The Week Ahead: ECB and BoJ to remain on hold; US February wage growth in focus

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US: NFP data for February and tariffs on steel and aluminium

The risk of a trade war has increased after President Donald Trump indicated that he would impose tariffs on imported steel (25%) and aluminium (10%). The measures are due to be formally announced this week, with a number of countries suggesting that they will consider action in response. The introduction of steel and aluminium tariffs, by themselves, will have a limited impact US growth given their small contribution to the economy. However, rising protectionism would, depending on the extent, dampen US and global growth. The key data releases this week include non-farm payrolls for February, with consensus expecting robust job growth of 205K (January: 200K). Consensus sees the unemployment rate falling to 4% in February, though we see the possibility of it remaining at 4.1% with a likely rise in the participation rate. Wage growth will particularly be in focus after the sharp increase in January raised inflationary concerns. Wage growth is forecast to moderate to 0.2% m-o-m and 2.8% y-o-y (January: 0.3% m-o-m, 2.9% y-o-y). We believe that the Fed is on track to hike the FFTR by 25 bps in March, with solid data and communication expressing greater confidence on the economic outlook (page 3). Last week, Fed Chair Jerome Powell indicated greater conviction about three rate increases this year, whilst opening the door to four.

Eurozone: ECB likely to adjust forward guidance

The ECB is expected to adjust its forward guidance as a tentative step away from its ultra-easy monetary stance at its 8 March meeting. We expect the ECB to modify the following phrase – “we stand ready to increase the asset purchase programme (APP) in terms of size and/or duration” by removing the reference to increasing the programme’s size. Attention will also be on the ECB’s new economic projections, which are likely to factor in higher EUR and oil price assumptions. We believe that ECB projections will continue to reflect increasing confidence in the growth outlook albeit with inflation projections remaining largely steady. Despite the tweaks in language and the improved economic backdrop, the tone of the meeting is likely to remain dovish to contain any upward pressure on the EUR. We expect ECB President Mario Draghi to reaffirm that patience is required during the press conference, especially given the still weak inflation backdrop (page 5).

Japan: BoJ to keep monetary policy steady

The BoJ is expected to keep its monetary policy steady at its 9 March meeting, including keeping the 10-year yield target at 0% and asset purchases at the same rate and size. However, there have been further signs of reduced JGB purchases, thus markets will follow any comments on tapering and exit guidance closely. BoJ Governor Haruhiko Kuroda last week highlighted that there are no plans for any comprehensive reassessment of the BoJ’s monetary policy at this point. This suggests that the current accommodative monetary policy will continue until inflation reaches the 2% target. Kuroda’s reappointment as governor also suggests a continuation of current monetary policy with any normalisation process likely to be very gradual.

I. Recent Events and Data Releases

A. MENA Economies

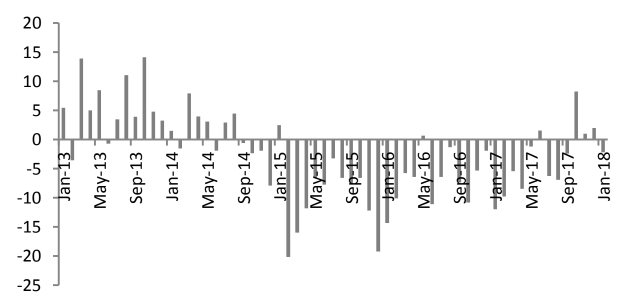
Saudi Arabia: Economic activity weak in January due to fiscal reforms

SAMA's NFAs resume their monthly fall, likely reflecting higher government spending

Data for January showed that SAMA's net foreign assets (NFAs) resumed their general trend of a monthly decline, after rising for the previous three months. SAMA's NFAs fell by USD2.2 billion compared to December, to USD486.7 billion. On a yearly basis, they are down 5.8% y-o-y. We believe the fall partly reflects higher government spending in January linked to a government hand-out package to limit the impact of fiscal reforms on nationals. For further details, please see our note – **Saudi Arabia: New allowance package to counter impact of fiscal reforms**, published on 8 January 2018. Indeed, the government's deposits and reserves with SAMA fell by 4% m-o-m (USD6.8 billion). The drop in the government current account with the central bank, of 31.2% m-o-m, was particularly marked. Government deposits with commercial banks also fell (by 3.1% m-o-m) in January, also likely reflecting the higher government expenditure.

