

## The Week Ahead: Global inflation and ECB minutes in focus

### ► **US: June CPI inflation and semi-annual monetary policy report**

This week will be a quieter one in the US following the FOMC minutes and labour data last week (page 3-4). The key US data releases this week will be June CPI inflation and the May JOLTS report. Consensus projects headline CPI inflation remained steady at 0.2% m-o-m in June, with higher gasoline prices being a key driver. This is expected to boost the annual inflation reading to 2.9% in June (May: 2.8%). Core inflation is also forecast to have remained unchanged at 0.2% m-o-m in June, as in May, supported by rising shelter prices. The other important events will be the Fed's semi-annual monetary policy report to Congress due on Friday (13 July) ahead of Fed Chairman Jerome Powell's testimony on 17 July. We expect this report to reiterate the Fed's positive stance on the economy, albeit highlighting the risks from rising trade tensions. Overall, we still expect the statement to suggest a total of four 25 bps FFTR hikes in 2018. Moreover, a number of FOMC members have speaking engagements this week, including John Williams and Raphael Bostic.

### ► **Europe: Brexit white paper to outline detailed proposals**

In the UK, market attention will be on the government's forthcoming Brexit white paper due on 12 July. Prime Minister Theresa May's proposals for a soft and market-friendly Brexit deal in a 12-point plan over the weekend is positive, in our view. May re-imposed "collective responsibility" over her cabinet – a move which bans ministers from publicly disagreeing with party policy – aimed at reducing dissenting voices during negotiations with the EU. However, EU support for the deal is uncertain and we still expect ongoing discord within the Conservative Party. Indeed, Brexit Secretary David Davis resigned from the government, particularly over the plan's stance on the customs union and single market. Thus, we see political tensions remaining elevated. Separately, the ECB minutes are expected to highlight gradual monetary policy normalisation despite the announcement of the end to the asset-purchase programme in end-December 2018. We expect the minutes to reflect a cautious or slightly dovish stance on the growth and inflation outlook, in line with the recent incoming data. However, we see potential for some dissenting voices regarding the timing of the next interest rate hike.

### ► **EM: China and India inflation likely accelerated in June**

We expect headline inflation to have accelerated in both India and China in June on the back of higher crude oil prices. Consensus believes headline inflation in India strengthened to 5.3% y-o-y from 4.9% in May. We believe that risks to India's inflation outlook are skewed to the upside due to high crude prices, the INR's further depreciation and the increase in government housing allowances. Moreover, increased government spending ahead of the general elections in mid-2019 is expected to fuel additional inflationary pressure in 2H2018 and early 2019. Meanwhile, consensus estimates China's headline inflation strengthened to 1.9% y-o-y in June from 1.8% in May. Producer price inflation is also forecast to have risen to a YTD high of 4.4% y-o-y in June, marking the fourth consecutive increase.

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## I. Recent Events and Data Releases

### A. MENA Economies

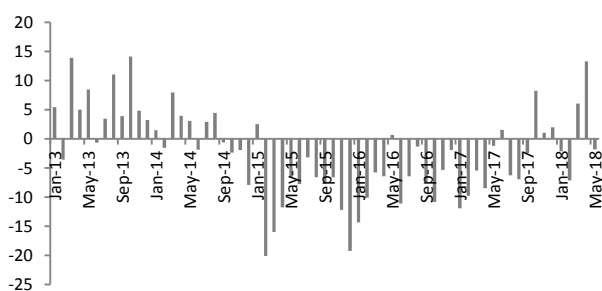
#### Saudi Arabia: Moderate fall in SAMA's FX reserve position in May

