The Week Ahead: Trade negotiations and US CPI inflation in focus

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US: March FOMC minutes and inflation data

All eyes will be on any further trade announcements from the US and China. We believe that the risk of a trade war has increased further after US President Donald Trump instructed the US trade representative to consider additional tariffs on USD100 billion worth of imports from China. In response, China stated that it will fight "to the end" with measures of "similar scale and intensity", which was an equally strong reply, in our view. Thus, any further escalation in tariff measures from either side may keep markets on edge. Moreover, the US administration is likely to shift its focus towards signing a NAFTA agreement-in-principle in the upcoming weeks (p. 4). Meanwhile, market attention will also be on the US inflation data and FOMC minutes due this week. The consensus forecasts both headline and core inflation to have accelerated in March to 2.4% y-o-y (February: 2.2%) and 2.1% (February: 1.8%) respectively as the one-off contraction in wireless phone services will have fallen out of the y-o-y calculations. However, on a m-o-m basis, headline inflation is estimated to have remained flat due to a decline in gasoline prices. The March FOMC minutes are expected to highlight gradual interest rate hikes, in line with the Fed Chair Jerome Powell's communication last week. Separately, in the Eurozone, the ECB President Mario Draghi's speech and ECB's accounts of March policy meeting are the events to watch.

China: Economic activity likely softened in March

China's economic data for March is expected to exhibit some softening in momentum amid rising trade tensions between the US and China. Consensus estimates CPI inflation moderated to 2.6% y-o-y in March (February: 2.9%), driven by softer food prices. We see inflation to soften further and average 2.3% in 2018. Meanwhile, export growth is forecast to reverse back to 11.9% y-o-y in March after rising sharply by 44.5% in the previous month. This is largely in line with the March PMI survey data released last week, which highlighted that new orders fell to 52.1 in March (February: 53.1) – the lowest reading since September. Moreover, the focus will also be on the Boao forum, where Chinese President Xi Jinping and new PBOC Governor Yi Gang will make keynote speeches.

India: Inflation and industrial production data to watch

We expect headline inflation to decelerate further to 4.2% y-o-y in March from 4.4% in February, due to softening food inflation. Notably, vegetable prices are seen weakening further in March upon fresh harvest arrivals. However, fuel prices and housing inflation are seen rising in the month. Meanwhile, the RBI also revised down its headline inflation projection to 4.5% in 4Q FY2017-18 (April to March) after vegetable prices decelerated at a faster pace than anticipated (p. 6). We still see some upside risks to inflation from persistently high crude prices and an increase in minimum support prices (MSP) for crops. Thus, we expect inflation to remain in the range of 4-5% in 1H FY2018-19. Meanwhile, consensus estimates industrial production to accelerate in February, reflecting the recent pick-up in economic activity.

I. Recent Events and Data Releases

A. MENA Economies

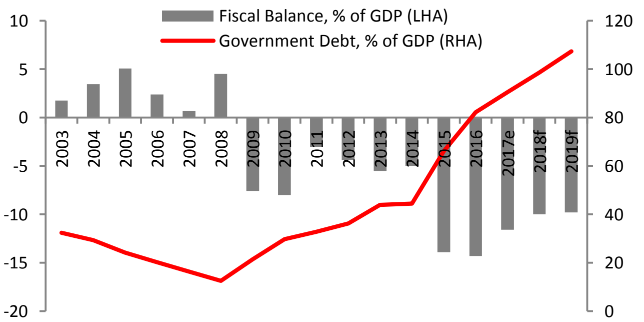
Bahrain: Large oil and gas discovery; medium-term economic impact

Substantial hydrocarbon reserves found – but critical questions remain

Bahrain announced last week that it has discovered its largest oil and gas reserve to date off the country's west coast. The offshore Khalij al-Bahrain basin is substantially larger than its current reserves by several multiples with c.81.5 billion barrels of tight oil and c.13.7 trillion cubic feet of deep gas. Bahrain is a small oil producer that is currently pumping some 45K b/d from its onshore Bahrain field and also sharing half the income from the offshore Abu Safah field with Saudi Arabia which produces about 300K b/d. The amount of oil that can be extracted from the Khalij al-Bahrain Basin is yet to be studied; an agreement with Halliburton is in place to further evaluate the reservoir's potential. The discovery is positive for Bahrain's economic outlook though a number of uncertainties remain at this point. Critical factors will be the amount of hydrocarbons that can be extracted and at what cost. Official indications suggest that it is not yet known how much of the new discovery will be recoverable. Moreover, the production methods required to extract the oil and gas from this asset are likely to be technically challenging and thus potentially expensive to develop.

