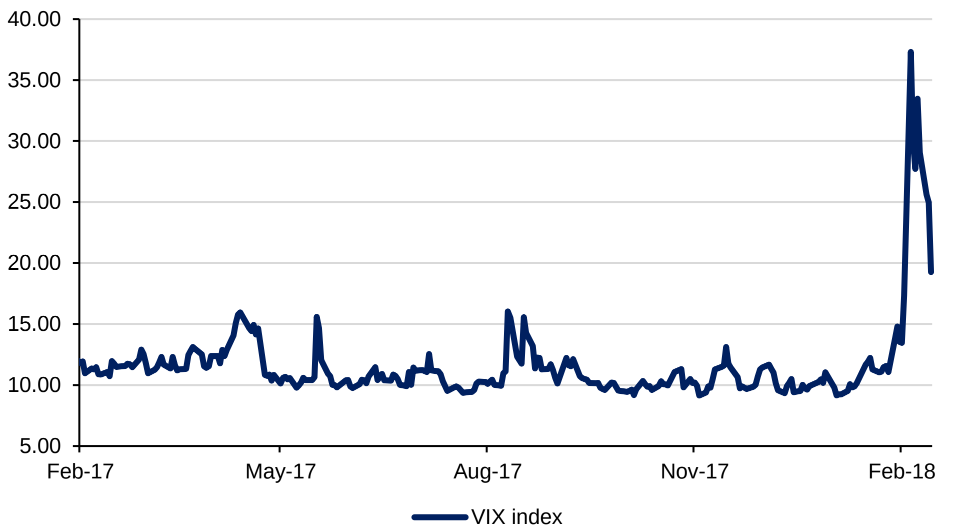
بنك الإمارات دبي الوطني
Emirates NBD

Monthly Insights

Last month we thought that some of the optimism that was driving markets higher was unsustainable, and the last fortnight has shown that this was indeed the case. Regional equity markets have been less affected by recent market volatility partly on account of them not participating as much in earlier rallies.

- **Global macro:** Evidence of returning inflation pressures are causing central banks to review their monetary policies amidst increasingly volatile financial market conditions.
- **GCC macro:** The effects of VAT's introduction across the GCC were visible in January's regional PMI's.
- **MENA macro:** Fiscal deficits will narrow across North Africa and the Levant in 2018, although political pushback will slow the pace of this as populations tire of austerity measures.
- **Sector focus:** An overview of the GCC's Artificial Intelligence (AI) sector.
- **Emerging market focus:** An overview of the outlook for India.
- **Interest rates:** Government bonds fell and yield curves steepened as expectations of higher inflation got firmly entrenched.
- **Credit:** GCC bonds suffered from bear steepening of the UST benchmark yield curve as well as widening credit spreads amid increased volatility in financial markets.
- **Currencies:** Midway through February, the USD is currently on target to decline for a fourth successive month, despite attempting to rally at the start of it.
- **Equities:** February has been a volatile month for global equities. The return of inflation was flagged as one key concern for 2018. However, it was not anticipated that the risk would manifest itself so early in the year.
- **Commodities:** We have marked our oil forecasts to market but expect further downside ahead as fundamentals and external factors drag down on prices.

Volatility shoots up as inflation risks grow



Source: Bloomberg, Emirates NBD Research.

Monthly

15 February 2018

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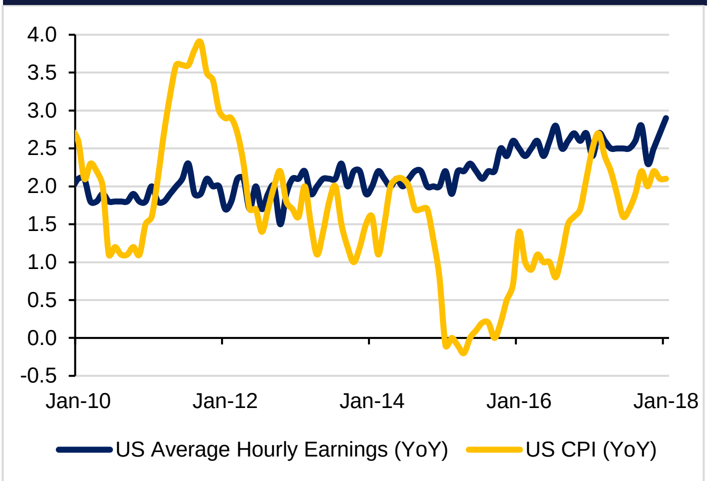
Content

Global Macro

Global markets under strain

Last month we thought that some of the optimism that was driving markets higher was unsustainable, and the last fortnight has shown that this was indeed the case. Technical as well as fundamental arguments explain the recent corrections, with these forces likely to maintain pressure on markets in the coming months (See Equities page 17). The starting point was the January non-farm payrolls report, which along with a 200k increase in January non-farm payroll jobs saw the average earnings rate rise to 2.9%, the highest level since 2009. Bond yields which had been rising prior to the report pushed up further, catalyzing pressure on equities via an unwind in short volatility positions.

US inflation starting to show up



Source: Bloomberg, Emirates NBD Research

As inflation heats up

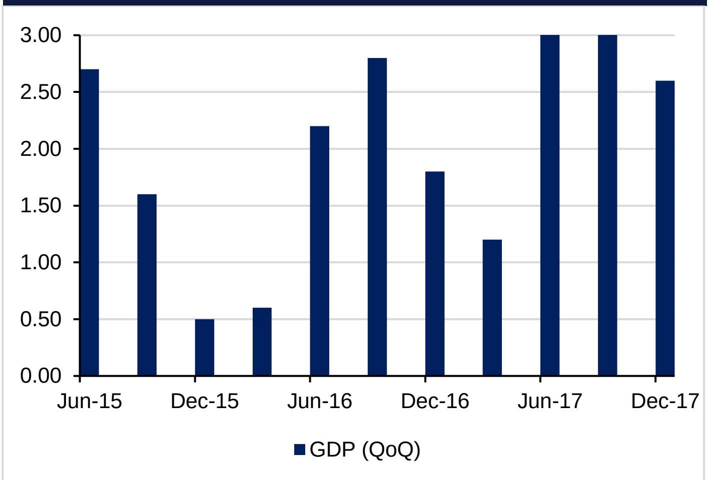
So the sell-off was started by good news, but clearly news that was not widely expected. Much less expected was the US January CPI increase, outpacing expectations both on a headline (0.5%) and an underlying (0.3%) basis. Investors have for some time underestimated the likelihood that inflation might reappear and that the Fed could be forced to raise interest rates by more than the three times suggested by its dot plot. The market has now adjusted its assumptions closer to the Fed's, but it is still not pricing the possibility that the Fed itself is being too cautious, and will have to raise rates more than three times this year.

It may actually be the Fed's ultra-easy policies over the last few years that have perpetuated cycles prone to periodic booms and busts. In addition markets have become used to a Fed that often backstops equity weakness by delaying increases in interest rates, begging the question of whether it is the markets or the Fed that is in control of monetary policy. This 'Greenspan Put' morphed into a 'Greenspan-Bernanke-Yellen Put' , but the promising development this time around is that the Fed under new Chairman Jerome Powell seems relatively relaxed about the slide in equities. This may be because it recognizes that valuations have become too extreme, and does not mind a correction in order that financial stability is maintained. Clearly it is early days in the Powell Fed, but the signs are that even with a number of vacant positions still to fill its balance is turning slightly more hawkish, which suggests it will look through equity market volatility as it continues the process of interest rate and balance sheet normalization.

Fiscal stimulus to boost US growth

This is just as well as the momentum in the U.S. economy appears to be building, with recent fiscal developments only adding to upside growth and inflation risks that already exist. These are also being amplified by the global nature of the recovery, which for the first time in years appears to be entering a strong synchronised growth phase. As far as the budget is concerned, Congress has passed a USD300bn two-year spending bill which puts the U.S. on course for deficits for years to come. Taken together with the tax cuts passed in December the combined stimulus amounts to approximately 1.2% of GDP over the coming year which will have considerable near term growth and inflation implications. The overall USD4.4 trillion budget proposal projects deficits through the next decade and assumes that US real GDP grows 3% a year over the period, something that looks highly improbable. If anything the monetary tightening that will probably be needed to offset inflationary risks will more than likely bring about a recession in the coming years, especially as the U.S. economy has never had a recovery that has lasted beyond ten years. Should this happen then the trajectory for federal debt will probably be even worse, a situation that could reduce the appetite for U.S. debt among foreign investors, prompting higher bond yields and a weaker dollar (See FX page 15).