The monetary data and proxy economic indicators for May released by SAMA continued to show reduced external stress and some pickup in economic activity. SAMA's net foreign assets (NFA) fell only moderately in May by USD1.85 billion to USD497.1 billion, after two consecutive months of increases. This equated to a monthly contraction of 0.4% in May, though FX reserves are up 1.1% y-o-y. The yearly rise in SAMA's NFAs has been supported by i) government borrowing and ii) the higher oil revenue which reduces the need for the government to draw down FX reserves. The monthly rise in SAMA's NFAs in the previous two months reflected the government raising USD11 billion in an international bond (in April) and increasing the size of its international syndicated loan by an additional USD6 billion (in March). The reduced fiscal pressure on the government due to the higher oil revenue was also visible in other monetary indicators for May, including government deposits in the banking system which rose by 2.4% m-o-m. The yearly fall in government deposits in the banking sector has moderated to 7.1% y-o-y, from 15.3% in December 2017. A similar trend is also seen in government deposits held with SAMA, i.e. one of a moderating yearly contraction in deposits. The growth in the government's domestic borrowing (bond) has also slowed to 42.4% y-o-y in May (from 53.2% in March). Meanwhile, quarterly data showed that Saudi Arabia's current account surplus widened to USD11.1 billion in 1Q2018, from USD7.8 billion in 4Q2017 and USD4.7 billion in 1Q2017.

*SAMA's NFAs up 1.1% y-o-y in May, supported by higher government borrowing and higher oil revenue*

**Fig. 1. Saudi Arabia: SAMA's NFAs fall by just USD1.9 billion m-o-m in May, below monthly average drop in 2017**

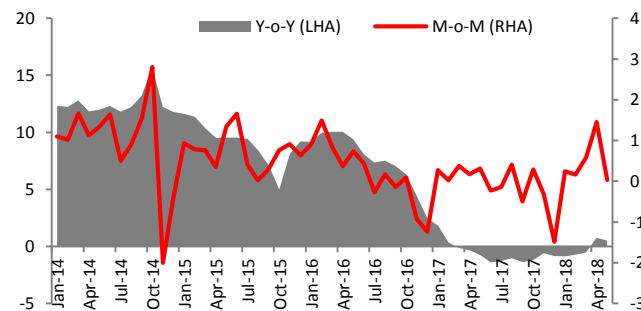
USD billion, monthly change



Source: SAMA, ADCB calculations

**Fig. 2. Saudi Arabia: Private sector credit growth flat in monthly terms in May**

% change



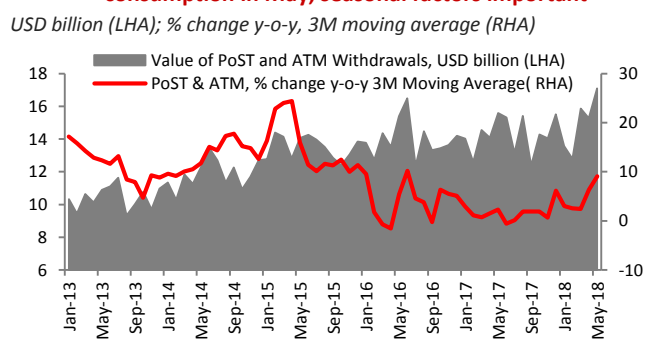
Source: SAMA, ADCB calculations

Wider monthly data released by SAMA also pointed to a gradual pickup in economic activity, albeit a patchy one with growth momentum soft overall. The main area seeing notably stronger performance was indicators linked to private consumption – notably points of sale transactions (PoST) in value terms. Combined PoST and ATM withdrawals rose by 11.9% m-o-m in May (Fig. 3). A breakdown of the PoST data shows that the rise in spending in value terms was relatively broad based, though spending on hospitality (hotels and restaurants), food, and clothing were key drivers. We believe that price discounting by corporates and seasonal factors, i.e. spending linked to Ramadan, likely supported the jump in the value of sales in May. The fading impact of VAT introduction and the allowance payments to nationals at the beginning of the year have also been

