore, the statement noted that the CBE’s first inflation target of 13% (± 3 pp) for 4Q2018 had been achieved and that the global tightening of financial conditions had eased.

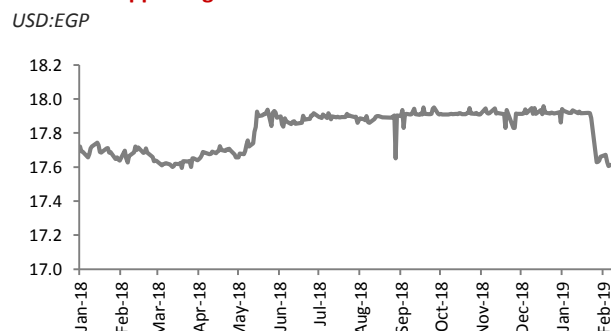
CBE notes moderation in underlying inflationary pressure in post-meeting communication

Fig. 1. Egypt: Monetary policy remains tight, with softening inflation resulting in real positive rates



Source: Central Bank of Egypt, CAPMAS, ADCB estimates

Fig. 2. Egypt: EGP strengthens against USD since mid-January, supporting rate cut



Source: Bloomberg

We expect further rate cuts by the CBE at its upcoming meetings, especially as real interest rates remain positive and relatively high as inflation has weakened (to c.4.5% ahead of the cut). The rate cuts will help to reduce pressure on the government’s heavy debt servicing bill. Indeed, the government had shortened the maturity profile of domestic debt issuance last year, likely reflecting the higher yields in our view. Moreover, private investment in the domestic economy has remained weak, despite the pickup in GDP growth. The CBE highlighted that preliminary data for 3Q2018 indicate that net external demand continued to support economic activity while private domestic demand remained contained. However, any further easing will be contingent on a number of factors, including further moderation in inflation and stability in the EGP. Last week’s rate cut came after the EGP saw some strengthening against the USD from mid-January, following the introduction of a more flexible exchange rate policy as the repatriation mechanism for foreign investors ended. The central bank might pause rates in times of subsidy and price reforms, including around the implementation of a new price indexation mechanism on 95 octane gasoline starting in April.

Monetary policy remains tight, though CBE will need to see further declines in inflation

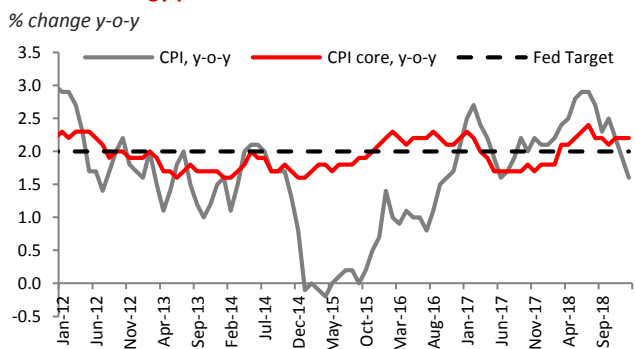
B. G4 Economies

US: Core CPI remains solid in January, but headline inflation softens

Core CPI inflation remained steady at 0.2% m-o-m in January, but there was an uptick in the unrounded figure (0.2395% vs 0.1803% in December). Core goods inflation strengthened to 0.4% m-o-m in January (December: 0%), led by a positive residual seasonality in apparel costs (1.1%) and an increase in new vehicle and household product prices. The Bureau of Labor Statistics issues new seasonal adjustment factors every February to account for price movements in the previous calendar year, ahead of the release of the January CPI data. This monthly rise resulted in y-o-y core inflation surprising to the upside vs the consensus estimate (2.1%), though remaining steady at 2.2% in January. Core services inflation was unchanged at 0.2% m-o-m in January, supported by shelter prices. Telephone service prices were flat m-o-m in January after the Bureau of Labor Statistics introduced new methodology adjustments, including linked to technology advancements. We believe that this change in methodology will likely lead to lower inflation in telephone services in the near term as service providers migrate to the 5G network. We believe that the Fed will remain comfortable with the steady core inflation for now, and would need to see a further acceleration in core prices before altering its current patient stance on interest rates.