US GDP was healthy in 2017

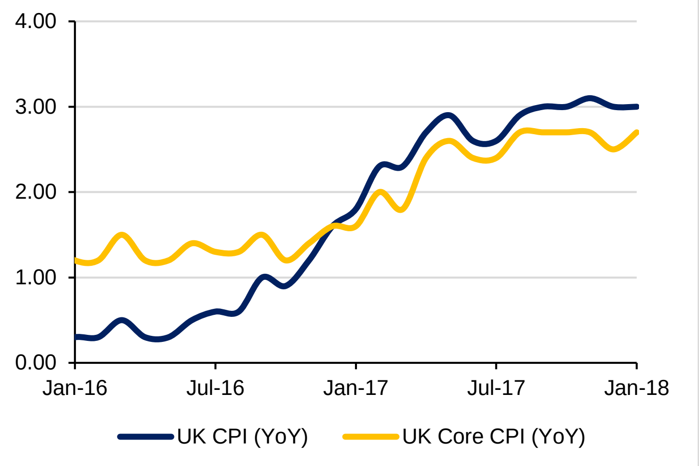


Source: Bloomberg, Emirates NBD Research

Bank of England signals need to move faster

Last week the Bank of England also signalled that interest rates in the UK are likely to rise sooner and faster than it previously indicated due to rising demand and weak productivity. This came as UK GDP growth expanded by 0.5% q/q in Q4, more than expected, and as UK inflation data showed January CPI holding steady at 3.0% y/y, the same level as in December, but still 1 percentage point higher than the Bank's 2.0% target Core CPI rose to 2.7% y/y from 2.5%, also above market expectations. The outcome still fits with BoE projections, which ultimately expects CPI to decline to 2.0% y/y by 2020. Meanwhile PPI data showed input prices gaining 4.7% y/y, down from 5.4% y/y in December, while output prices rose by 2.8% y/y, down from 3.3%, suggesting that pipeline price pressures are starting to ease.

UK inflation remains elevated



Source: Bloomberg, Emirates NBD Research

May UK rate hike looking likely

Nevertheless, a May UK interest rate rise looks like a very real possibility with another hike in the second half of the year also likely. The main risk to the UK economy continues to be the Brexit negotiations, with discussions over trade now taking centre-stage. These are not proving straightforward, however, with the EU's Brexit negotiator Michel Barnier recently remarking that a transition deal is ‘not a given,’ and signaling that border checks on the Irish border may be ‘unavoidable’. Complicating matters for UK Prime Minister May is the division within her government about whether to pursue a hard Brexit outside of the EU’s customs union, or whether to compromise a little in order to maintain the UK’s access into the single market. Following the disastrous general election held last year, May’s ability to cling on to power is not guaranteed, and another election would not be out of the question should support for her begin to crumble.

New German government positive for growth

Political developments have also been to the fore in the EU, especially in Germany, where an agreement has been reached about the formation of a new government. Chancellor Merkel’s CDU, the winners of the 2017 election will hold eight cabinet seats, while the second placed SPD will take five. However crucially, of these five the SPD has control of the Finance Ministry and the Foreign Ministry, probably the most powerful portfolios. Conditional on SPD members approving the coalition in a postal ballot this outcome will likely play in to greater government spending and a more integrationist EU policy. Accordingly there will be upside risks to German growth, which was confirmed at 0.6% in Q4, and perhaps even to inflation, especially after German unions reached a landmark pay deal of 4.3% with employers, signaling the end of wage restraint. Such developments should also strengthen the arm of the Bundesbank on the ECB Council when it comes to making the case for QE to be brought to an end. The March ECB meeting is likely to be a pivotal one in which some policymakers will seek to articulate a timeline for QE to be phased out. However, it will also coincide with election risks in Italy at the start of that month, with the possibility of a confusing picture emerging out the new election process there, and with right wing parties likely to be in the ascendency in the third largest country in the Eurozone.

BOJ at back of the tightening queue

Japan's GDP grew by just 0.5% q/q in Q4 according to preliminary estimates, down from a revised 2.2% growth rate in Q3. Private consumption grew 0.5% in Q4, while business spending improved by 0.7%. This was a relatively disappointing report, with growth slowing in Q4 by a much more than anticipated. Although Japan's GDP has improved for eight consecutive quarters, the fall back in momentum suggests that Japan's economy is still some way from being self-sustaining, and will likely mean that the Bank of Japan will be at the back of the queue when it comes to normalizing monetary policy.

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GCC: VAT comes into effect

Although the headline results of the Emirates NBD regional PMI surveys (Saudi Arabia, UAE and Dubai Economy Tracker) differed in some regards, there are some common threads across all three, largely related to the introduction of a value added tax (VAT) across the GCC in January.

All three of the Emirates NBD regional PMIs (Saudi Arabia, UAE and Dubai Economy Tracker indices) were comfortably above the neutral 50 level which delineates contraction (below 50) and expansion (above) in January, but there was some disparity between them. Both the UAE and Saudi PMIs declined in January, with Saudi Arabia's falling from 57.3 to 53.0, and the UAE's from 57.7 to 56.8, while Dubai's Economy Tracker was the only index to climb on the previous month, from 54.7 to 56.0.

The outlook is generally positive in the UAE and Dubai in both the immediate and near term, as both current output, and new orders and business optimism, have performed strongly across the two surveys. This is broadly the case in Saudi Arabia also, despite the fact that January's score of 53.0 was the lowest in the index's history. We believe that the more muted performance in the UAE and Saudi Arabian PMI surveys as compared to December is probably the result of elevated Q4 2017 activity prior to VAT's implementation, rather than the start of a more sinister structural slowdown.

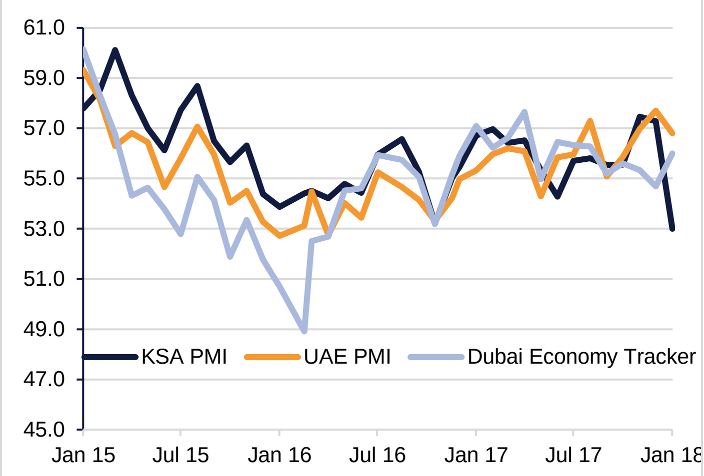
VAT effects felt prior to implementation

The introduction of VAT at 5% across the GCC at the start of the year has arguably been one of the strongest factors affecting the respective non-oil private sectors over the past several months, as businesses were preparing for it even before its implementation. Indeed, the January survey results need to be examined in context with firms' activity as they prepared for VAT's introduction in order to fully understand the trends. In January, the first month of operations under the new tax for businesses, its implementation clearly manifested itself in both the data and anecdotal reports from respondents.

In Saudi Arabia, the introduction of VAT was likely responsible for the record low PMI score in January. The survey suggested that many firms boosted orders and output in Q4 ahead of VAT implementation, and that the January slowdown is likely to be transitory. Unsurprisingly given slower growth in output and new work, purchasing activity also slowed in January as firms likely stocked up on pre-production inventory at the end of last year. The impact of VAT, as well as cuts to fuel subsidies in January, is also evident in higher input cost inflation last month. However, firms appear to have absorbed the higher input costs last month, citing "competitive market conditions" and "subdued client demand". Selling prices were only marginally higher in January as a result.

In the UAE, the impact of VAT was evident on prices and purchasing activity during January. As in Saudi Arabia, stock-building in advance of VAT coming into force was responsible for a slowdown in the rates of expansion in both purchasing activity and stocks of inputs. Respondents also indicated that stock building prior to VAT introduction meant that inventory levels were sufficient to deal with current workloads.

Headline Emirates NBD PMI and Dubai tracker



Source: IHS Markit, Emirates NBD Research

This trend was also reflected in the Dubai Economy Tracker. New orders rose strongly in January although at a slightly slower rate than in December. Stocks of pre-production inventories also increased at a slower rate, as many firms would have boosted purchases in December ahead of the introduction of VAT. The impact of the new tax is evident in the sharply higher input cost index (59.2 in January from 51.7 in December. However, the selling price index only rose 1.7 points last month, to 52.2, suggesting that not all firms passed on the full impact of VAT to purchasers. In fact in the travel and tourism sector, prices were close to unchanged from December, suggesting that the full impact of VAT was absorbed by firms in this sector.

Firms retain optimism

Despite the introduction of VAT in January, firms across the GCC retain optimism regarding future conditions, reaffirming our view that the decline in Saudi Arabia and the UAE last month was driven primarily by base effects on strong Q4 data.

In the UAE, survey respondents expect activity to further increase once the new VAT system becomes more familiar, with higher new orders expected to support output growth over the coming year. Notably there was a robust improvement in business confidence in January, with sentiment at the highest level since June 2015. In Saudi Arabia, meanwhile, some firms reported hiring ahead of new project starts. Staff costs rose at a faster rate as well, with many private sector firms following suit after the government announced wage increases in January. Despite a softer headline PMI in January, businesses were more optimistic about the prospects for the coming year than they have been since April 2017.