*Big jump in value of points of sale transactions in May of 18.9% m-o-m*

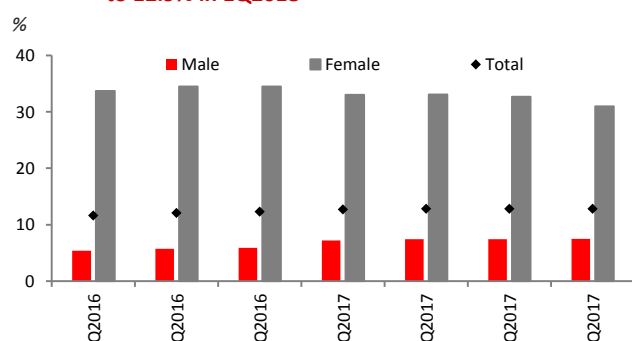
support factors in 2Q2018, in our view. Nevertheless, the high unemployment levels will remain a drag. Recently released data showed that unemployment of nationals edged up to 12.9% in 1Q2018, from 12.8% in the previous three quarters. Notably, the number of jobs held by Saudis fell by 13.4K in 1Q, contributing to the male unemployment levels rising moderately to 7.6% (4Q: 7.5%). The female unemployment level edged down to 30.9% (4Q: 31%). The fall in national jobs was despite a further 234.4K drop in the expatriate workforce in 1Q2018, after 277K jobs were lost in 4Q2017. Thus, both the level of employed nationals and expatriates fell in 1Q, highlighting the difficulty in the economy creating jobs. Overall, the trend over the previous quarters has been one of not all the jobs being lost by expatriates being taken up by nationals. Price discounting by corporates is visible in the moderation in inflation, especially in components linked to domestic consumption. However, private sector credit growth weakened in May in monthly and yearly terms highlighting the weak demand backdrop (Fig. 2), albeit it remained positive. Overall, the loan-to-deposit ratio rose moderately to 89.6% in May, after total deposits fell by 0.6% m-o-m.

**Fig. 3. Saudi Arabia: Marked jump in indicators of private consumption in May, seasonal factors important**



Source: SAMA, ADCB calculations

**Fig. 4. Saudi Arabia: Unemployment rate for nationals rises to 12.9% in 1Q2018**



Source: General Authority for Statistics

## B. G4 Economies

### US: Solid job creation but softer than expected wage growth in June

The June labour report was mixed, with better than expected NFP but subdued wage growth and an increase in the unemployment rate. The economy added 213K jobs in June, beating the consensus estimation of 195K. Jobs growth was also revised up for the previous two months, adding 37K jobs to the first print. The pace of the jobs growth has been very impressive with 2Q average gains now standing at 210K, compared to an average of 218K in 1Q and 221K in 4Q 2017. The main employment gains in June were in manufacturing (36K), education and health (54K), professional business services (50K), and leisure and hospitality (25K). Despite strong jobs creation, wage growth remains the weak point, with average hourly earnings growth decelerating to 0.2% m-o-m in June (consensus: 0.3%), down from 0.3% in May. This in turn kept the annual wage growth steady at 2.7% y-o-y in June, lower than the consensus estimate of 2.8%.

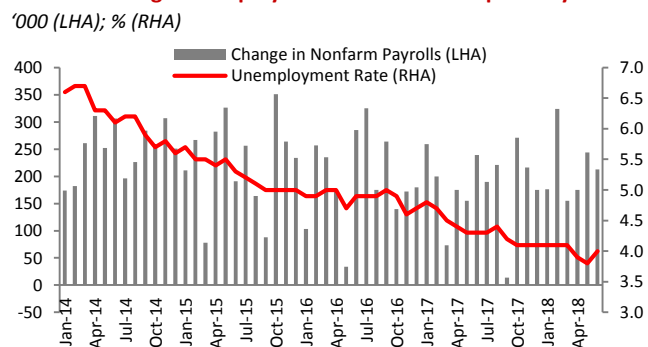
*Wage growth decelerates to 0.2% m-o-m in June, from 0.3% in previous month*

Importantly, the unemployment rate surprised to the upside and rose to 4% in June (consensus: 3.8%), from 3.8% in May. This was largely due to the participation rate, which accelerated to 62.9% in June, from 62.7% in May. We believe that the labour market will continue to absorb the excess slack and put gradual upward pressure on wage growth.