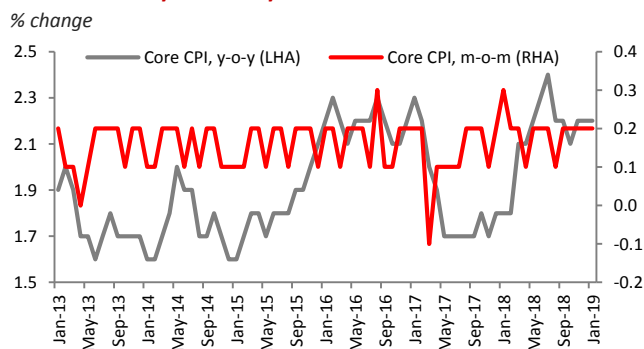
Core goods inflation accelerates in January, led by apparel costs

Fig. 3. US: Headline inflation moderates in January on soft energy prices



Source: Bureau of Labor Statistics

Fig. 4. US: Both annual and monthly core inflation remain steady in January



Source: Bureau of Labor Statistics

Retail sales: The December retail sales report was much weaker than expected, with headline sales contracting by 1.2% m-o-m (November: +0.1%) – the biggest drop since 2009. The retail sales control group, which feeds into GDP data, also fell by 1.7% m-o-m, from an upwardly revised +1% in November. The sharp drop in retail activity during the end of the holiday season could be due to: i) the government shutdown and ii) some payback from November data which included Black Friday sales. This drop could be due to one-off factors especially given that the other incoming high frequency data suggest healthy household consumption activity.

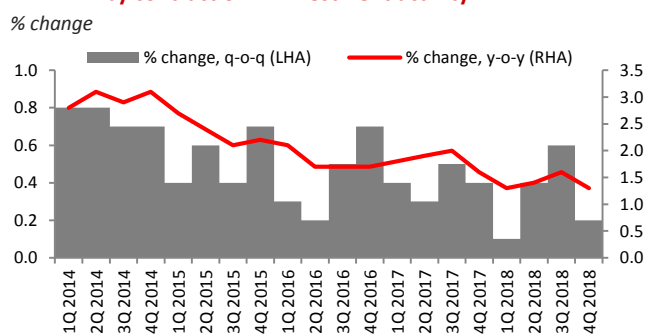
Retail sales contract in December by 1.2% m-o-m, compared to a rise of 0.1% in November

UK: 4Q2018 GDP growth hit by Brexit uncertainty

The UK economy slowed markedly in 4Q, with Brexit-related uncertainty having a profoundly negative impact on investment and net exports. Real GDP growth moderated to 0.2% q-o-q, lower than both the consensus expectation of 0.3% and the 3Q print of 0.6%. For full year 2018, real GDP growth stood at 1.4% - the lowest print since 2012. Notably, gross fixed capital formation contracted by 0.5% q-o-q in 4Q, with growth flat on a y-o-y basis, suggesting that business investment has taken a beating largely due to the lack of clarity over the UK's future relationship with the EU. The BoE during its 7 February policy meeting also revised down its growth forecasts for 2019, citing ongoing weakness in investment activity due to Brexit-related uncertainty. Net exports also contributed to the slowdown in external demand in 4Q. The moderation in economic activity came despite solid government spending (up 1.4% q-o-q) and healthy personal consumption in 4Q (0.4%). However, we believe that the prolonged uncertainty will have an adverse impact on household consumption. Meanwhile, headline CPI inflation decelerated to 1.8% y-o-y in January from 2.1% in December, reflecting lower energy costs.

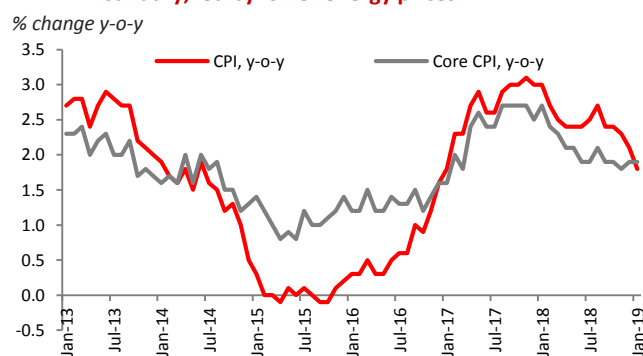
GDP growth decelerates to 1.4% in 2018, lowest level since 2012

Fig. 5. UK: Real GDP growth softens to 0.2% q-o-q in 4Q, led by contraction in investment activity



Source: Office for National Statistics

Fig. 6. UK: Headline inflation moderates to 1.8% y-o-y in January, led by lower energy prices



Source: Office for National Statistics

We believe that the economic momentum will likely to remain weak in 1Q2019. Recent political developments suggest that the Brexit deadlock continues, with no further progress seen on the Irish backstop. Indications are that the next round of votes in parliament will be on 26-27 February, albeit with the possibility of negotiations continuing up to the March deadline. Our core scenario is for an extension of Article 50, potentially for three months.