Fig. 1. Saudi Arabia: SAMA's NFA's fall by USD2.2 billion in January, likely reflecting higher government spending

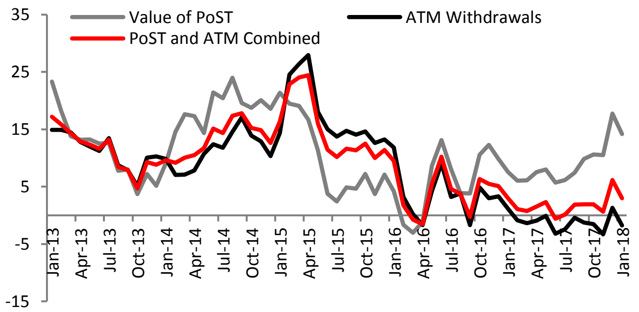
Monthly change in SAMA's NFAs, USD billion



Source: SAMA, ADCB calculations

Fig. 2. Saudi Arabia: Private consumption weakens in January with implementation of fiscal reforms

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



Source: SAMA, ADCB calculations

Indicators of personal spending point to monthly contraction, despite government's allowance package

Despite the increase in government spending in January, economic indicators remained weak. This is in line with our assumption that there would be a limited fiscal stimulus from the additional government allowance package, which was subsequently followed by a number of private sector companies announcing similar payments to nationals. Rather, we thought the package would counterbalance the impact of fiscal reforms, albeit these would vary amongst the population. Reflecting the still weak private consumption backdrop, the combined value of point-of-sale transactions (PoST) and ATM cash withdrawals fell by 12.5% m-o-m, despite the rise in prices (with the introduction of VAT and increases in fuel and electricity prices). For further details, please see our note – **Saudi Arabia: Sharp rise in inflation on VAT and subsidy reforms**, published on 25 February 2018. In volume terms, PoST were down 2.4% m-o-m, partly reflecting the front loading of spending, whilst ATM withdrawals were down 9.2% m-o-m. Meanwhile, private sector credit growth saw its 11th consecutive month of yearly contraction, falling by 0.9% y-o-y. Overall, the monthly data is in line with our expectation that it will take time for economic momentum to build. Our forecast of a relatively modest pickup in real non-oil GDP growth is based on an expectation of a gradual strengthening in government investment.

Saudi Arabia: Increasing size of its international syndicated loan

Size of loan to be increased to USD16 billion, from USD10 billion in 2016

Saudi Arabia's Debt Management Office (DMO) has said that the government is increasing the size of its USD10 billion syndicated loan, by USD6 billion. The DMO indicated that there was strong demand from the banks involved in the deal for the restructuring, which would introduce a "significant" Islamic tranche to the transaction. Saudi Arabia initially raised USD10 billion loan from 14 core banks in 2016. The restructured deal is intended to close by mid-March, with all banks participating in the refinancing having accepted terms, including a 30% reduction in the cost of borrowing compared to 2016. The Ministry of Finance suggested that it would offer banks a margin of 75 bps over Libor; the previous five-year loan carried a spread of 120 bps over Libor, according to Bloomberg. Indications also suggest that the maturity will likely be extended. We had expected the Saudi government to further raise international debt in 2018 to help to cover the fiscal deficit. This is especially as government debt remained low at 17% of GDP at end-2017. Moreover, debt issuance will help to limit the drawdown in the government's FX reserves. The government is also likely to issue a new dollar-denominated bond in the coming weeks, once the restructures loan is finalised.