*Unemployment rate increases to 4% in June, from 3.8% in May*

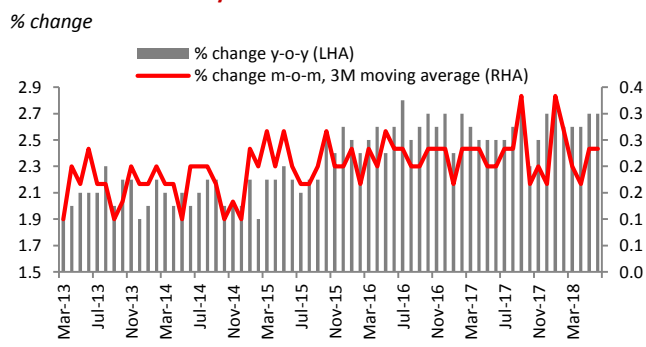
Thus, we expect the Fed to retain its steady rate hike stance, with two additional 25 bps FFTR hikes in 2018 (one each in September and December).

**Fig. 5. US: June jobs growth beats market expectations, though unemployment rate rises unexpectedly**



Source: Bureau of Labor Statistics

**Fig. 6. US: Wage growth softens to 0.2% m-o-m in June, from 0.3% in May**



Source: Bureau of Labor Statistics

**US: FOMC minutes highlight increasing concerns about trade policy**

No major surprises came out of the minutes of the Fed’s June 12-13 FOMC meeting. The minutes showed the Fed’s increased confidence on the growth and inflation outlook over the medium term, in line with the post-meeting statement. Despite greater confidence over the growth outlook, most Fed officials saw increased risks related to the rising trade tensions, which could have negative effects on business sentiment and investment spending. On the labour market, “a number of participants noted that, with the unemployment rate expected to remain below estimates of its longer-run normal rate, they anticipated wage inflation to pick up further.” However, members expressed two diverging views on inflation, with some participants worried about increasing inflationary pressure if the economy were to continue to grow above trend for a prolonged period. On the other hand other members argued that inflation above 2% for some time could help inflation expectations rise, especially given the subdued inflation in the recent years. On balance, members expressed confidence that inflation would realise the Fed’s 2% symmetric target on a sustained basis.

*Fed to continue with gradual interest rate hikes*

The minutes reaffirmed that it would be appropriate to continue with gradual interest rate hikes until the FFTR gets close to or somewhat above the Fed’s longer run FFTR estimates by 2019 or 2020. Moreover, a number of members argued that it might soon be appropriate to change the language related to “monetary policy remains accommodative”, especially given the tightening monetary conditions. The Fed officials had a detailed discussion on the flattening yield curve, with a number of participants stating that it would be important to monitor the slope of the yield curve, given the historical relationship between an inverted yield curve and chances of recession.

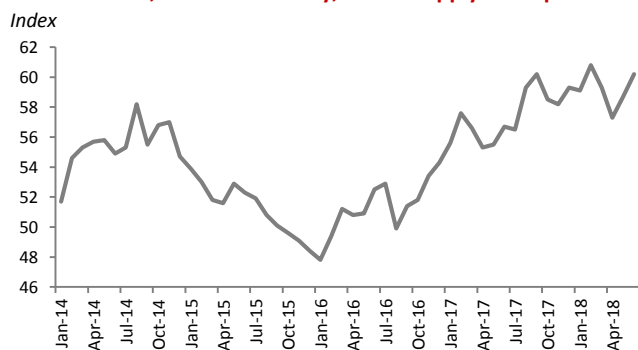
*Participants noted that it would be important to monitor slope of yield curve*

**ISM Manufacturing:** The ISM manufacturing index rose to a four-month high of 60.2 in June (May: 58.7), beating the consensus estimate of 58.5. The stronger-than-expected report suggests that demand remains robust, with 17 of the 18 industries having reported growth in June. The rise in June manufacturing activity was largely due to a six-point rise in the supplier deliveries index, which rose to 68.2 from 62 in May. The rising delivery time was due to supply-chain shortages leading to a delay in production materials, transportation difficulties and ongoing uncertainty in the steel and aluminium