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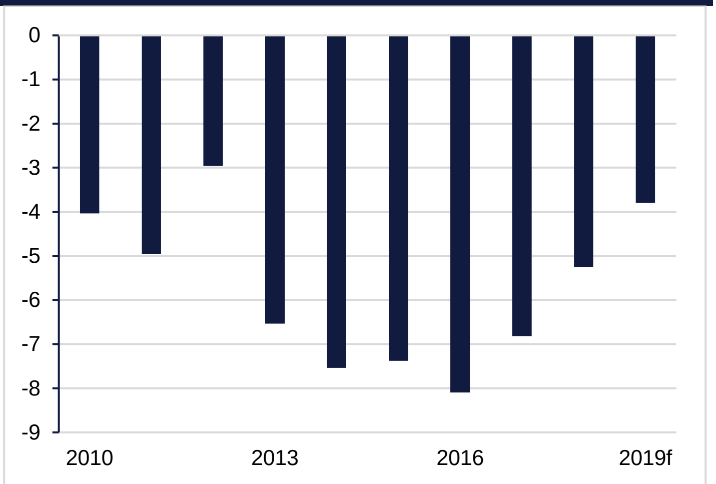
MENA Macro: Narrowing fiscal deficits

We expect fiscal deficits to narrow across North Africa and the Levant over the coming years, as regional governments put some of their recent troubles behind them. Pushback on austerity measures will slow the speed of consoldation, however, and capital investment is likely to lag, to the detriment of long-term growth and competitiveness.

Budget shortfalls climbed fairly uniformly across the 9 countries* we cover in the North Africa and Levant region over 2013 to 2016, owing to the disruptive effects of the 2011 ‘Arab Spring’ protests and their subsequent unrest, compounded in some countries by the oil price slump which took hold in H2 2014. The weighted average budget deficit for the states climbed from equivalent to 3.0% of GDP in 2012, to 8.1% in 2016. Last year, as the outlook began to improve, this fell to 6.8%.

In 2018 and 2019 we expect that the weighted average budget deficit will fall further, to 5.2% and 3.8% respectively, as all 9 countries successfully rein in their shortfalls to varying degrees. This will have clear benefits for the governments, meaning not only that debt levels will grow more slowly, but that they should be able to borrow the debt they do incur at more favourable rates of interest – especially important in the wider environment of tightening monetary policy in the US and elsewhere. The means by which the deficits are drawn down will not be uniform; oil exporters will benefit from higher global prices, while importers are expected to see improvements in tourist numbers. Most will likely see stronger GDP growth..

Weighted average budget deficit, % GDP

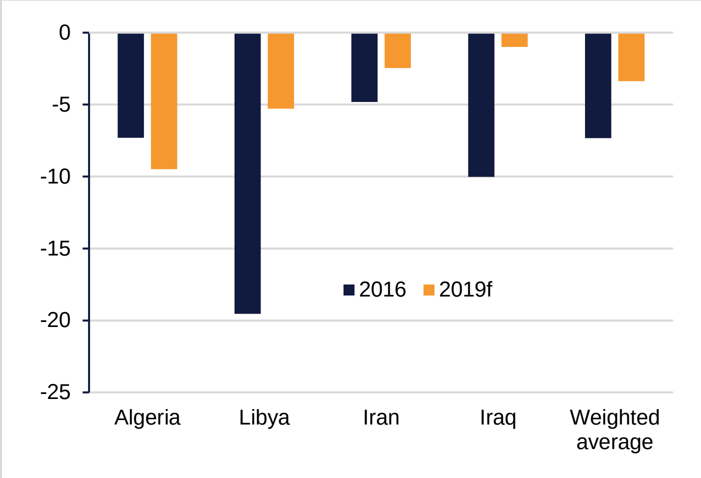


Source: Haver Analytics, Emirates NBD Research

Austerity will come under pressure

In contrast to the oil-exporting countries of the Arabian Peninsula, where the purse strings have been loosened in 2018, most ex-GCC MENA countries remain committed to austerity measures. Although some of the more substantial planned reforms have already been implemented in many countries, efforts to curb recurrent spending, slash subsidies and raise taxes will continue as governments move forward with multi-year reform programmes. In Egypt, further utility tariff hikes are planned in July, while in Algeria, finance minister Abderrahmane Raouia told the press in February that the government envisaged cutting petrol subsidies in 2019 and other – unspecified – subsidies in 2020. In January, Lebanese Prime Minister Saad Hariri called on all government ministries and government agencies to slash their 2018 spending by 20%.

Oil exporters budget deficit, % GDP

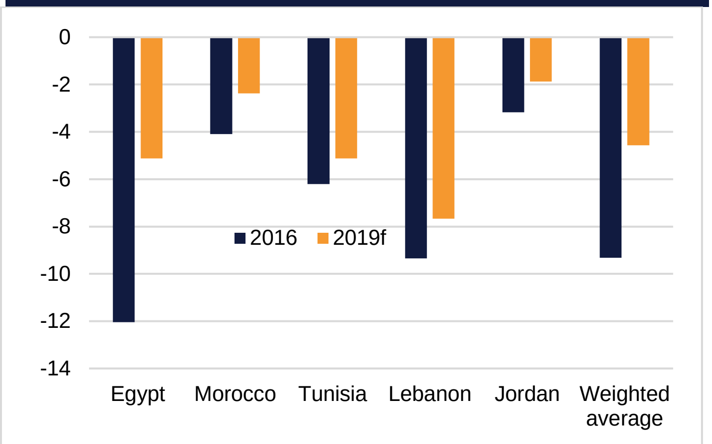


Source: Haver Analytics, Emirates NBD Research

However, after several years of cost-cutting, the political space to push through these austerity measures is dissipating, especially in the face of rising public discontent, and progress will likely not be as swift as governments hope.

Already in 2018, we have seen widespread protests in both Tunisia and Iran – at least partly prompted by government austerity programmes – succeed in a partial unwinding of planned budget cuts. In Tunisia, the government pledged USD70mn to aid the poor in a bid to quell unrest. In Iran, President Hassan Rouhani’s planned budget cuts were initially defeated in parliament, and only later passed through the house after significant amendments.

Oil importers budget deficit, % GDP



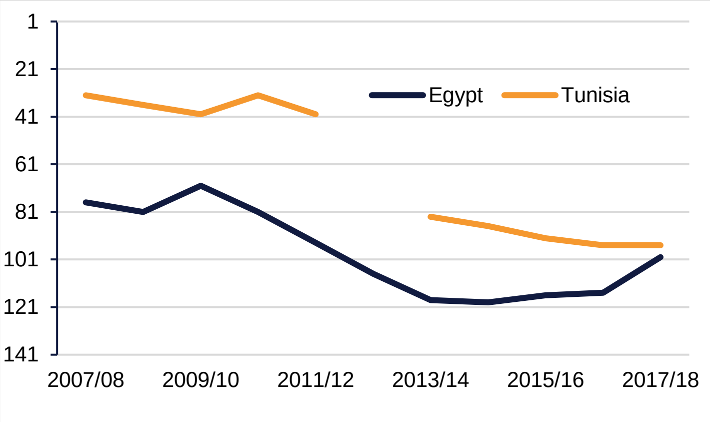
Source: Haver Analytics, Emirates NBD Research

In Egypt, which has been at the regional vanguard of pushing through hardship-inducing reforms since November 2016, the electricity tariff hikes which were scheduled to be implemented in one go in July will reportedly now be staggered over a period of three years. Whether Algeria – which has already rolled back on several fiscal consolidation measures in recent years – manages to push through the elimination of subsidies will be a significant test of Prime Minister Ahmed Ouyahia's political nous.

Government strength will dictate success

How successful countries will be at pushing through unpalatable reforms will to a large extent depend on the strength of the government, and, to a degree, how democratic. Tunisia has arguably gained the most in terms of political freedoms over the seven years since it was at the epicentre of the 2011 protests, yet a succession of weak governments have struggled to implement austerity policies in the face of popular opposition. By contrast, in Egypt, where political space has been notably curtailed since 2013, the government of President Sisi has effectively pushed through a succession of policies which have hurt the least well-off.

Global competitiveness ranking



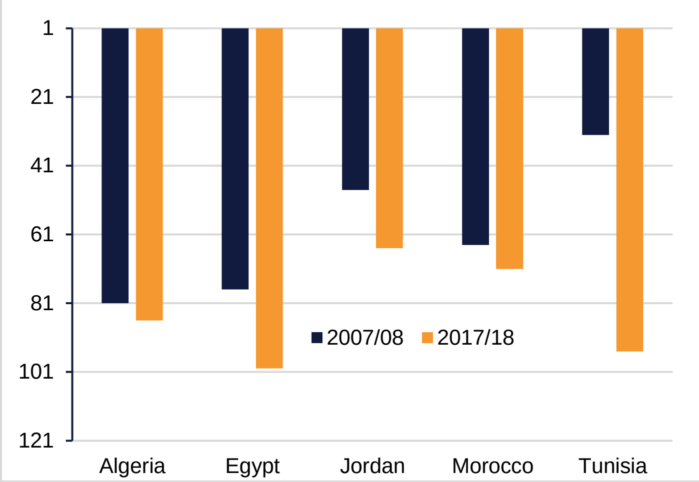
Source: World Economic Forum, Emirates NBD Research

One measure of the diverging trajectories of the two countries can be seen by looking at their respective rankings on the World Economic Forum's Global Competitiveness Report. Tunisia has gone from the strongest performer in the region to falling over successive years from 2011, and is yet to see any improvement. On the other hand, Egypt's score, after a similarly sharp deterioration, has started to improve significantly over the past several years.