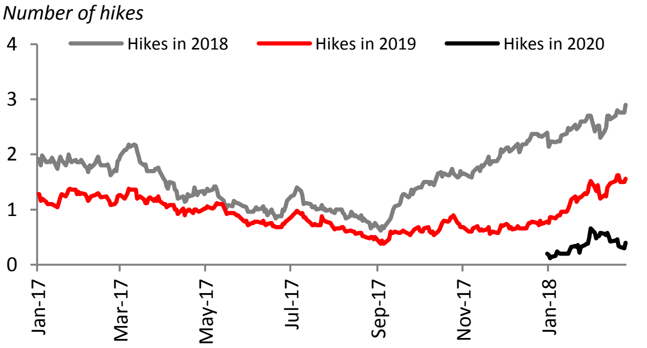
B. G4 Economies

US: Powell's testimony highlights greater optimism on economy

Powell highlights increasing confidence in growth and inflation outlook…

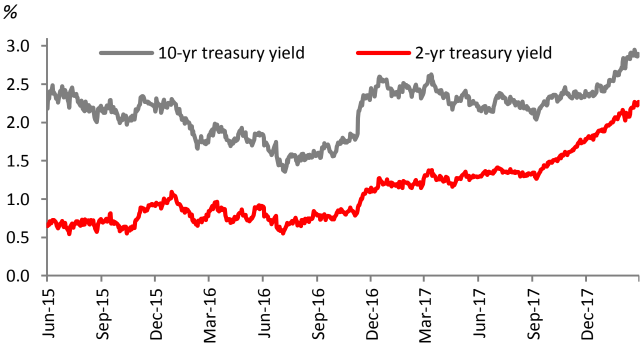
Fed Chairman Jerome Powell expressed increasing confidence in the US's growth and inflation outlook in his first semi-annual monetary policy testimony. The tone of the speech was moderately more hawkish than markets had anticipated, thereby opening the door for four rate hikes in 2018. Powell also highlighted that the economic outlook remains strong with some of the headwinds that the US economy has faced in previous years now becoming tailwinds – namely fiscal policy and global growth. He sees the extra fiscal stimulus in the country as having meaningfully added to demand. Powell also outlined that the labour market was robust though fell short of saying that it had reached full employment. A notable development was the comment that his macroeconomic outlook had improved since last December, when the median dot-plot forecast called for three rate hikes this year.

Fig. 3. US: Markets have fully prices three 25bps rate hikes for 2018



Source: Bloomberg

Fig. 4. US: Treasury yields rise further after Powell opens possibility of four rate hikes in 2018



Source: Bloomberg

...though still outlined gradual approach for near term

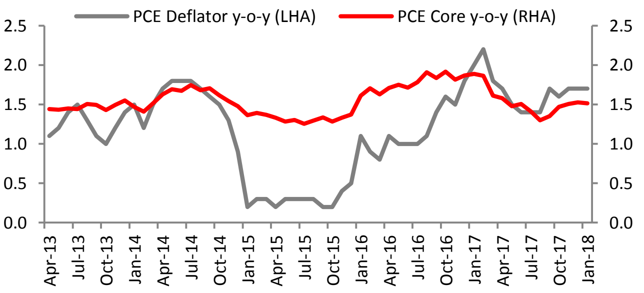
However, still reflecting the need for a gradual approach, Powell noted that the FOMC must "strike a balance between avoiding an overheated economy and bringing PCE price inflation to 2% on a sustained basis". Moreover, the prepared statement maintained that the "committee views the near-term risks to the economic outlook as roughly balanced" and stated that "further gradual increases in the federal funds rate will best promote attainment of both of our objectives". On inflation, Powell outlined his expectations that inflation will gradually rise to the Fed's 2% target, which was reinforced by the recent strong data. Thus, the Fed is likely to continue its gradual rate-hiking communication in 1H2018 whilst gauging the impact of fiscal stimulus on growth and inflation. On balance, Powell did not fully signal a faster rate hiking path at this point, though hinted at risks of this with his more hawkish comments. We maintain our forecast for three 25 bps FFTR hikes in 2018 but highlight that risks are skewed towards four hikes.

March dot plot critical for upcoming Fed communications

We believe that the March FOMC meeting will be particularly important for policy communications, notably the interest rate outlook implied by the new dot plot projections. We believe that there is a chance that some members may shift their individual dot plot projections higher, though we expect the median to remain at three rate hikes for 2018. In addition, market attention will also be on the committee's terminal rate projections, which could suggest increasing scope for rate hikes in the current hiking cycle. Separately, on financial regulations, Powell argued that the Fed is having a fresh look at the Volcker rule limits and stressed that Libor reform remains a major priority.