*Solid manufacturing activity in June*

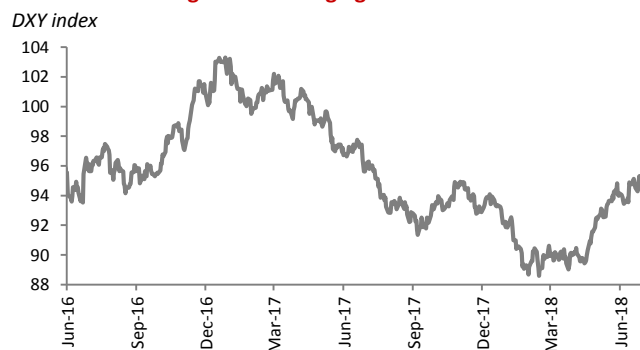
markets. Moreover, the report highlighted that "respondents are overwhelmingly concerned about how tariff-related activity is and will continue to affect their business."

**Fig. 7. US: ISM manufacturing activity strengthens to 60.2 in June, from 58.7 in May, due to supply chain pressures**



Source: Institute for Supply Management

**Fig. 8. US: Dollar index weakens slightly at end of last week, following subdued wage growth data**



Source: Bloomberg

## Japan: Business sentiment softens in 2Q; capital spending plans intact

The BoJ's Tankan survey showed that business sentiment remained expansionary in 2Q despite some moderation in manufacturing reading. Large manufacturers' sentiment softened to 21 in 2Q 2018 from 24 in 1Q, though this remains well above the 2017 average of 19. The deceleration in manufacturing sentiment was mainly due to slowing domestic demand and concerns over rising trade tensions. However, overseas demand remained solid in 2Q, likely supported by the JPY's depreciation against the USD over the period. Moreover, corporates have been optimistic about fixed investments with increased spending planned for information technology and research activities. Non-manufacturing activity surprised to the upside and accelerated slightly to 24 in 2Q – higher than both the consensus estimate and the previous quarter's 23. This was the best reading since December 2015. The report highlighted that labour market conditions have tightened further in 2Q though there were no meaningful signs of a pick-up in wage growth. Thus, we expect inflationary pressures to remain subdued in 2H 2018. We envisage that the BoJ will retain its ultra-loose monetary policy until inflation shows a clear uptrend.

*Business sentiment weakens in 2Q due to slowing domestic demand and rising trade tensions*

## C. Emerging Market Economies

### India: Government approves MSP hike for Kharif crops

The Indian government approved a minimum support price (MSP) hike for kharif crops last week (June to October sowing), ensuring 50% return over the cost of cultivation. The sharp increase in MSP is targeted to ease the ongoing distress in the farming sector and boost disposable income for rural consumers. It is a common practice for the ruling government to increase MSP substantially ahead of general elections. The announcement was largely in line with market expectations and we expect the MSP hikes to increase headline inflation by c.30-40 bps and widen the fiscal deficit by c.0.1%-0.2% in the current fiscal year (Apr-Mar). However, these estimates are likely to change based on the procurement policy and prevailing market prices for crops in October – the starting month of government procurement. Moreover, the government stated that it is

*Higher minimum support prices announced*

yet to finalise the procurement policy, which will also be crucial to estimate the exact impact on the inflation and fiscal outlook. We believe that the risks to the inflation outlook are skewed to the upside given the higher MSPs for crops, elevated crude oil prices and INR depreciation. Thus, we expect the RBI to be ready to hike policy rates again at its August or October meeting if inflation deviates significantly from the central bank's projections.