Fig. 1. Bahrain: Higher oil revenue potentially positive for improving strained fiscal position

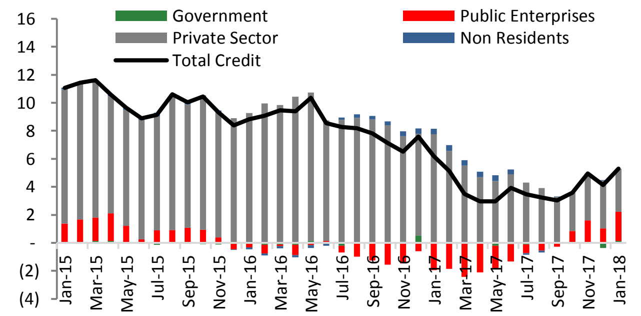
% of GDP



Source: Central Bank of Bahrain, IMF ADCB estimates

Fig. 2. Oman: Some rise in credit growth to public enterprises from 4Q2017; support likely from regulation changes

PP contribution to y-o-y credit growth



Source: Central Bank of Oman, ADCB calculations

Nearer-term impact on economy from higher investment levels

Commercial production from the reserve is expected to begin in five years, thus the near-term impact will be limited. The government is targeting output at c.200K b/d, which would be twice its current production. This would have a marked impact on the economy, including on the currently stretched fiscal position. The additional revenue could help to lower the fiscal deficit to below 5% of GDP from our forecast of 10% of GDP for 2018, although the cost of extraction and the funding requirements to develop the field will be important factors. Partnerships with international oil companies will be required to develop the field. Greater hydrocarbon output/revenues will also support GDP growth and bolster the trade balance (higher exports and lower fuel imports) and the development of the downstream industry. We believe that the more immediate support to the economy could come from investment to develop the field, which is expected to be significant. On the debt front, we believe that investors will still need to see: i) signs of short-term fiscal consolidation; ii) explicit support from other GCC countries; and iii) clarity regarding the cost of extraction and the timeframe for production from the new field. Rising investor concern over Bahrain's weak fiscal position was reflected in the government's recent sukuk issuance. For further details, please see our recent note – **Economic Research Weekly - Global Data Watch 2-6 April 2018**, published on 2 April 2018.

Oman: Central bank introduces regulations to support loan growth

Measures aimed at increasing ability of domestic banks to lend to key development projects

The Central Bank of Oman has announced a number of regulations aimed at raising commercial banks' ability to provide credit to various projects and support economic activity. The measures include reducing the capital adequacy ratio from 12% to 11%. The central bank expects this to free up an additional OMR2.6 billion for lending. Local interbank net borrowing will also be included in the lending ratio calculation. This should support increased interbank lending and potentially credit into the real economy. The measures are aimed at reducing the cost of interbank borrowing. Moreover, the cap on non-resident credit was raised to 75% from 50%. This will allow banks to increase their external borrowing to finance local projects of national importance. We see these moves as positive for supporting Oman's investment programmes and domestic banks' ability to lend to them. Foreign funding has been vital in supporting investment into larger government projects, including its key economic zone. These include projects to broaden Oman's logistics and manufacturing capabilities. With the slowdown in the country's economic activity, credit demand has weakened and banks have become more cautious about lending. Tight liquidity with weak deposit growth has also been a factor. We believe that there will now likely be greater appetite among Bahrain's commercial banks to lend to government-led projects, potentially supporting credit growth. The new measures are effective from 1 April.