Brexit uncertainty to continue into March

Japan: 4Q GDP growth accelerates on solid capex

Real GDP growth rebounded in 4Q2018 to 0.3% q-o-q after contracting by 0.7% in 3Q due to adverse weather conditions. However, this was marginally lower than the consensus estimate of 0.4%. There was broad-based growth across sub sectors, with private consumption strengthening to 0.6% q-o-q in 4Q (3Q: -0.2%), driven by increased personal disposable income. The other key takeaway was that business investment increased by a solid 2.4% q-o-q in 4Q18 (3Q: -2.7%), with corporates likely stepping up their spending on automation to counter labour shortages. On the external front, net exports subtracted 0.5ppt from headline growth as import growth outpaced export growth. Indeed, export growth was relatively soft amid weakening Chinese demand for

Strong domestic demand offsets external sector weakness

smartphones and semiconductors. The economic recovery in 4Q was a positive development, but the momentum remains weak, in our view. Thus, we expect the BoJ to maintain its accommodative monetary policy stance throughout 2019.

C. Emerging Market Economies

India: Inflation eases further in January, supporting rate cut in April

Headline inflation decelerated further to 2% y-o-y in January from a downwardly revised 2.1% in December (2.2% in first print). This supports the case for another 25bps rate cut at the April meeting. Notably, core inflation (ex-food, tobacco and fuel) also softened to 5.4% y-o-y (December: 5.7%), with all the major sub-components showing a broad-based deceleration in January. This was the lowest core inflation print since April 2018. Meanwhile, the sharp increase in the education and health components in the December print appears to have been due to one-off factors, with both segments normalising on a sequential basis in January. Food deflation continued for a fourth consecutive month, though the pace of contraction moderated to -1.3% y-o-y in January from -1.6% in December.

Core inflation softens to 5.4% y-o-y in January, from 5.7% in December

Fig. 7. India: Both headline and core inflation decelerates in January, supporting case for further rate cut in April

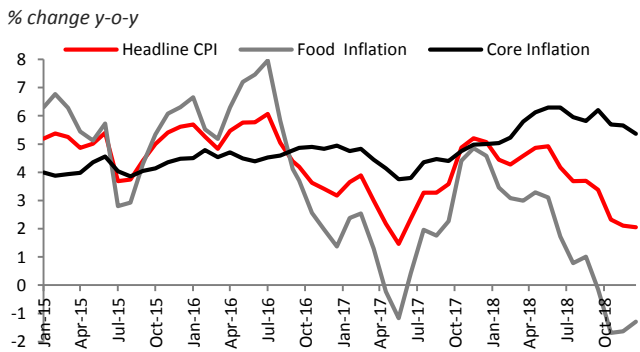
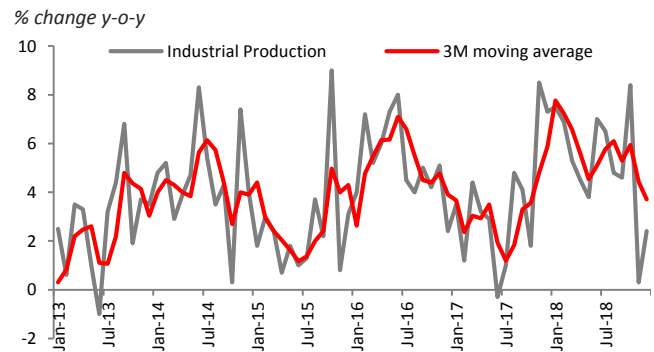


Fig. 8. India: Industrial activity remains weak, with 3M moving average showing downtrend



We expect headline inflation to remain under the RBI's target of 4% (+/-2 pp) in 1H2018, supported by relatively weak rural demand, food deflation and contained global crude oil prices. The RBI at its February policy meeting projected that headline inflation would average 2.8% in 1Q2018, but the surprise moderation in core inflation in January suggests that the risks are tilted to the downside. Thus, we believe that the RBI will grow more confident that inflationary pressures will remain weak in the near term. Indeed, we now expect the central bank to cut its benchmark policy rate by another 25bps at its 4 April meeting.

We expect another 25bps repo rate cut by RBI at its 4 April policy meeting

China: Export growth surprises to upside in January

The China trade data released last week showed that exports grew by a solid 9.1% y-o-y in January, from -4.4% in December. However, we highlight the need for caution regarding the January data, as the jump could be partly due to the frontloading of shipments ahead of the Lunar New Year in early February. We do not read too much into this print, as other high-frequency data continue to suggest that economic momentum remains weak in China. Overall, we expect China's exports to remain soft in the near term, especially with signs of weakening global growth. Meanwhile, imports fell by 1.5% y-o-y in January, less than the 7.6% contraction seen in December. We expect China's imports from the US to rise at a faster pace if the US and China agree a trade deal, potentially leading to a sharp increase in energy and agricultural goods imports. We believe that China's accommodative monetary and fiscal policy measures announced in recent months are likely to remain somewhat supportive of domestic demand in the near-term.