**Fig. 9. India: Minimum support price hike for crops**

Crop	CPI weight	Old MSP	New MSP	Increase in MSP	FY19 Cost: A2+FL	Return over cost (A2+FL)
Unit	%	INR/quintal	INR/quintal	%	INR/quintal	%
Paddy *	4.7%	1570	1760	12.1	1166	50.9
Jowar **	0.2%	1713	2440	42.5	1619	50.7
Bajra	0.1%	1425	1950	36.8	990	97
Maize	0.1%	1425	1700	19.3	1131	50.3
Ragi	0.0%	1900	2897	52.5	1931	50
Arhar	0.8%	5450	5675	4.1	3432	65.4
Moong	0.3%	5575	6975	25.1	4650	50
Urad	0.3%	5400	5600	3.7	3438	62.9
Groundnut	0.3%	4450	4890	9.9	3260	50

\* denotes average of common grade and grade A;

\*\* denotes average of hybrid and Maldandi grades

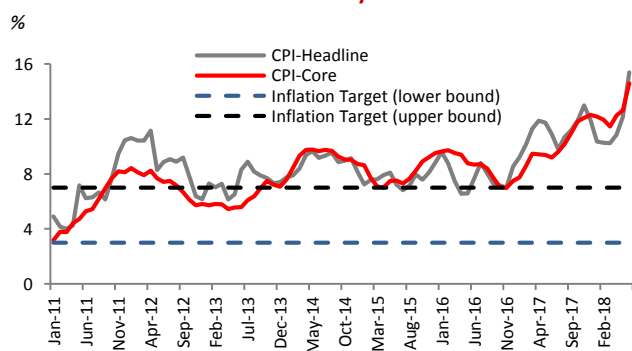
Source: PIB, ADCB estimates

## Turkey: Inflation outlook deteriorates further in June

Headline CPI inflation accelerated sharply to 15.4% y-o-y in June from 12.2% in May – the highest reading since October 2003. This was well above the consensus expectation of 13.9% y-o-y in June. Notably, headline inflation has been in double digits since February 2017 with the exception of July 2017. The rise in June inflation was broad-based with a pick-up in prices seen in all of the major sub-categories, supported by both demand-driven price pressure and TRY depreciation-related pass-through effects in our view. Goods inflation strengthened to 17.3% y-o-y in June, led by a sharp rise in energy prices (17%) and unprocessed food (23.2%). Core inflation (c-index) also rose to a series high of 14.6% y-o-y in June from 12.6% in May. This was due to a strengthening in core goods inflation, led largely by durable goods prices (automobile and white goods). Moreover, services inflation, which tends to be sticky, accelerated sharply to 11% y-o-y in June (May: 9.5%) despite rental prices remaining broadly stable.

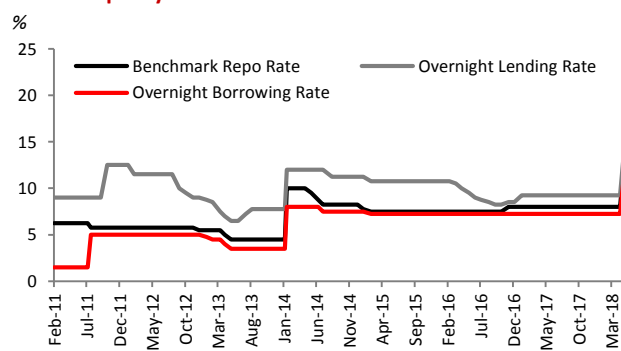
*Both headline and core inflation rise sharply in June*

**Fig. 10. Turkey: Headline inflation accelerates to 15.4% y-o-y in June from 12.2% in May**



Source: Turkish Statistical Institute, CBRT

**Fig. 11. Turkey: We expect CBRT to retain its tight monetary policy in 2H2018**



Source: CBRT

We had earlier anticipated headline inflation peaking around c.15% y-o-y by the end of 3Q. However, with inflation already reaching our target in June, we now expect it to strengthen further and reach c.17% y-o-y in 3Q before moderating gradually from 4Q. The rise in headline inflation in June suggests that the real policy rate will now be c.2.4%, which is lower than some other major emerging market economies. We believe that this is likely to put additional pressure on the TRY to weaken further in the upcoming period. Thus, we see an increasing chance of the CBRT hiking interest rates at its 24 July policy meeting to limit further weakening of the TRY and deterioration of the inflation outlook.