B. G4 Economies

US: Hiring activity slowed in March, though underlying trend looks solid

Average jobs growth remains solid, further signs of labour market tightening

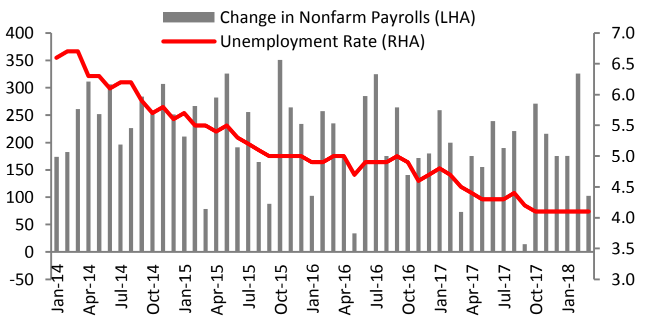
The US economy added just 103K jobs in March, substantially below the consensus expectation of 185K. The disappointing hiring activity was due to both weather-related distortion and some give-back following outsized strength in March. Despite this, average hiring in 1Q was solid at 202K jobs, well above the 2017 average of 182K a month. Moreover, average hourly earnings growth accelerated to 0.3% m-o-m in March (February: 0.1%), taking the annual reading to 2.7% y-o-y (2.6% previously). The average work week and unemployment rate also held steady at 34.5 hours and 4.1% respectively in March. However, the participation rate eased marginally to 62.9% in March after picking up sharply to 63% in February (January: 62.7%). Thus, the overall report continued to suggest that the slack in the labour market has been declining.

Fed likely to continue with gradual interest rate hikes in 2018

Looking into the details, the soft jobs growth in March was due to contraction in construction and retail employment. Construction jobs fell by 15K in March (February: +65K), whereas retail jobs fell by 4K versus 47K in February. However, on the positive side, professional and business services (33K), manufacturing (22K), healthcare (22K) and mining (9K) continued to create jobs in March. Thus, we believe that this one-off soft headline non-farm payroll print will not have any impact on the Fed policymakers' intention to raise the FFTR in June. Meanwhile, Federal Reserve Chair Jerome Powell last week highlighted that the "absence of a sharper acceleration in wages suggests that the labour market is not excessively tight", thus arguing for gradual interest rate hikes over the next few years. Thus, we continue to expect three 25 bps rate hikes in 2018.

Fig. 3. US: 1Q average jobs growth still robust despite weak March print

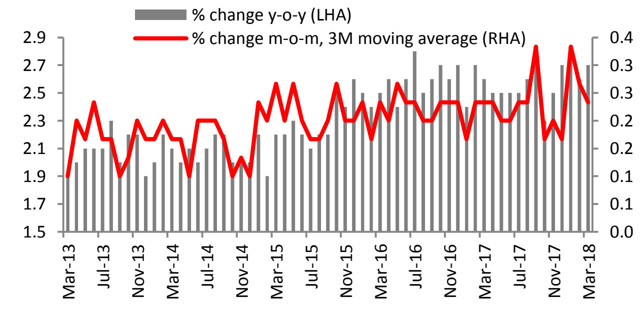
'000 (LHA); % (RHA)



Source: Bureau of Labor statistics

Fig. 4. US: Wage growth accelerates in March, in line with expectations

% change



Source: Bureau of Labor statistics

US: Trade dispute between US and China escalates

Trade escalation between US and China keeps global markets on edge

The risk of a trade war between the US and China has increased further with both countries announcing details of their proposed tariff measures last week. The US made the first announcement with an additional tariff of 25% worth c.USD50 billion on 1,300 Chinese products. The US administration's list was particularly concentrated on high-technology industries, including robotics, machinery, aerospace and information & communication technology. In response to the US announcement, China reciprocated with 25% tariffs on 106 US products (soybeans, autos, aircraft, and chemicals), worth c.USD50 billion. In retaliation to the Chinese announcement, Trump instructed the US trade representative to consider additional tariffs on USD100 billion worth of imports from China. This led to a strongly-worded statement from the Chinese pointing that it will fight "to the end" with measures of "similar scale and intensity". These developments prompted US equity markets to fall sharply on Friday. We believe that any further escalation in tariff measures from either side will keep markets on edge in the upcoming weeks.

US administration expected to shift attention towards finalising NAFTA agreement

Looking ahead, the US will be gathering public opinion until the end of May before finalising and implementing the tariff measures on Chinese imports. However, the US administration is expected to shift its attention to the NAFTA negotiations and sign an agreement-in-principle before proceeding with the Chinese tariff issue. China has also kept the date of the implementation of its tariffs open for now and indicated that it will depend on the US's next move. We believe that negotiations are the best way to reduce the US trade deficit but now the politically sensitive trade issue needs a win-win agreement for both parties. Thus, we remain cautious and will watch any new developments closely.

Eurozone: Headline inflation rises but core inflation remains sticky

Core inflation steady at 1% y-o-y in March, lower than consensus estimate of 1.1%.