Export growth strengthens, while imports continue to contract

II. Economic Calendar

Fig. 9. The week ahead

Time*	Country	Event	Period	Prior	Consensus
Expected this week					
	UAE	CPI, y-o-y	Jan	0.3%	
	UAE	M2 Money Supply, m-o-m	Jan	1.6%	
	UAE	Central Bank Foreign Assets	Jan	362.55B	
	Saudi Arabia	CPI, y-o-y	Jan	2.2%	
	Bahrain	CPI, y-o-y	Jan	2%	
	Oman	CPI, y-o-y	Jan	0.8%	
Monday, 18 February					
3:50	Japan	Core Machine Orders, m-o-m	Dec	0%	-1.1%
3:50	Japan	Core Machine Orders, y-o-y	Dec	0.8%	3.4%
Tuesday, 19 February					
13:30	UK	Average Weekly Earnings, 3M/y-o-y	Dec	3.4%	3.5%
13:30	UK	Weekly Earnings, ex-Bonus, 3M/y-o-y	Dec	3.3%	3.4%
13:30	UK	ILO Unemployment Rate 3M	Dec	4%	4%
13:30	UK	Employment Change, 3M/3M	Dec	141K	152K
14:00	Germany	ZEW Survey Expectations	Feb	-15	-13.7
14:15	Eurozone	ECB Vice-President Guindos Speaks in Brussels			
17:50	US	Fed's Mester Speaks on Economic Outlook and Monetary Policy			
19:00	Eurozone	ECB's Praet Participates in Panel Discussion in Berlin			
Wednesday, 20 February					
3:50	Japan	Trade Balance	Jan	-¥55.3B	-¥1029.5B
3:50	Japan	Exports, y-o-y	Jan	-3.8%	-5.7%
3:50	Japan	Imports, y-o-y	Jan	1.9%	-3.2%
19:00	Eurozone	Consumer Confidence	Feb A	-7.9	-7.7
22:30	US	Fed's Bullard Takes Part in Monetary Policy Forum in New York			
23:00	US	FOMC Meeting Minutes	30-Jan		
Thursday, 21 February					
8:30	Japan	All Industry Activity Index, m-o-m	Dec	-0.3%	-0.2%
12:30	Germany	Germany Manufacturing PMI	Feb P	49.7	49.9
13:00	Eurozone	Eurozone Manufacturing PMI	Feb P	50.5	50.3
16:50	US	Fed's Bostic Speaks on Economy and Monetary Policy			
17:30	US	Philadelphia Fed Business Outlook	Feb	17	14.7
17:30	US	Durable Goods Orders	Dec P	0.7%	1.8%
17:30	US	Durables, ex-Transportation	Dec P	-0.4%	0.3%
17:30	US	Capital Goods Shipments, Non-defence, ex-Air	Dec P	-0.2%	0%
18:45	US	US Manufacturing PMI	Feb P	54.9	55
19:00	US	Leading Index	Jan	-0.1%	0.2%
19:00	US	Existing Home Sales	Jan	4.99M	5M
Friday, 22 February					
3:30	Japan	National CPI, y-o-y	Jan	0.3%	0.2%
3:30	Japan	National CPI, ex-Fresh Food, y-o-y	Jan	0.7%	0.8%
11:00	Germany	GDP SA, q-o-q	4Q F	0%	0%
11:00	Germany	GDP NSA, y-o-y	4Q F	0.9%	0.9%
13:00	Germany	IFO Expectations	Feb	94.2	94.2
14:00	Eurozone	CPI Core, y-o-y	Jan F	1.1%	1.1%
14:00	Eurozone	CPI, y-o-y	Jan F	1.6%	1.4%
19:15	US	Fed's Williams, Daly Discusses Inflation at a Forum in New York			
22:30	US	Fed's Bullard to Speak on Balance Sheet in New York			
22:30	US	Fed's Harker Takes Part in Panel Discussion on Balance Sheet			
22:30	US	Fed's Quarles Speaks in New York on Future of Fed Balance Sheet			