*CBRT likely to hike policy rate at 24 July meeting*

## II. Economic Calendar

Fig. 12. The week ahead

Time*	Country	Event	Period	Prior	Consensus
<b>Expected this week</b>					
	UAE	Dubai Airport Cargo Volume, y-o-y	May	-0.7%	
	Bahrain	GDP Constant Prices, y-o-y	1Q	3.4%	
	Oman	CPI, y-o-y	Jun	0.8%	
	Qatar	CPI, y-o-y	Jun	0.5%	
	Egypt	Urban CPI, y-o-y	Jun	11.4%	
	China	Money Supply M2, y-o-y	Jun	8.3%	8.4%
	China	New Yuan Loans CNY	Jun	1150B	1520B
<b>Monday, 9 July</b>					
3:50	Japan	BoP Current Account Balance	May	¥1845.1B	¥1266B
4:30	Japan	Kuroda speaks at Branch Managers' Meeting			
11:50	UK	BOE's Broadbent Speaks at Conference in London			
15:00	Eurozone	ECB's Nowotny Speaks in Zurich			
17:00	Eurozone	ECB's Draghi speaks to European Parliament			
	China	Foreign Reserves	Jun	\$3110.6B	\$3103B
<b>Tuesday, 10 July</b>					
3:50	Japan	Money Stock M2, y-o-y	Jun	3.2%	3.2%
5:30	China	PPI, y-o-y	Jun	4.1%	4.5%
5:30	China	CPI, y-o-y	Jun	1.8%	1.9%
12:30	UK	Trade Balance	May	-£5280	-£3378
12:30	UK	Industrial Production, m-o-m	May	-0.8%	0.5%
12:30	UK	Manufacturing Production, m-o-m	May	-1.4%	0.8%
12:30	UK	U.K. Statistics Office Publishes First Monthly Estimate of GDP			
18:00	US	JOLTS Job Openings	May	6698	6660
<b>Wednesday, 11 July</b>					
3:50	Japan	Core Machine Orders, m-o-m	May	10.1%	-5%
8:30	Japan	Tertiary Industry Index, m-o-m	May	1%	-0.3%
16:30	US	PPI Final Demand, m-o-m	Jun	0.5%	0.2%
16:30	US	PPI Final Demand, y-o-y	Jun	3.1%	3.1%
18:00	US	Wholesale Inventories, m-o-m	May F	0.5%	0.4%
19:35	UK	BOE Governor Mark Carney Speaks in Boston, Massachusetts			
<b>Thursday, 12 July</b>					
0:30	US	Fed's Williams Speaks with Community Leaders in Brooklyn			
13:00	Eurozone	Industrial Production SA, m-o-m	May	-0.9%	1.2%
16:00	India	CPI, y-o-y	Jun	4.9%	5.3%
16:00	India	Industrial Production, y-o-y	May	4.9%	5.9%
16:30	US	CPI, m-o-m	Jun	0.2%	0.2%
16:30	US	CPI, y-o-y	Jun	2.8%	2.9%
16:30	US	CPI, ex-Food and Energy, m-o-m	Jun	0.2%	0.2%
16:30	US	CPI, ex-Food and Energy, y-o-y	Jun	2.2%	2.3%
20:15	US	Fed's Harker Speaks at Rocky Mountain Economic Summit			
22:00	US	Monthly Budget Statement	Jun	-\$146.8B	-\$80B
<b>Friday, 13 July</b>					
15:00	UK	Bank of England Deputy Governor Jon Cunliffe Speaks			
16:30	US	Import Price Index, m-o-m	Jun	0.6%	0.1%
18:00	US	University of Michigan Sentiment	Jul P	98.2	98
19:00	US	Fed Releases Monetary Policy Report to Congress			
20:30	US	Fed's Bostic Holds Town Hall Chat in Northern Virginia			
	China	Trade Balance	Jun	\$24.9B	\$27.2B
	China	Exports, y-o-y	Jun	12.6%	10.4%
	China	Imports, y-o-y	Jun	26.0%	22.0%