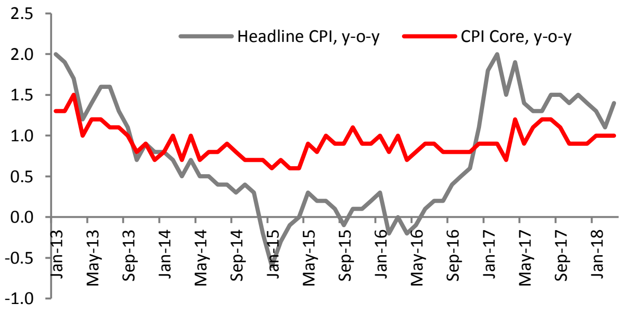
Headline inflation accelerated to 1.4% y-o-y in March, in line with the market's expectation. However, the February print was unexpectedly revised down to 1.1% from 1.2%. The pick-up in March inflation was largely due to a one-off variation in the timing of Easter, which pushed up travel-related prices (service inflation). Despite the pick-up in service inflation, core inflation showed no signs of acceleration and remained steady at 1% y-o-y for a third consecutive month. This was lower than the consensus estimate of 1.1% and mainly due to a sharp deceleration in core industrial goods prices. We believe that the EUR's appreciation could be one of the reasons behind the downwards pressure on industrial goods inflation. However, this should be watched closely in the coming months for further confirmation.

ECB likely to maintain dovish tone at April policy meeting

Meanwhile, the eurozone unemployment rate fell to 8.5% in February (January: 8.6%), suggesting some further tightening in labour markets. However, wage inflation is yet to show any signs of a pick-up as there is still reasonable slack in the labour market, in our view. Thus, we see the ECB maintaining its dovish tone on the inflation outlook while expressing increasing confidence in the eurozone's growth at the upcoming April policy meeting. Nevertheless, we will be looking for any hints or guidance regarding the timing of the extension of the QE programme (June/July). We expect the ECB to extend its asset purchase programme for another three months to December, albeit at a slower pace of EUR15 billion per month compared to the current rate of EUR30 billion a month.

Fig. 5. Eurozone: Core inflation remains steady at 1% y-o-y in March though headline inflation picks up to 1.4%

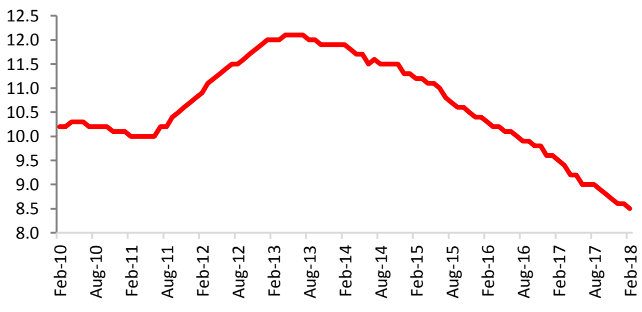
% change, y-o-y



Source: Eurostat

Fig. 6. Eurozone: Unemployment rate falls to 8.5% in February from 8.6% in January

%



Source: Eurostat

Japan: Tankan survey highlights firm business sentiment

Business sentiment remains firm, supported by both domestic and external demand

The Bank of Japan's Tankan survey showed that business sentiment remained resilient in 1Q, supported by synchronised global growth and improved economic fundamentals. Notably, corporates have been optimistic about fixed investments with increased spending planned for information technology and research activities. However, large manufacturers highlighted that they see headwinds emanating from the recent appreciation of the JPY and the rise in protectionist trade policies. Thus, large manufacturers' sentiment eased slightly to 24 in 1Q 2018 from 25 in 4Q 2017 though this remains well above the 2017 average of 19. Lending activity in Japan also remained accommodative on the back of the BoJ's expansionary monetary policy. The report continued to highlight the country's improved fundamentals with GDP growth likely to remain firm in the coming quarters.

Corporates see inflation expectations rising amid tight labour market conditions

The positive economic sentiment in Japan was also reflected in the Tankan survey's inflation expectations with both input and output prices seen rising for a second consecutive quarter. The report highlighted that labour market conditions have tightened further in 1Q but we still do not see this being reflected in wage growth. Thus, we expect inflationary pressures to remain subdued with additional headwinds emanating from the recent JPY appreciation. We believe that the BoJ will maintain its ultra-loose monetary policy until inflation shows a clear uptrend.