Fig. 5. US: Core PCE deflator remains steady at 1.5% y-o-y in January, despite monthly acceleration

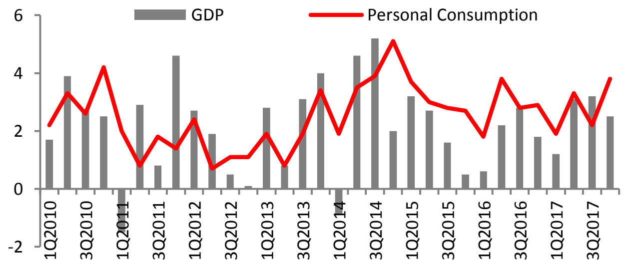
% change y-o-y



Source: Bureau of Economic Analysis

Fig. 6. US: Real headline GDP growth revised down moderately to 2.5% q-o-q in second estimate

% change q-o-q, SAAR



Source: Bureau of Economic Analysis

US: Core PCE deflator steady in January

Strong gains in personal income in January

Personal consumption expenditure (PCE) data for January largely mirrored trends seen in previously released interim data. There were strong gains in personal income of 0.4% m-o-m (December: 0.4%) likely supported by the Tax Cuts and Jobs Act. Wages and salaries rose by a robust 0.5% m-o-m in January, after expanding by 0.4% in December and 0.5% in November. Notably, the y-o-y increase in wages and salaries has stood above 4% for the last three months. However, reflecting the weak retail sales for the month, personal spending growth slowed to 0.2% m-o-m in January (December 0.4%). This softness in spending is expected to be temporary, reflecting two short-term factors: i) adverse weather hindered retail sales, and ii) payback after strong spending in 4Q. Robust disposable income growth, driven by tax cuts, should boost consumption in 1Q.

Core PCE inflation printed at 0.3% m-o-m (December: 0.2%), partially replicating the rise in January CPI data. The larger-than-average price increases could again be due to temporary factors that are typical at the beginning of the year and normalise as the year progresses. However, a key area to watch is healthcare, where prices were up 2% y-o-y in January; this is the highest since March 2013, and up from a post-Obamacare low of 0.5% for much of 2015. On a y-o-y basis, the core PCE deflator remained steady at 1.5% in January.

Real GDP growth moderates to 2.5% q-o-q in second estimate from 2.6% in first

4Q2017 GDP: US real GDP growth was revised lower to 2.5% q-o-q SAAR in 4Q2017 in its second estimate (first estimate: 2.6%). This moderate downward revision was in line with consensus estimates. The slowdown was mainly due to weaker private inventory build. There were limited changes to gross private investment, consumption and government spending. Fixed investment, government consumption and export growth contributed positively to the GDP growth. On an annual basis, real GDP growth increased to 2.3% in 2017 from 1.5% in 2016.

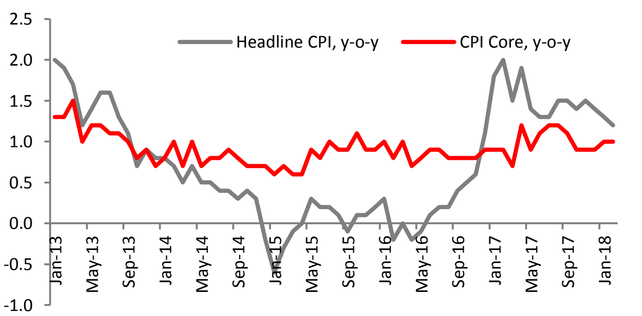
Eurozone: Draghi reiterates that patience is needed on monetary policy

Draghi underlines that economic slack could be larger than estimated

ECB President Mario Draghi testified to the European Parliament's Committee on Economic and Monetary Affairs last week. The tone of his statement was on the bearish side and broadly in line with the minutes of the January statement. Draghi once again reiterated the need for "patience and persistence" regarding monetary policy as inflation is yet to show more convincing signs of a sustained pick-up. Notably, he highlighted that the slack in the economy may be larger than estimated, which could slow down the emergence of inflationary pressures. Despite this bearish tone, Draghi suggested that the ECB's confidence in the inflation outlook has strengthened somewhat on the back of strong economic growth momentum. Moreover, he continued to express his concerns over EUR appreciation and its possible impact on the medium-term inflation outlook.