Capital investment will lag

The downside of curbing expenditure is that in many cases, much-needed capital investment will also be curbed, exacerbating the existing infrastructure and skills gap between the region and global competitors. The countries under discussion have nearly all declined on the global rankings for indicators such as Global Competitiveness and Ease of Doing Business over the past decade, and this trend is unlikely to be reversed without significant investment. The capital expenditure needed to move forward with infrastructure projects and developing new industries will be at odds with drawing down fiscal deficits and keeping debt levels under control. With the public sector still the dominant force in the region, insufficient government investment will weigh on future growth.

Global competitiveness ranking



Source: World Economic Forum, Emirates NBD Research

In most of the region, growth in capital expenditure will be fairly lacklustre, or will be directed into controversial projects such as the new administrative capital planned in Egypt. One country that is bucking this trend is Algeria, where a planned 25% increase in spending this year will all be directed into capital spending. The government is planning to invest in education, infrastructure, and increasing self-sufficiency in staple foodstuffs. This makes Algeria the one country within the 9 where we anticipate a wider budget deficit in 2019 than seen in 2016. The country's spending plan will come with a cost on short-term growth, given that the government plans to finance this through borrowing directly from the central bank, but could help foster much-needed economic diversification.

**Algeria, Egypt, Iran, Iraq, Jordan, Lebanon, Libya, Morocco, Tunisia.*

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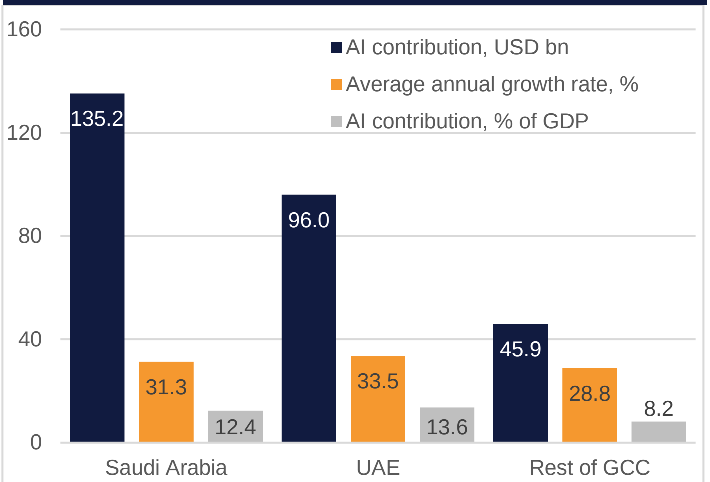
Sector Focus

The USD 277bn impact of Arificial Intelligence (AI) for the GCC by 2030

With the impact of Artificial Intelligence (AI) being increasingly disruptive for governments and businesses globally, AI is expected to contribute up to USD 15.7 trillion to the global economy by 2030, according to PwC Middle East. GCC economies are already moving towards AI and advanced technologies with the economic impact of AI adoption being estimated at roughly 2% of the total, or USD 277bn.

According to PwC, AI is expected to contribute USD 135bn or 12.4% of GDP in Saudi Arabia by 2030 followed by the UAE with USD 96bn (13.6% of GDP), and the rest of the GCC countries with USD 45.9bn (8.2% of GDP. The average annual growth rate of AI's contribution to the GCC is expected to range between 29-34% with the UAE recording the highest growth rate at 33.5% as well as the largest share of close to 14.0% of its GDP.

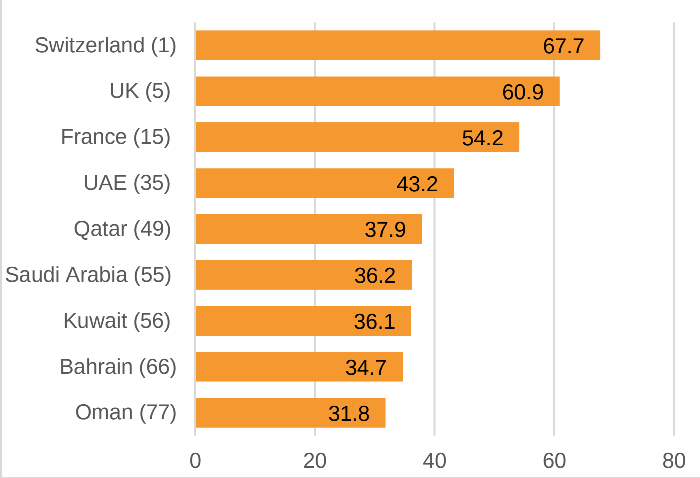
AI contribution to GCC by 2030



Source: PwC, Emirates NBD Research

With UAE and Saudi Arabia already demonstrating strong commitment towards AI development and implementation of AI technologies, the prospect of lower oil prices enhances the need for governments to seek alternative sources for revenue and growth. The development of non-oil sectors through investment in AI technologies could strategically position the GCC economies by pushing the boundaries of innovation across businesses and sectors. Both UAE and Saudi Arabia are placed within the top 60 countries in the world on the Global Innovation Index (GII) in terms of of their ability to innovate and the outputs of their innovation. The UAE ranked first in the GCC in 2017, moving up six places from last year while Kuwait improved the most in its overall GII ranking, moving up eleven places. The GII index measures the innovation performance of 127 economies and is a by-product of Cornell University, INSEAD, and the World Intellectual Property Organization (WIPO).

Global Innovation Index (GII) 2017

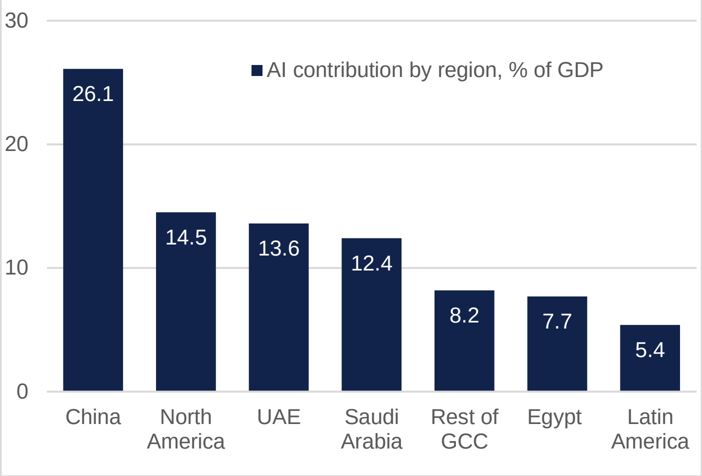


Source: GII, Emirates NBD Research

Dubai leading the way for AI development in the UAE

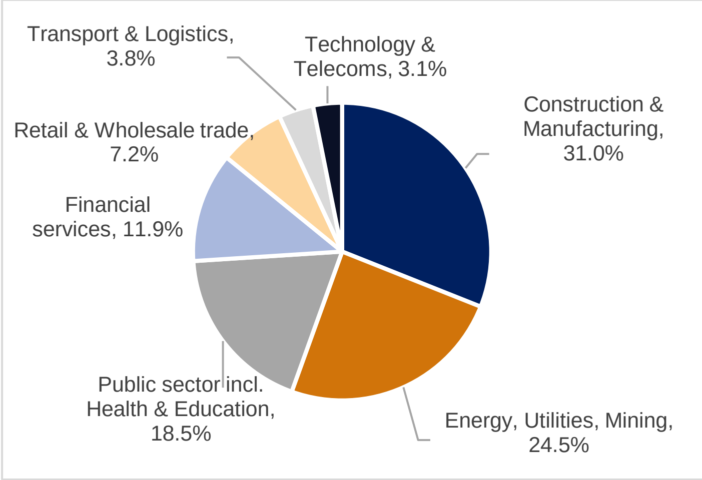
The UAE launched its AI strategy in October last year aiming to boost government performance, adopt an integrated smart digital system and make the UAE the first in the field of AI investments in various sectors such as transport, health, space, rewenable energy, water, education and environment. The UAE's commitment towards AI development was further enhanced with the appointment of the first minister of AI globally. Within the UAE, Dubai is leading the way with a number of related strategies including the Smart Dubai strategy, the Dubai 3D Printing strategy and the Dubai Autonomous Transformation strategy.Smart Dubai is aiming to transform Dubai through innovation and digital transformation with the launch of AI smart lab last year focusing on the training of both public and private sector employees in AI implementation. Moreover, the 3D Printing strategy is targeting Dubai's construction sector with a goal of 25% of buildings in the emirate constructed using 3D printing technology by 2030. Last but not least, the Autonomous Transformation strategy targets to cut transportation costs by 44%, carbon emissions by 12% and accidents by 12% by transforming 25% of all transportation in Dubai to autonomous modes by 2030.