\* UAE time

Source: Bloomberg



Fig. 13. Last week's data

Time*	Country	Event	Period	Prior	Consensus	Actual
<b>GCC Economies</b>						
	UAE	UAE PMI	Jun	56.5		57.1
	UAE	CPI, y-o-y	May	3.5%		3.5%
	UAE	CPI, m-o-m	May	-0.2%		-0.1%
	Saudi Arabia	Non-Oil Exports, y-o-y	Apr	11.1%		26.5%
	Saudi Arabia	Unemployment Rate (Saudis)	1Q	12.8%		12.9%
	Saudi Arabia	M2 Money Supply, y-o-y	May	-0.3%		0.1%
	Saudi Arabia	SAMA Net Foreign Assets SAR	May	1870.9B		1863.9B
	Saudi Arabia	Current Account Balance	1Q	7834M		11065M
	Saudi Arabia	GDP Constant Prices, y-o-y	1Q	-1.2%		1.2%
	Saudi Arabia	Saudi Arabia PMI	Jun	53.2		55
	Qatar	GDP Constant Prices, y-o-y	1Q	3%		1.4%
<b>Monday, 2 July</b>						
3:50	Japan	Tankan Large Manufacturing Index	2Q	24	22	21
3:50	Japan	Tankan Large Manufacturing Outlook	2Q	20	20	21
5:45	China	Caixin China PMI Manufacturing	Jun	51.1	51.1	51
9:00	India	Nikkei India PMI Manufacturing	Jun	51.2		53.1
12:00	Eurozone	Markit Eurozone Manufacturing PMI	Jun F	55	55	54.9
12:30	UK	Markit UK PMI Manufacturing SA	Jun	54.3	54	54.4
13:00	Eurozone	Unemployment Rate	May	8.4%	8.5%	8.4%
17:45	US	Markit US Manufacturing PMI	Jun F	54.6	54.6	55.4
18:00	US	ISM Manufacturing	Jun	58.7	58.5	60.2
18:00	US	ISM Prices Paid	Jun	79.5	75	76.8
<b>Tuesday, 3 July</b>						
3:50	Japan	Monetary Base, y-o-y	Jun	8.1%		7.4%
11:00	Turkey	CPI, y-o-y	Jun	12.2%	13.9%	15.4%
11:00	Turkey	Core CPI, y-o-y	Jun	12.6%	13.4%	14.6%
13:00	Eurozone	Retail Sales, m-o-m	May	-0.1%	0.1%	0%
13:00	Eurozone	Retail Sales, y-o-y	May	1.6%	1.6%	1.4%
18:00	US	Factory Orders	May	-0.4%	0%	0.4%
18:00	US	Durable Goods Orders	May F	-0.6%	-0.5%	-0.4%
18:00	US	Capital Goods Shipments, Non-defence, ex-air	May F	-0.1%		0.2%
<b>Wednesday, 4 July</b>						
12:30	UK	Markit UK PMI Services SA	Jun	54	54	55.1
12:30	UK	Markit UK PMI Composite SA	Jun	54.5	54.5	55.2
4:30	Japan	Nikkei Japan PMI Composite	Jun	51.7		52.1
15:00	US	MBA Mortgage Applications	29-Jun	-4.9%		-0.5%
<b>Thursday, 5 July</b>						
10:00	Germany	Factory Orders, m-o-m	May	-1.6%	1.1%	2.6%
16:15	US	ADP Employment Change	Jun	189K	190K	177K
18:00	US	ISM Non-Manufacturing Composite	Jun	58.6	58.3	59.1
<b>Friday, 6 July</b>						
10:00	Germany	Industrial Production SA, m-o-m	May	-1.3%	0.3%	2.6%
12:30	UK	Unit Labor Costs, y-o-y	1Q	2.9%		3.1%
16:30	US	Change in Nonfarm Payrolls	Jun	244K	195K	213K
16:30	US	Unemployment Rate	Jun	3.8%	3.8%	4%
16:30	US	Average Hourly Earnings, m-o-m	Jun	0.3%	0.3%	0.2%
16:30	US	Average Hourly Earnings, y-o-y	Jun	2.7%	2.8%	2.7%
16:30	US	Trade Balance	May	-\$46.1B	-\$43.6B	-\$43.1B

\* UAE time

Source: Bloomberg

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