C. Emerging Market Economies

India: RBI in wait and watch mode with neutral stance

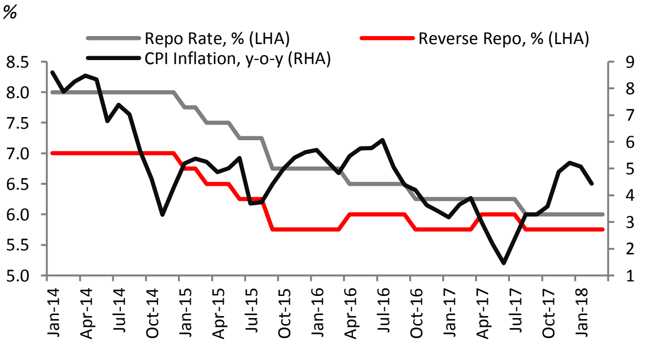
RBI keeps policy rates unchanged with neutral stance

The RBI kept its repo rate unchanged at 6% at its 5 April meeting, in line with our and the market's expectations. The overall tone of the meeting was neutral, in our view. The voting pattern remained unchanged at 5-1 with only one MPC member continuing to vote for a 25bps rate hike. There were four key takeaways from the meeting. The RBI: i) revised down its inflation projections, owing to softer-than-expected vegetable prices; ii) reiterated upside risks to inflation, with more clarity likely in the next two months; iii) displayed increasing confidence in the growth outlook, supported by buoyant rural consumption and capital spending; and iv) switched to the GDP (Gross Domestic Product) measure from the GVA (Gross Value Added) measure it used previously to maintain global standards.

We expect RBI to remain on hold in 2018

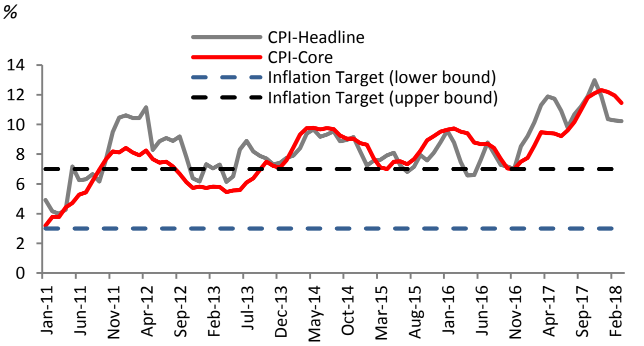
Following the sharp deceleration in food inflation in February, the RBI lowered its inflation projections to 4.7-5.1% in 1H FY2018-19 (previously 5.1-5.6%) and 4.4% (4.5-4.6% earlier) in 2H whilst highlighting upside risks to its projections. Despite the downward revisions, the RBI continues to expect inflation in the upper band of its target range of 4% (+/-2%) in FY2018-19 (April to March). The RBI governor also highlighted that the government's minimum support price (MSP) for crops, higher crude prices, fiscal slippage and rising domestic demand pose upside risks to the inflation outlook. We believe that the central bank has managed to balance the tone of its inflation outlook by highlighting risks on the one hand and lowering the inflation projections on the other. On the growth front, the RBI expressed increasing confidence and forecasts GDP growth to accelerate to 7.4% in FY2018-19 from 6.6% in FY2017-18 with the risks evenly balanced. Overall, we see growth-inflation mix to improve in FY2018-19. Thus, we expect the RBI to remain on hold with a neutral stance in 2018, assuming normal monsoon rainfall.

Fig. 7. India: RBI keeps policy rates steady at April meeting whilst maintaining neutral stance



Source: RBI, India Central Statistical Organisation

Fig. 8. Turkey: Both headline and core inflation remain in double digits in March



Source: CBRT, State Institute of Statistics Turkey

Turkey: Headline inflation beats market expectations in March

Headline inflation came in higher than consensus estimates amid rising food and transport prices

Headline inflation moderated slightly to 10.2% y-o-y in March (January: 10.3%) but came in higher than the market's expectation of 10%. Food inflation remained elevated with meat, eggs and some vegetable prices accelerating in March. Transportation prices, accounting for 17.5% of the basket, also picked up on the back of the persistently high crude oil prices. We believe that both food and transport prices are likely to remain high as domestic demand pressures remain strong. Meanwhile, core inflation softened to 11.4% y-o-y in March (February: 11.9%) but remained well above the CBRT's target. The elevated core inflation was mainly due to higher rental prices and durable goods inflation. Moreover, the government's recent announcement to increase household electricity tariffs (2.9%) from April 2018 is expected to add upside pressure to underlying inflation in the coming months.