Fig. 7. Eurozone: Headline inflation softens in January mainly due to unprocessed food prices

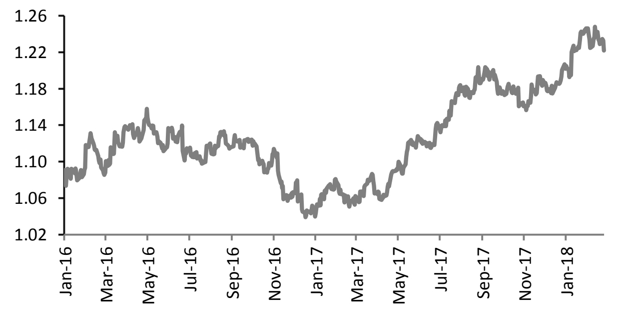
% change, y-o-y



Source: Eurostat

Fig. 8. Eurozone: EUR appreciation remains major concern for ECB policy makers

EURUSD



Source:

We expect changes to forward guidance after March meeting

We believe that ECB communications have been consistent with a very gradual withdrawal of accommodative monetary policy with slow and steady adjustments to the central bank's forward guidance. We expect the ECB to adjust its forward guidance in the statement following its March meeting by removing the phrase "[the] Governing Council (GC) stands ready to increase the asset purchase programme (APP) in terms of size". Meanwhile, we see the central bank extending its asset purchases for another three months to December, albeit at a slower pace. Regarding interest rate hikes, consistently hawkish GC member Jens Weidmann last week said that the market's pricing of a mid-

2019 rate hike was "not completely unrealistic", supporting our view of likely interest rate hikes by mid-2019.

Eurozone: Headline inflation slows slightly in February

Headline inflation softens to 1.2% in February whilst core inflation remains steady at 1%

The need for a gradual approach by the ECB was further highlighted by the weak inflation print for February. Headline inflation softened to 1.2% y-o-y in February (January: 1.3%), in line with the consensus expectation. This is the lowest reading since December 2016. The moderation in inflation was largely due to a contraction in unprocessed food prices, which fell by 0.9% in February (January: 1.1%) due to base effects related to bad weather in 2017. Energy prices also eased to 2.1% y-o-y in February (January: 2.2%) due to softer pump prices. The other major components were largely stable, with core inflation remaining steady at 1% in February. Services inflation picked up slightly to 1.3% y-o-y in February after remaining steady for four months at 1.2%. Non-energy industrial goods inflation also inched up surprisingly to 0.7% y-o-y (January: 0.6%) despite the recent EUR appreciation. Looking ahead, March inflation is likely to pick up as Easter spending and waning base effects will likely provide some support.

C. Emerging Market Economies

India: Real GDP accelerates in 4Q2017, as impact of disruptions fades

Strong rebound in investment growth, though private consumption weakens to multi-year low

India's GDP growth accelerated to a five-quarter high of 7.2% y-o-y in 4Q (3Q: 6.5%), beating the consensus estimate of 7%. The pick-up was led by a strengthening investment activity suggesting that the disruption caused by the implementation of the goods and services tax has likely bottomed out. Gross fixed capital formation expanded by double digits at 12% y-o-y – the highest in the past six quarters. Investment growth was likely supported by government spending in infrastructure, including its focus on boosting affordable housing. Despite the pickup in government expenditure, final consumption growth was its weakest in the past 10 quarters after private consumption moderated to 5.6% y-o-y. This was the softest level of private consumption growth since 2Q2014 and the first time in over three years that it has slowed to below 6%. The softness in household expenditure was likely due to the rural component, though this could see some support given the focus of the FY2018-19 budget (April-March) on boosting the rural economy.