* UAE time

Source: Bloomberg

Fig. 10. Last week's data

Time*	Country	Event	Period	Prior	Consensus	Actual
Monday, 11 February						
8:15	UAE	Dubai Economy Tracker SA	Jan	53.7		55.8
13:30	UK	GDP, q-o-q	4Q P	0.6%	0.3%	0.2%
13:30	UK	GDP, y-o-y	4Q P	1.5%	1.4%	1.3%
13:30	UK	Trade Balance	Dec	£3615M	£3000M	£3229M
13:30	UK	Industrial Production, y-o-y	Dec	-1.3%	-0.5%	-0.9%
	China	Foreign Reserves	Jan	\$3072.7B	\$3080B	\$3087.9B
Tuesday, 12 February						
3:50	Japan	Money Stock M2, y-o-y	Jan	2.4%	2.4%	2.4%
8:30	Japan	Tertiary Industry Index, m-o-m	Dec	-0.4%	-0.1%	-0.3%
16:00	India	CPI, y-o-y	Jan	2.1%	2.5%	2%
16:00	India	Industrial Production, y-o-y	Dec	0.3%	1.6%	2.4%
19:00	US	JOLTS Job Openings	Dec	7166	6846	7335
Wednesday, 13 February						
13:30	UK	CPI, m-o-m	Jan	0.2%	-0.7%	-0.8%
13:30	UK	CPI, y-o-y	Jan	2.1%	1.9%	1.8%
13:30	UK	CPI Core, y-o-y	Jan	1.9%	1.9%	1.9%
14:00	Eurozone	Industrial Production WDA, y-o-y	Dec	-3%	-3.3%	-4.2%
17:30	US	CPI, m-o-m	Jan	0%	0.1%	0%
17:30	US	CPI, ex-Food and Energy, m-o-m	Jan	0.2%	0.2%	0.2%
17:30	US	CPI, y-o-y	Jan	1.9%	1.5%	1.6%
17:30	US	CPI, ex-Food and Energy, y-o-y	Jan	2.2%	2.1%	2.2%
23:00	US	Monthly Budget Statement	Dec	-\$204.9B	-\$11B	-\$13.5B
Thursday, 14 February						
3:50	Japan	GDP SA, q-o-q	4Q P	-0.7%	0.4%	0.3%
3:50	Japan	GDP Annualized SA, q-o-q	4Q P	-2.6%	1.4%	1.4%
11:00	Germany	GDP SA, q-o-q	4Q P	-0.2%	0.1%	0%
11:00	Turkey	Current Account Balance	Dec	1.1B	-1.5B	-1.44B
11:00	Turkey	Industrial Production, y-o-y	Dec	-6.6%	-7.5%	-9.8%
14:00	Eurozone	GDP SA, q-o-q	4Q P	0.2%	0.2%	0.2%
17:30	US	Retail Sales Advance, m-o-m	Dec	0.1%	0.1%	-1.2%
17:30	US	Retail Sales, ex-Auto, m-o-m	Dec	0%	0%	-1.8%
17:30	US	Retail Sales Control Group	Dec	1%	0.4%	-1.7%
	Egypt	Lending Rate	14-Feb	17.75%		16.75%
	Egypt	Deposit Rate	14-Feb	16.75%	16.75%	15.75%
	China	Trade Balance	Jan	\$57.1B	\$34.3B	\$39.2B
	China	Exports, y-o-y	Jan	-4.4%	-3.3%	9.1%
	China	Imports, y-o-y	Jan	-7.6%	-10.2%	-1.5%
Friday, 15 February						
5:30	China	CPI, y-o-y	Jan	1.9%	1.9%	1.7%
5:30	China	PPI, y-o-y	Jan	0.9%	0.3%	0.1%
8:30	Japan	Industrial Production, m-o-m	Dec F	-0.1%		-0.1%
8:30	Japan	Industrial Production, y-o-y	Dec F	-1.9%		-1.9%
13:30	UK	Retail Sales, Incl-Auto Fuel, m-o-m	Jan	-0.7%	0.2%	1%
13:30	UK	Retail Sales, Incl-Auto Fuel, y-o-y	Jan	3.1%	3.4%	4.2%
17:30	US	Empire Manufacturing	Feb	3.9	7	8.8
18:15	US	Industrial Production, m-o-m	Jan	0.1%	0.1%	-0.6%
19:00	US	University of Michigan Sentiment	Feb P	91.2	93.7	95.5
	India	Exports, y-o-y	Jan	0.3%		3.7%
	China	Money Supply M2, y-o-y	Jan	8.1%	8.2%	8.4%
	China	New Yuan Loans CNY	Jan	1080B	3000B	3230B

* UAE time

Source: Bloomberg

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