TRY stability and crude prices remain critical factors for 2018 inflation outlook

We expect headline inflation to remain in double digits until 3Q2018 before moderating to the 9-10% range in 4Q2018. The recent depreciation of the TRY is likely to further dampen the inflation outlook for 2H2018. TRY stability and crude prices will remain key factors in shaping the CBRT's interest rate outlook, in our view. We believe that the CBRT will remain on hold until 3Q2018 and maintain its hawkish tone given the increasing upside risks to the inflation outlook.

II. Economic Calendar

Fig. 9. The week ahead

Time *	Country	Event	Period	Prior	Consensus
EM Countries					
	UAE	Dubai Economy Tracker SA	Mar	55.8	
	Oman	CPI, y-o-y	Mar	0.5%	
	Qatar	CPI, y-o-y	Mar	0.8%	
	Egypt	Urban CPI, y-o-y	Mar	14.4%	
	Egypt	Urban CPI, m-o-m	Mar	0.3%	
	China	Money Supply M2, y-o-y	Mar	8.8%	8.9%
	China	New Yuan Loans CNY	Mar	839.3B	1200B
Monday, 9 Apr					
3:50	Japan	BoP Current Account Balance	Feb	¥607.4B	¥2196B
20:45	Eurozone	ECB's Peter Praet speaks in Frankfurt			
Tuesday, 10 Apr					
13:30	UK	BoE's Haldane speaks in Melbourne			
16:30	US	PPI Final Demand, m-o-m	Mar	0.2%	0.1%
16:30	US	PPI Final Demand, y-o-y	Mar	2.8%	2.9%
18:00	US	Wholesale Inventories, m-o-m	Feb F	1.1%	0.8%
Wednesday, 11 Apr					
3:50	Japan	Core Machine Orders, m-o-m	Feb	8.2%	-2.5%
5:00	China	PBOC Governor Yi Gang speaks at Boao Forum, China			
5:30	China	PPI, y-o-y	Mar	3.7%	3.3%
5:30	China	CPI, y-o-y	Mar	2.9%	2.6%
12:30	UK	Trade Balance	Feb	-£3074	-£2600
12:30	UK	Industrial Production, m-o-m	Feb	1.3%	0.4%
12:30	UK	Manufacturing Production, m-o-m	Feb	0.1%	0.2%
15:00	Eurozone	ECB’s Draghi speaks in Frankfurt			
16:30	US	CPI, m-o-m	Mar	0.2%	0%
16:30	US	CPI, ex-Food and Energy, m-o-m	Mar	0.2%	0.2%
16:30	US	CPI, y-o-y	Mar	2.2%	2.4%
16:30	US	CPI, ex-Food and Energy, y-o-y	Mar	1.8%	2.1%
22:00	US	Monthly Budget Statement	Mar	-$215.2B	-$185B
22:00	US	FOMC Meeting Minutes	21-Mar		
Thursday, 12 Apr					
3:50	Japan	Money Stock M2, y-o-y	Mar	3.3%	3.2%
4:30	Japan	Kuroda Speaks at Branch Managers Meeting			
4:45	China	PBOC Governor Yi Gang speaks at IMF/PBOC conference			
10:30	UK	BoE's Broadbent speaks			
13:00	Eurozone	Industrial Production SA, m-o-m	Feb	-1%	0.1%
15:30	Eurozone	ECB's Coeure speaks in Paris			
16:00	India	CPI, y-o-y	Mar	4.4%	
16:00	India	Industrial Production, y-o-y	Feb	7.5%	
16:15	Eurozone	ECB Publishes accounts of March policy meeting			
16:30	US	Import Price Index, m-o-m	Mar	0.4%	0.1%
	UK	Mark Carney speaks at Canada Growth Summit in Toronto			
Friday, 13 Apr					
16:00	US	Fed's Rosengren Speaks on Economic Outlook			
18:00	US	JOLTS Job Openings	Feb	6312	
18:00	US	U. of Mich. Sentiment	Apr P	101.4	100.6
	China	Trade Balance	Mar	$33.7B	$27.9B
	China	Exports, y-o-y	Mar	44.5%	11.9%
	China	Imports, y-o-y	Mar	6.3%	12.4%