RBI to stay on hold with pace of recovery remaining gradual

Looking ahead, we expect the growth recovery to remain shallow and in part supported by the weak base. Continued excess capacity should check the recovery in investment growth, making the strong performance in 4Q2017 difficult to repeat. The gradual pace of recovery is partly behind our expectation of the RBI remaining on hold over the next six months.

II. Economic Calendar

Fig. 9. The week ahead

Time*	Country	Event	Period	Prior	Consensus
MENA data					
	UAE	UAE PMI	Feb	56.8	--
	UAE	CPI, y-o-y	Jan	2.7%	
	UAE	CPI, m-o-m	Jan	0.7%	
	Saudi Arabia	Saudi Arabia PMI	Feb	53	--
	Egypt	Gross Official Reserves	Feb	38.2B	--
	Egypt	Urban CPI, y-o-y	Feb	17.1%	--
	Egypt	CPI Core, y-o-y	Feb	14.4%	--
Monday, 5 Mar					
4:30	Japan	Nikkei Japan PMI Composite	Feb	52.8	--
5:45	China	Caixin China PMI Composite	Feb	53.7	--
9:00	India	Nikkei India PMI Composite	Feb	52.5	--
13:30	UK	Markit/CIPS UK Composite PMI	Feb	53.5	53.6
14:00	Eurozone	Retail Sales, y-o-y	Jan	1.9%	--
19:00	US	ISM Non-Manfacturing PMI	Feb	59.9	59
	China	China's National People's Congress Begins in Beijing			
Tuesday, 6 Mar					
16:30	US	Fed's Dudley Speaks at U.S. Virgin Islands			
19:00	US	Factory Orders	Jan	1.7%	-1.3%
19:00	US	Factory Orders, ex-Transport	Jan	0.7%	--
19:00	US	Durable Goods Orders	Jan F	-3.7%	-3.5%
19:00	US	Durables, ex-Transportation	Jan F	-0.3%	--
19:00	US	Cap Goods Shipment, Non-def, ex-Air	Jan F	0.1%	--
Wednesday, 7 Mar					
2:30	US	Fed's Brainard to Speak in New York			
5:30	US	Fed's Kaplan Speaks at Energy Conference			
14:00	Eurozone	GDP SA, q-o-q	4Q F	0.6%	0.6%
14:00	Eurozone	GDP SA, y-o-y	4Q F	2.7%	2.7%
17:00	US	Fed's Dudley Speaks in Puerto Rico			
17:00	US	Fed's Bostic Speaks on the Economic Outlook			
23:00	US	US Federal Reserve Releases Beige Book			
	China	Foreign Reserves	Feb	$3161.5B	$3150B
Thursday, 8 Mar					
3:50	Japan	GDP SA, q-o-q	4Q F	0.1%	0.2%
16:45	Eurozone	ECB Main Refinancing Rate	8-Mar	0%	0%
16:45	Eurozone	ECB Marginal Lending Facility	8-Mar	0.25%	0.25%
16:45	Eurozone	ECB Deposit Facility Rate	8-Mar	-0.4%	-0.4%
	China	Trade Balance	Feb	$20.3B	-$8.5B
	China	Imports, y-o-y	Feb	36.8%	6.5%
	China	Exports, y-o-y	Feb	11.1%	10%
Friday 9 Mar					
	Japan	BOJ 10-Yr Yield Target	9-Mar	0%	0%
	Japan	BOJ Policy Balance Rate	9-Mar	-0.1%	-0.1%
5:30	China	CPI, y-o-y	Feb	1.5%	2.4%
13:30	UK	Industrial Production, m-o-m	Jan	-1.3%	1.5%
13:30	UK	Manufacturing Production, m-o-m	Jan	0.3%	0.2%
17:30	US	Change in Nonfarm Payrolls	Feb	200K	205K
17:30	US	Unemployment Rate	Feb	4.1%	4%
17:30	US	Average Hourly Earnings, m-o-m	Feb	0.3%	0.2%
17:30	US	Average Hourly Earnings, y-o-y	Feb	2.9%	2.8%
17:30	US	Labor Force Participation Rate	Feb	62.7%	62.7%