AI contribution to GDP by 2030



Source: PwC, Emirates NBD Research

AI contribution to GCC* by industry by 2030, % of total USD 320bn



**Including Egypt*
Source: PwC, Emirates NBD Research

AI adoption in construction and manufacturing to be the driver in the GCC

The biggest opportunity for AI in the GCC is in the construction and manufacturing sector where it is estimated that 31.0% of all AI investment in the region predicted for 2030, or USD 100bn, will be spent on developing AI solutions, according to PwC. This is followed by the energy, utilities and mining sector with USD 78bn (24.5%) and the public sector including education and healthcare with USD 56bn (18.5%). Overall, the potential gains at the industry level are likely to depend on the ability of businesses to automate processes, and on the potential impact of further innovation due to AI. The former implies that labour intensive sectors, with greater scope of automation in sectors such as automotive and healthcare, are more likely to see the largest initial gains from AI. The latter suggests that sectors with compelling use cases in AI applications, such as healthcare (robo doctors, AI diagnostics), automotive (predictive engine monitoring, autonomous maintenance), financial services (automated insurance underwriting, machine-learning analytics), transport and logistics (autonomous tracking and delivery, automated picking in warehouses), etc, are more likely to innovate in early stages of AI development.

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EM Focus - India

Indian markets weathered the recent turmoil in financial markets much better than their emerging market peers. The outperformance was likely driven by continuous signs of improvement in domestic growth and government broadly sticking to financial discipline. The fact that Indian equities were lagging behind global equities before the start of this correction could have also played a part in this outperformance.

Budget 2018

As widely expected, the budget presented by the Indian government for FY 2019 had shades of political motivation. The government laid greater emphasis on the rural economy as it sought to make itself battle-ready before the general elections in 2019.

As part of the initiatives for the rural economy, the finance minister announced a one-and-half times minimum support price of the cost of production for Kharif crops for farmers. This is akin to providing more money in the hand of the farmer but it is also inflationary. Another key initiative taken by the government is to introduce free healthcare for 100 million poor families or around 500 million people. This is modelled on similar lines to 'Obamacare' in the US but of a much bigger scale and size. The entire scheme is likely to be government-funded.

However, it was encouraging to see the government broadly maintain the fiscal discipline displayed over the past four years. The government estimated fiscal deficit for FY 2018 at 3.5% of GDP against an earlier target of 3.2%. The slippage in the current year can be partly attributed to the fact that the government will receive GST revenues for only 11 months instead of 12. For the next fiscal year, the government forecasts a fiscal deficit of 3.3% of GDP a number that should be achievable. .

RBI – On guard

At its last meeting, the Reserve Bank of India (RBI) left repo rates unchanged at 6% and maintained neutral stance even as it flagged upside risks to inflation. Five of the six member committee voted in favour of the decision. The dissenting member was in favour of a 25 bps hike. The RBI marked up its inflation forecast for H1 FY 2019 to stay between 5.1% and 5.6% and between 4.5% and 4.6% in H2 FY 2019. While the central bank said in its statement that 'the nascent recovery needs to be carefully nurtured, it also flagged various upside risks to inflation. These risks include measures proposed by government in its budget and oil prices.

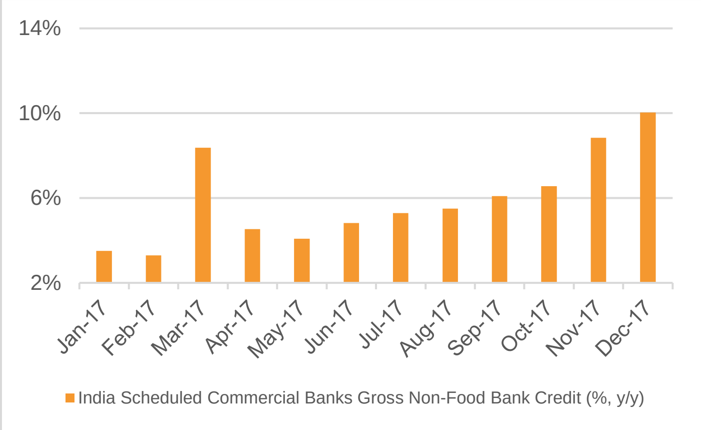
On growth the RBI projects Gross Value Add (GVA) at 7.2% y/y for FY 2019. For the current FY 2018, the RBI revised their GVA forecast lower to 6.6% y/y. The revised forecast by the RBI reflects downward revisions by the CSO earlier this year.
We expect the RBI to remain on a prolonged pause and look for cues for any policy changes from the implementation of policies announced in the budget, and from the monsoon season. .

Credit growth – Positive signs

Loan growth in India is finally showing signs of revival. For the fortnight ending 22 December 2017, India's banking sector registered double-digit growth for the first time since September 2016. Encouragingly, this was followed up in the next fortnight as well with total loans sanctioned improving by 11% y/y.

While the data points to bottoming out of credit growth and reflects revival in private sector investments, it must be noted that there is a considerable base effect. In the last two months of 2016, loan growth had stalled owing to demonetization.

Credit growth in India picks up



Source: Bloomberg, Emirates NBD Research

An interesting aside

Earlier this month, Indian exchanges decided to terminate their relationship with their offshore counterparts. This means that foreign bourses will not be able to get live prices from Indian exchanges which in turn effectively ends their ability to structure and list derivative products based on India's benchmark indices. This move has been interpreted by a lot of investors as insular and protectionist and could potentially have an impact on India's weighting in global benchmarks compiled by various index providers.

The exchanges likely to be impacted by the move includes SGX, the CME Group, the Taiwan Futures Exchange and Osaka Securities Exchange.

It is worth noting that China's unwillingness to do licensing deals with offshore markets was a major reason behind the delay in its domestic market being included in the MSCI benchmark indices.

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Interest Rates

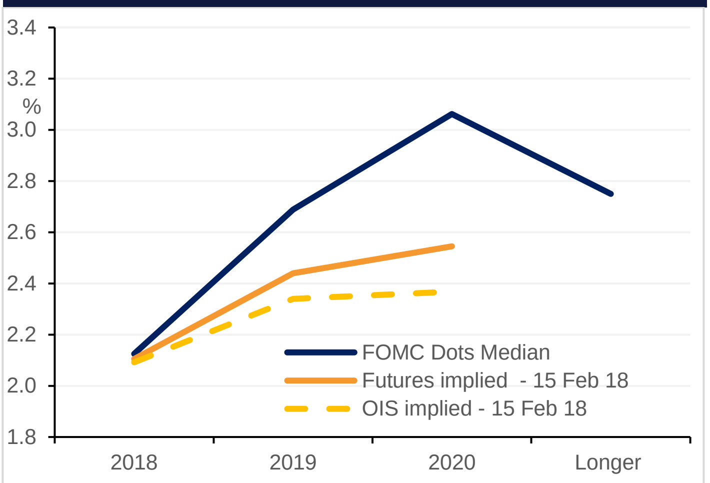
Government bond yields rose materially during the month as economic growth became more ingrained and inflation in the US finally began to inch higher.

US Rates

The sharp swings in market sentiment and bond prices that got triggered after the strong wage growth data in the US, seem to have subsided somewhat. However, market participants are still on edge with concerns rising about a possible beginning of a bear market as UST yields broke key support levels. There seemed no apparent fundamental justification for the magnitude of the sell off. However, we think that the increase in volatility (MOVE Index) is somewhat justified in view of the central bank 'put' that had supported financial markets in this decade so far, which is now gradually receding. Aside from a less accommodative stance and less liquidity from central banks; a number of other factors drove the sell-off: (1) the 'beginning of the year' effect with risk allocation away from bonds to risky assets; (2) increased supply; and (3) better macroeconomic data.

To put the sell-off into perspective, 10Y USTs have sold off 38bps since the start of the year compared with nearly 76bps in two weeks around the 2016 US presidential election and more than 134bps in the second half of 2013 (during the taper tantrum). High yield and emerging market bonds would be vulnerable to further US rate rises, which we think will generate a bid for safe haven assets such as the USTs. Thus, we think that rates should consolidate around current levels and stand a chance to get lower over the coming weeks.

FOMC Dot Plot vs Market Expectations

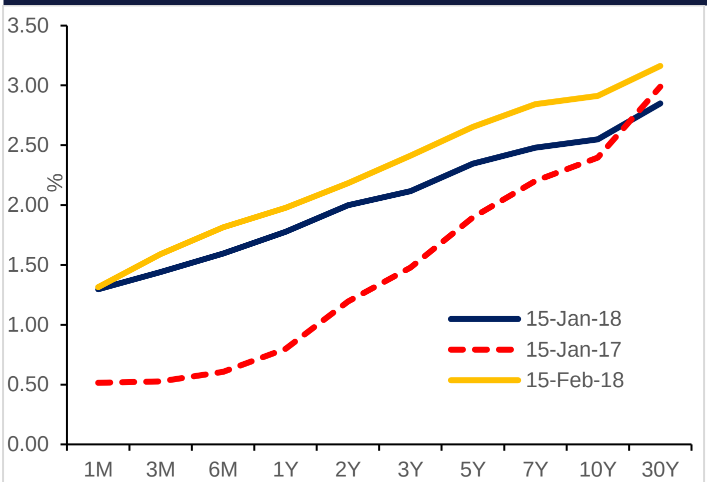


Source: Bloomberg

That said, we take note of the infrastructure plan that was presented alongside the President's budget proposal last month which has the potential to increase growth and inflation that could lead the Fed to raise rates faster than the current dot plot implies. While futures-implied market expectation for rate hikes in 2018 has converged with that of the Fed, investors remain sceptical about the longer term trajectory.