* UAE time
Source: Bloomberg

Fig. 10. Last week's data

Time *	Country	Event	Period	Prior	Consensus	Actual
	UAE	UAE PMI	Mar	55.1		54.8
	UAE	Dubai Airport Cargo Volume, y-o-y	Feb	-2.9%		-0.6%
	Saudi Arabia	GDP Constant Prices, y-o-y	4Q	-0.4%		-1.2%
	Saudi Arabia	Saudi Arabia PMI	Mar	53.2		52.8
	Egypt	Gross Official Reserves	Mar	42.5B		42.6B
	Egypt	Egypt PMI	Mar	49.7		49.2
Monday, 2 Apr						
3:50	Japan	Tankan Large Manufacturing Index	1Q	26	25	24
3:50	Japan	Tankan Small Manufacturing Index	1Q	15	14	15
5:45	China	Caixin China PMI Manufacturing	Mar	51.6	51.7	51
15:30	India	Eight Infrastructure Industries	Feb	6.1%		5.3%
18:00	US	Construction Spending, m-o-m	Feb	0%	0.4%	0.1%
18:00	US	ISM Manufacturing	Mar	60.8	59.6	59.3
18:00	US	ISM Prices Paid	Mar	74.2	72.5	78.1
Tuesday, 3 Apr						
3:50	Japan	Monetary Base, y-o-y	Mar	9.4%		9.1%
9:00	India	Nikkei India PMI Manufacturing	Mar	52.1		51
10:00	Germany	Retail Sales, m-o-m	Feb	-0.3%	0.7%	-0.7%
12:30	UK	Markit UK PMI Manufacturing SA	Mar	55	54.7	55.1
Wednesday, 4 Apr						
4:30	Japan	Nikkei Japan PMI Composite	Mar	52.2		51.3
5:45	China	Caixin China PMI Composite	Mar	53.3		51.8
9:00	India	Nikkei India PMI Composite	Mar	49.7		50.8
13:00	Eurozone	Unemployment Rate	Feb	8.6%	8.5%	8.5%
13:00	Eurozone	CPI Core, y-o-y	Mar A	1.0%	1.1%	1%
13:00	Eurozone	CPI Estimate, y-o-y	Mar	1.2%	1.4%	1.4%
16:15	US	ADP Employment Change	Mar	246K	210K	241K
18:00	US	ISM Non-Manufacturing Composite	Mar	59.5	59	58.8
18:00	US	Factory Orders	Feb	-1.3%	1.7%	1.2%
18:00	US	Durable Goods Orders	Feb F	3.1%		3%
18:00	US	Cap Goods Shipments, Non-def, ex-air	Feb F	1.4%		1.4%
Thursday, 5 Apr						
10:00	Germany	Factory Orders, m-o-m	Feb	-3.5%	1.5%	0.3%
12:30	UK	Markit/CIPS UK Composite PMI	Mar	54.5	54	51.7
13:00	Eurozone	Retail Sales, m-o-m	Feb	-0.3%	0.5%	0.1%
13:00	India	RBI Repurchase Rate	5-Apr	6%	6%	6%
13:00	India	RBI Reverse Repo Rate	5-Apr	5.75%	5.75%	5.75%
13:00	India	RBI Cash Reserve Ratio	5-Apr	4%	4%	4%
16:30	US	Trade Balance	Feb	-$56.7B	-$56.8B	-$57.6B
Friday, 6 Apr						
9:00	Japan	Leading Index CI	Feb P	105.6	105.5	105.8
10:00	Germany	Industrial Production SA, m-o-m	Feb	0.1%	0.2%	-1.6%
16:30	US	Change in Nonfarm Payrolls	Mar	326K	185K	103K
16:30	US	Change in Private Payrolls	Mar	320K	188K	102K
16:30	US	Unemployment Rate	Mar	4.1%	4%	4.1%
16:30	US	Average Hourly Earnings, m-o-m	Mar	0.1%	0.3%	0.3%
16:30	US	Average Hourly Earnings, y-o-y	Mar	2.6%	2.7%	2.7%
16:30	US	Average Weekly Hours All Employees	Mar	34.5	34.5	34.5
16:30	US	Labor Force Participation Rate	Mar	63%		62.9%

* UAE time
Source: Bloomberg

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