* UAE time
Source: Bloomberg

Fig. 10. Last week's data

Time*	Country	Event	Period	Prior	Consensus	Actual
EM data						
	UAE	M2 Money Supply, m-o-m	Jan	2.2%		0.1%
	UAE	Central Bank Foreign Assets	Jan	347.7B		326B
	UAE	Dubai Airport Cargo Volume, y-o-y	Jan	-0.5%		-2.9%
	Saudi Arabia	M2 Money Supply, y-o-y	Jan	-1%		0.50%
	Saudi Arabia	SAMA Net Foreign Assets SAR	Jan	1833.4B		1825.2B
	Qatar	M2 Money Supply, y-o-y	Jan	21.3%		19.6%
	India	Eight Infrastructure Industries	Jan	4%		6.7%
	India	GDP, y-o-y	4Q	6.5%	7%	7.2%
Monday, 26 Feb						
19:00	US	New Home Sales	Jan	643K	647K	593K
Tuesday, 27 Feb						
13:00	Eurozone	M3 Money Supply, y-o-y	Jan	4.6%	4.6%	4.6%
17:00	Germany	CPI EU Harmonized, y-o-y	Feb P	1.4%	1.3%	1.2%
17:30	US	Wholesale Inventories, m-o-m	Jan P	0.6%	0.4%	0.7%
17:30	US	Durable Goods Orders	Jan P	2.6%	-2%	-3.7%
17:30	US	Durable goods, ex-Transportation	Jan P	0.7%	0.4%	0.3%
17:30	US	Cap Goods Shipments, Non defence, ex-Air	Jan P	0.7%	0.3%	0.1%
19:00	US	Conference Board Consumer Confidence	Feb	124.3	126.4	130.8
Wednesday, 28 Feb						
3:50	Japan	Retail Trade, y-o-y	Jan	3.6%	2.4%	1.6%
3:50	Japan	Industrial Production, m-o-m	Jan P	2.9%	-4%	-6.6%
5:00	China	Manufacturing PMI	Feb	51.3	51.2	50.3
14:00	Eurozone	CPI Core, y-o-y	Feb A	1%	1%	1%
14:00	Eurozone	CPI Estimate, y-o-y	Feb	1.3%	1.2%	1.2%
17:30	US	GDP Annualized, q-o-q	4Q S	2.6%	2.5%	2.5%
17:30	US	Personal Consumption	4Q S	3.8%	3.6%	3.8%
18:45	US	Chicago Purchasing Manager	Feb	65.7	64.1	61.9
19:00	US	Pending Home Sales, m-o-m	Jan	0%	0.5%	-4.7%
Thursday, 1 Mar						
3:50	Japan	Capital Spending, y-o-y	4Q	4.2%	3%	4.3%
5:45	China	Caixin China PMI Manufacturing	Feb	51.5	51.3	51.6
13:30	UK	Mortgage Approvals	Jan	61.7K	62K	67.5K
13:30	UK	Markit UK PMI Manufacturing SA	Feb	55.3	55	55.2
14:00	Eurozone	Unemployment Rate	Jan	8.6%	8.6%	8.6%
17:30	US	PCE Core, m-o-m	Jan	0.2%	0.3%	0.3%
17:30	US	PCE Core, y-o-y	Jan	1.5%	1.5%	1.5%
17:30	US	Personal Income	Jan	0.4%	0.3%	0.4%
17:30	US	Personal Spending	Jan	0.4%	0.2%	0.2%
17:30	US	Initial Jobless Claims	24-Feb	220K	225K	210K
19:00	US	ISM Manufacturing	Feb	59.1	58.7	60.8
Friday, 2 Mar						
3:30	Japan	Jobless Rate	Jan	2.7%	2.8%	2.4%
3:50	Japan	Monetary Base, y-o-y	Feb	9.7%		9.4%
13:30	UK	Markit UK Construction PMI	Feb	50.2	50.5	51.4
19:00	US	Univ. of Michigan Sentiment	Feb F	99.9	99.5	99.7

* UAE time
Source: Bloomberg

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