Despite long-term treasury yields rising sharply last month to their highest level in four years, broader measures suggest that overall financial conditions have remained strong. Corporate bond spreads have fallen to levels not seen since 2007 and banks are continuing to relax lending standards. However, 3 month USD LIBOR rate, the most common benchmark used for lending to corporates across the globe, has risen 9bps to 1.83% over the last one month, possibly to accommodate the upcoming predicted rate hike in March.

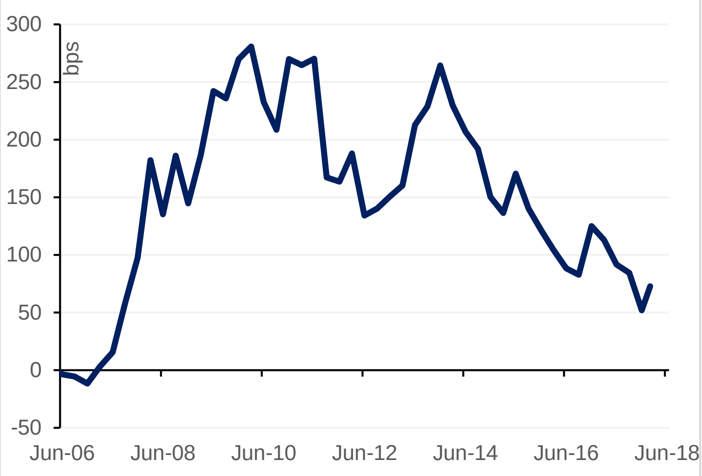
UST yield curve continued to steepen



Source: Bloomberg

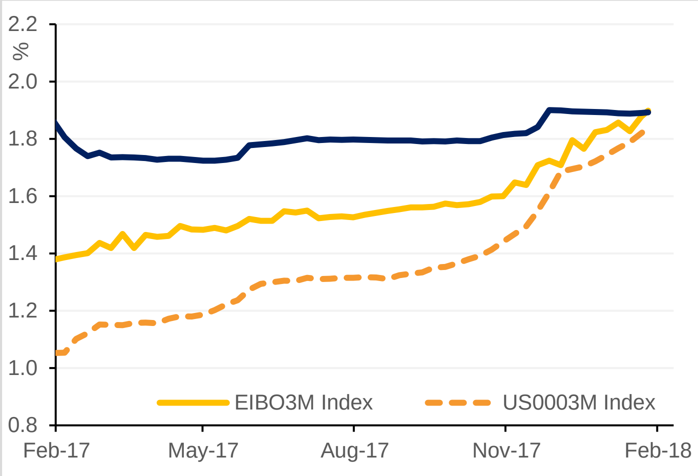
The 2yr-10yr UST spread has risen from a decade low of 50bps reached in early January this year to 73bps now, reflecting shifting expectations on Fed's terminal rate. The view that the Federal Reserve will probably raise its inflation target is gaining traction and market participants have begun to speculate that the Fed will readjust its terminal rate at a level higher than the current estimate of 2.75% in this cycle, particularly as growth and inflation are expected to get a boost from tax cuts and infrastructure spending. It is logical to see the 2yr-10yr curve steepen if the terminal rate is to be raised. However we think it's a bit too soon to expect a change in the Fed's thinking about future rate hikes, at least before the March FOMC meeting.

UST 2yr – 10yr spread (bps)



Source: Bloomberg

3m EIBOR/SAIBOR/LIBOR spreads



Source: Bloomberg

Global Rates

Yields in Europe, particularly for Bunds had been too low given the fundamental macro picture where deflationary risks have vanished and the euro area is growing solidly. However, the recent move upward has been faster than expected and may be prone to setbacks in coming weeks, particularly at the short end as higher inflation is yet to gain strong foothold in the Eurozone.

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10Yr Government Bond Yields

	Yield %	1M chg	3M chg	12M chg
US	2.83	+28	+46	+36
UK	1.60	+26	+28	+29
Germany	0.73	+16	+34	+37
Japan	0.06	-1	+2	-3
Brazil	5.04	+54	+25	+34
Russia	4.31	+33	+28	+21

Source: Bloomberg

Local Rates

We see little chance of GCC central banks, barring Kuwait, not following through with the US rate hikes, given the pegged currencies. In this regard, interbank rates in GCC currencies should generally trace the path etched by the USD LIBOR. Nevertheless, 3m EIBOR and 3m SAIBOR have not kept pace with LIBOR rate increases mainly as liquidity in the local banking systems remain abundant in the absence of strong loan growth.

Credit Markets

GCC bonds suffered from bear steepening of the benchmark UST yield curve as well as widening credit spreads amid increased volatility in financial markets last month.

Global Bonds

Global corporate bonds had a month of negative returns as the UST yield curve shifted upwards in response to increasing core inflation in the US. Yields on 2yr, 5yr, 10yr and 30yr UST closed the month at 2.10% (+10bps), 2.53% (+18bps), 2.82% (+27bps) and 3.10% (+25bps) respectively.

Volatility increased materially, reflecting investors' reaction to exaggerated fears of negative impact of higher interest rates on the health of corporates and ultimately the economic growth in the developed world. Retreating oil prices further added to the pressure on credit spreads to widen. CDS levels on US IG and Euro Main increased by 11bps and 13bps to 58bps and 57bps respectively.

Global Corporate Bond OAS (bps)

	OAS	1M chg	3M chg	12M chg
US IG Corp	95	+7	-6	-24
US HY Corp	364	+43	-3	-7
EUR IG Agg	48	-2	-6	-32
USD EM Agg	229	+12	-23	-37

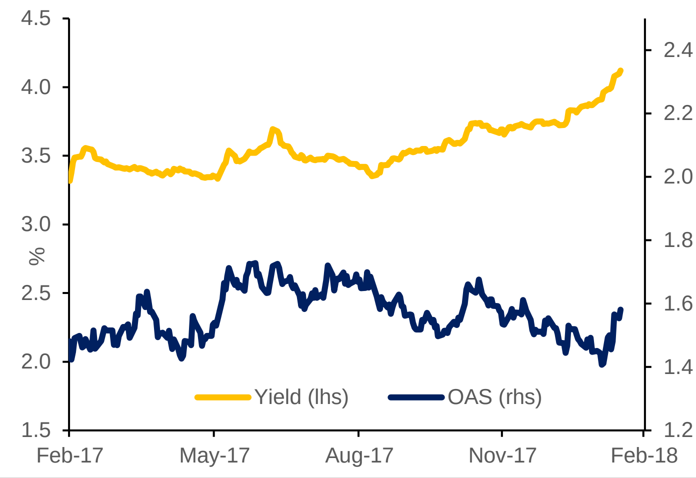
Source: Bloomberg data as at 14 Feb 2018

Although a bid for European bonds, under an accommodative ECB, provided some protection, bonds from the US and the emerging market universe fell between 1% to 2% in price during the month. Total return was negative for most corporate bond indices across the globe with US IG Corp, Euro aggregate and EM USD aggregate indices closing the month at loss of -2.14%, -0.50% and -2.02% respectively.

GCC Bonds – Secondary market

Yields on GCC bonds increased more than 25bps during the month to 4.12%, its highest level in five years, mainly as yields on benchmark USTs increased. Having said that, lower oil prices and sizeable new issues in the region also caused average credit spreads to widen by 12bps to 158bps. This however, is still below the five year average of 163bps and only 47bps higher than the lowest level of 110bps reached in mid 2014 before the region experienced multiple rating downgrades on the back of falling oil prices.

Barclays GCC Credit Index: YTW and OAS



Source: Bloomberg data as at 14 Feb 2018

Much in sync with the USTs curve, longer dated bonds from sovereigns and GREs topped the list of worst performers during the month. **TAQA 36s** fell more than six points to $122.20 and yield of 4.70% (+41bps) even after reporting profit for the FY2017 as investors took note of lower total output and possibility of higher capital expenditure going forward.

In contrast, **DARALA 22s** were amongst the best performing bonds, rising more than two and half points during the month to $98.66 and yield of 7.25% (-40bps) after reporting materially better than expected results. The increase of 121% increase in net profit to SAR 553 million was mainly due to higher property sales. The decrease in operating expenses and finance cost together with the increase in lease revenue positively impacted and contributed to the net income.

Upcoming Perp call dates

	Current coupon %	Next call date	Step-up margin %
ADIBUH	6.375	10/16/2018	USSW6+5.393
MAFUAE	7.125	10/29/2018	USSW5+5.702
GMSEDU	12.000	11/21/2018	USSW5+15.535
DIBUH	6.250	3/20/2019	USSW6+4.954
EBIUH	5.750	5/30/2019	USSW6+4.513
ALHILA	5.500	6/30/2019	USSW5+3.730
BGBKKK	7.250	9/30/2019	USSW5+5.325

Source: Emirates NBD

Perpetual bonds in the region, most of which are issued as Tier1 securities by local banks, held ground well as a lot of them have short term left to the next call date.

In terms of calling back of bank perpetual bonds, we are in the camp that believes that most Tier 1 securities will be called on their next call dates. Although credit ratings have fallen in the region in the last two years and cost of issuing new debt has increased, we think the high coupon step-up margins that will get triggered on call dates will make it prohibitively more expensive to continue the current securities than to refinancing them on call dates.

Tradeable securities in Bahrain's Al Baraka Banking Group had fallen last year due to its connection with the then arrested Saudi businessman, Mr Saleh Kamel. With ongoing peaceful resolution of the situation in KSA, perpetual Tier 1 bonds issued by Al Baraka Bank, BARKAB 7.875% have gradually risen in price and ended the month circa 3% higher at $99.20 (+$2.94) and yield at 8.09% (-83bps), making it the best performing perpetual bond in the region.

GCC Bonds - Primary Market

After the $6.5 billion raised by the Oman sovereign in early January, GCC Investors witnessed a further $8.9 billion worth of new supply last month albeit only $1.0 billion of this was in fixed rate USD denominated bonds, rest being either privately placed or in non-USD currency.

Last month, A3 rated Dubai Islamic Bank raised $1.0 billion via 5yr sukuk maturing in February 2023 at MS+115 bps, circa 15bps inside the original guidance and against an order book of over USD 1.83 billion. The sukuk was well received in the market, though currently is trading at yield of 3.89%, i.e. +12bps higher and in sync with the wider market movements.

Also during the month, B-/B2 rated, Shelf Drilling Holding Ltd, successfully raised $600 million to honour its offer to purchase for cash any and all of its (a) 8.625% Senior Secured Notes due 2018 and (b) 9.500% Senior Secured Notes due 2020. The refinance was successfully completed via private placement of the new 7nc3 bonds at T+557bps equating to circa 8.25%.

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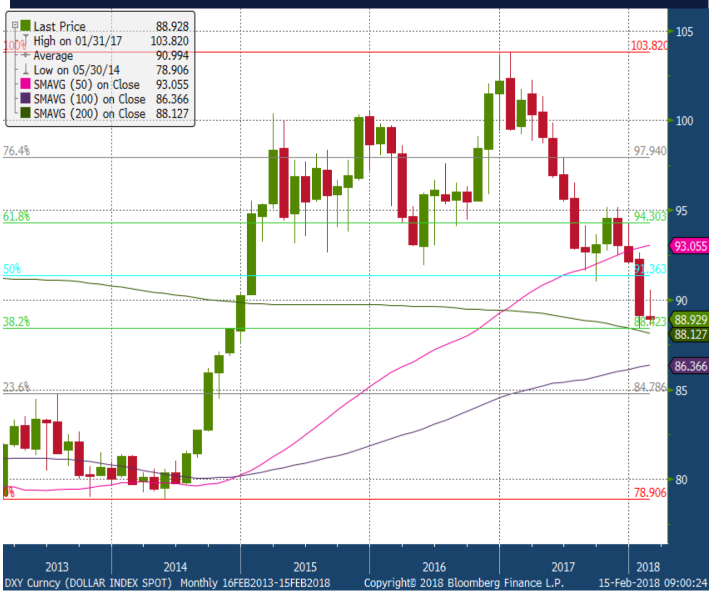
Currencies

Dollar attempts to rally in February…

Midway through February, the USD is currently on target to decline for a fourth successive month, despite attempting to rally at the start of it. The dollar benefited at first on a realization that long expected inflationary pressures are now beginning to surface, most prominently contained in the January employment report, which showied average hourly earnings increase by 2.9% y/y in January, up from 2.7% in the previous month. This made investors reconsider the pace at which the Federal Reserve will normalize monetary policy and was initially supportive of the greenback.

Dollar Index remains under pressure



Source: Bloomberg

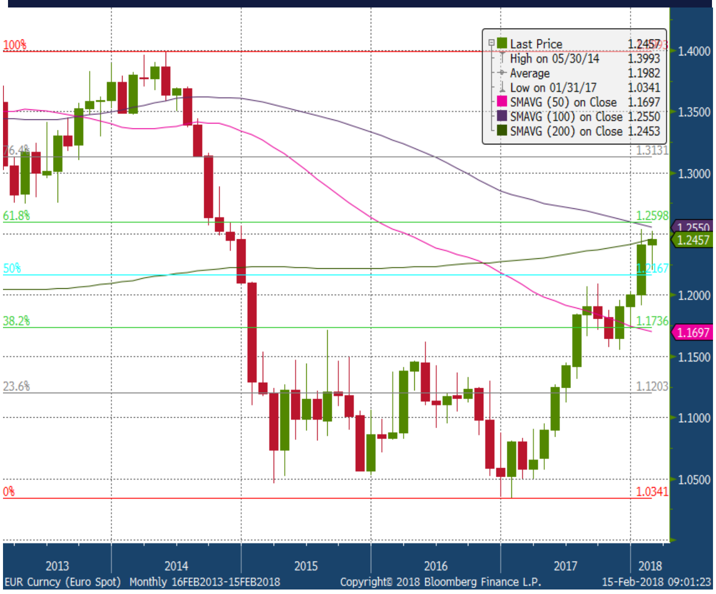
… before its gains are reversed

However a combination of officials attempting to jawbone the dollar lower, more political chaos in Washington, and creeping investor concern over twin deficits has kept the dollar under pressure. As of now, the Dollar Index is has lost 0.25% in February and is trading at 88.91. This comes after the index found support on January 25 at 88.43, close to the 38.2% five year Fibonacci retracement of 88.42 that we identified as the support last month ([January Monthly Insights]) managed to briefly climb above 90.50. The inability to sustain these gains means that the dollar remains vulnerable to further downside risk and a break of 88.42 could expose the index to a more significant slide towards 85.

Euro to rise for fourth month?

EURUSD is on target to rise for a fourth month, having gained 0.37% to reach 1.2459. Analysis of the monthly candle chart shows that for a second month, EURUSD is once again testing the 200 month moving average of 1.2457, a level which halted advances in January. Should the price break this level, we expect gains to be capped by the five year 61.8% Fibonacci retracement (1.2598). With the daily candle chart showing that the uptrend remains intact, a test of this level is possible in the short term. This would be consistent with our Q2 forecast, although the essence of our view is that EURUSD will most likely oscillate within a 1.20-1.25 range over the coming months.

Euro testing key resistance level



Source: Bloomberg

Bank of England see need to act…

The Bank of England turned more hawkish at its meeting on February 8. While the MPC voted 9-0 to leave interest rates unchanged at 0.50%, growth expectations were upgraded. Governor Mark Carney stressed 'that it will probably be necessary to raise interest rates ….. somewhat earlier and to a somewhat greater extent than we had thought in November", setting the stage for a rate hike as early as May.

According to the OIS, the market is currently pricing in a 63.2% chance of a 25bps hike on May 10, compared with a 47.6% chance before the meeting. As the bank of England moves towards tightening, we expect sterling to gradually strengthen over the remainder of 2018. With headline CPI returning to 3% y/y in January, the risks for interest rates remain to the upside.

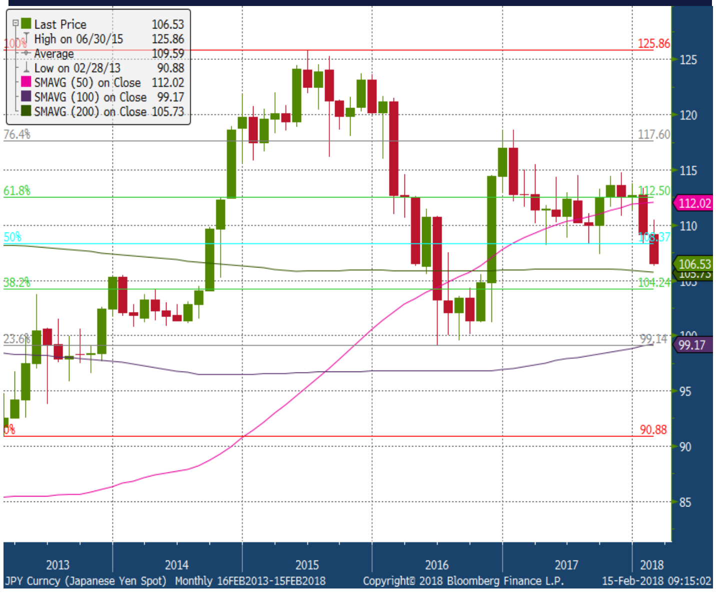
….yet sterling pares 2018 gains

Despite the more positive growth outlook and renewed expectations of higher interest rates, sterling remains vulnerable to Brexit concerns. Comments last week from the EU's Brexit negotiator Michel Barnier, stated that a transition deal is 'not a given,' highlighting the rift between the two sides. Such concerns have weighed on sterling and caused GBPUSD to fall from its 2018 highs of 1.4345 to 1.4013. Earlier, cable had fallen to as low 1.3765 but recovered on the back of renewed dollar weakness.

GBPUSD eases from 2018 highs

Source: Bloomberg

USDJPY breaks below support



Source: Bloomberg

Bank of Japan reverses "stealth tapering"…

Amid all the speculation that the BOJ was "stealth tapering", markets were caught off guard when the central bank increased JGB purchases under its yield curve control framework, reinforcing their commitment to keep the 10-year yield at 0%. This was accompanied by comments from BOJ officials confirming that the actions showed the BOJ still favours loose monetary policy.

… yet the yen soars

Despite this, JPY has strengthened due to safe haven bids resulting from the correction in equity markets and has reached new 2018 lows of 106.31. Currently trading at 106.54, USDJPY has crashed below the 23.6% one year Fibonacci retracement of 109.25 and the 50% five year Fibonacci retracement at 108.37. While the price remains below these key levels, further declines towards 105 can not be ruled out. As a result of this development, we have revised our Q1 2018 forecast downwards from 112 to 110. While we anticipate that the JPY will benefit from risk aversion bids in the short term, ultimately the divergence in monetary policy between the Fed and BOJ should result in a stronger dollar, although this correlation has recently broken down. The likelihood of it reasserting, however, has increased on the back of the recent strong US inflation data, and with Governor Kuroda confirmed to continue leading the Bank of Japan .

RBA puts AUD under pressure

AUDUSD has eased from its one year highs of 0.8136 after the RBA shifted to a neutral stance. At its first meeting of 2018, the central bank kept interest rates unchanged at their record low 1.50%. In addition, despite the unemployment rate falling to 5.4% in December, the MPC shared concerns over wage growth and low inflation. Data released by the Australian Bureau of Statistics showed that hourly earnings increased near a record low of 2.0% y/y in Q3 2017, prompting policy makers to stand by the bank's accommodative monetary policy. Having found support at the 100 day moving average of 0.7770 earlier this month, AUDUSD remains vulnerable, particularly due to the divergence in monetary policy between the Fed and the RBA and we expect the price to decline further towards 0.76 as we approach the end of Q1 2018.

NZD sold as RBNZ shifts to neutral

Like its neighbor, the NZD was another casualty of its central bank's first policy meeting of 2018. Contrary to market expectations of a rate hike in 2018, policy makers communicated the expectation that interest rates would not change until mid-2019. In addition, the time to reach the targeted level of inflation was moved two years later than previously forecasted. This in conjunction with data showing that average hourly earnings slowed from 1.2% q/q in Q3 2017 to 0.8% q/q in Q4 2017 is likely to keep interest rates lower for longer.

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Equities

February has been a volatile month for global equities. The return of inflation was flagged as one key concern for 2018. However, it was not anticipated that the risk would manifest itself so early in the year. Having said that, it can be argued that the recent bout of weakness in global equities is less to do with inflation but more about unchecked investor exuberance and complacency. The gains in major equity indices ahead of this correction does point to that possibility. In January 2018, global equities had their best start to the year since 1994 even after delivering returns in excess of 20% in 2017.

The flow data for January 2018 further boosts that theory. The inflow of USD 102bn into equity funds in January 2018 was more than a third of 2017's total inflow of USD 280bn. The positioning data also suggested that all investors were perhaps chasing the same trade. It is worth pointing that in 13 months ending January 2018, the VIX index averaged 11, compared to long-term average (since 2000) of 20.

The MSCI World index dropped -6.2% 1m with all its major sub-indices closing in negative territory. The MSCI G7 index declined -6.2% 1m with all developed markets moving into red for the year. The broad emerging markets showed a similar trend with the MSCI EM index losing -5.4% 1m but interestingly the MSCI BRIC index (+0.2% ytd) is still positive for the year. The reaction from regional markets were more subdued with the MSCI Arabian Markets index losing -0.8% 1m. This despite a -6.3% 1m drop in Brent oil prices. Volatility spiked the most with the VIX index (US), the V2X index (Europe) and the VXEEM index (EM) jumping +160% 1m, +159% 1m and 110% 1m respectively.

With most investors unwilling to look beyond the 'healthy correction' theory despite the velocity of moves, some more near-term volatility cannot be ruled out. The immediate direction could well be dictated by inflation data and moves in US treasuries. Looking beyond the very short-term, fundamentals are likely to reassert themselves and provide support to equities. More so when the earning story continues to remain strong with high double-digit growth in the US, and synchronized pick-up in global economic growth is gathering pace. The biggest wildcard from hereon will be the tone of central banks. The Federal Reserve is on track to continue tightening, the BoE has indicated rate hikes later this year and central banks in India and Brazil have pointed to an end of the easing cycle.

Key Factors

The recent move has allowed equity markets to reset. The market behavior from hereon could depend on how factors like inflation, earnings and volatility plays out.

Volatility

The move in global equities was also exaggerated by unwinding of short-VIX funds which saw record inflows in January 2018 despite the fact that the index was still at fairly low levels.

If we use history as a guide it can be said that it is likely that volatility is likely to remain at relatively elevated levels for the short term. It generally takes much longer to revert back to lower levels once it has traded above 30. Hence it can be said that global equities will be operating in a different regime then it has in the last 15 months.

Ironically, the recent spike in VIX cannot be attributed to panic selling as most banks have highlighted the 'buy the dip' mentality seen during this sell-off. If we believe that a wave of capitulation selling could still be due, then that makes the case of volatility remaining at elevated level even more stronger.

However, what is more interesting is the performance of the S&P 500 index in the next six months following spike in the VIX index. On an average the S&P 500 index has rallied 12.0% (excluding periods of recession) in six month and 20.3% in twelve months after the VIX index has broken 35.

VIX breaks 35

	S&P 500 forward performance		
Date	3 month	6 month	12 month
30-Oct-97	8%	24%	19%
27-Aug-98	14%	20%	29%
15-July-02	-12%	1%	10%
7-May-10	2%	8%	24%
8-Aug-11	13%	19%	22%
24-Aug-15	11%	1%	17%
Average	**5.9%**	**12.0%**	**20.3%**

Source: Bloomberg

Earnings

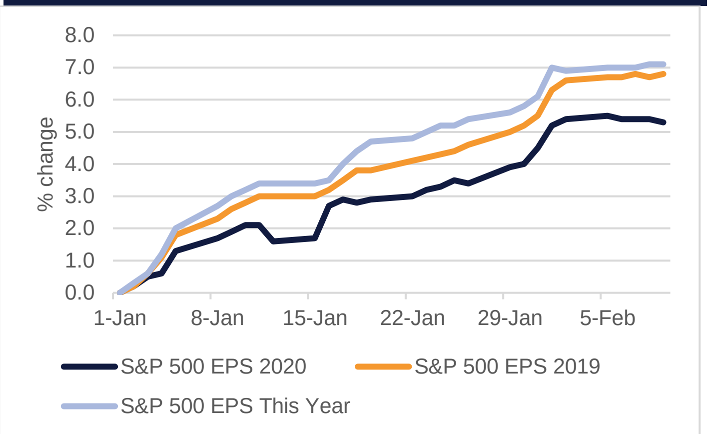
The biggest support for equity markets has been the growth in corporate earnings. The ongoing earnings season has been no different and is partly the reason why investors are calling the decline as a much needed correction.

So far nearly 68% of companies in the S&P 500 index have reported earnings. According to FactSet, 74% of those companies have reported positive EPS surprise and 79% have reported positive sales surprise. The aggregate earnings growth for Q4 2017 stands at 14.0% and is higher than estimated growth of 11% at the start of 2018. The blended sales growth stood at 8.0%. The earnings have been broad-based with all eleven sectors reporting earnings growth.

In Europe, 51% of companies who have reported earnings have beat expectations. The weighted earnings is now tracking 4.7% ahead of consensus. The sectors which have seen the broadest earnings beat has been financials and energy.

Having said that, it is the outlook for the year ahead which is likely to drive to markets than earnings which are currently being reported. On that count, there are reasons to weigh caution. It appears that the tailwind from rising earnings estimates may be coming to an end. While estimates for 2018 for S&P 500 index has increased by 7% since the start of the year, they have remained same or declined marginally for 2019 and 2020.

S&P 500 EPS estimate growth slows



Source: Bloomberg
Normalised to 100

The trend is similar for European equities as possible headwinds from a stronger EUR and decline in commodity prices is factored in. The EPS growth estimate for Euro Stoxx 600 index has declined to 6.8% at the end of last week from 8.6% at the start of the year. The sectors driving the drop are banks and healthcare.

European earnings revision trending lower

Source: Bloomberg

Inflation

The consensus view is that the fear of inflation is the reason behind the start of this sell-off. The first warnings came when the US core CPI surprised on the upside. While markets ignored the first warnings, the 2.9% rise in average hourly earnings in the US was too strong for the markets to turn a blind eye too.

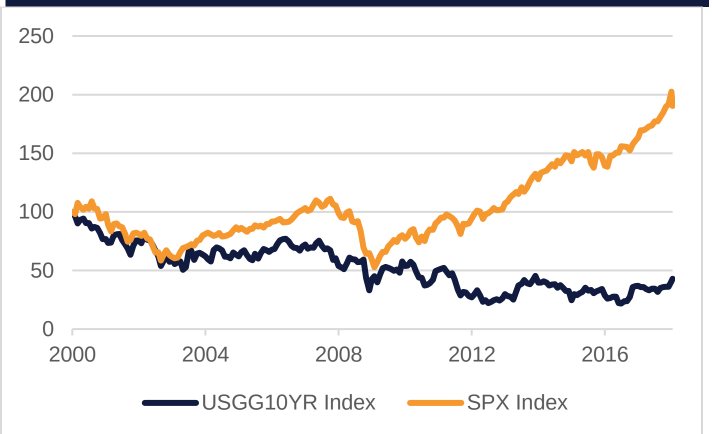
We believe that while inflation concerns are valid, they are not too strong or widespread at the moment to justify the recent sell-off. It is likely that stocks are simply re-pricing to adjust for the sharp moves up in the 10-year US treasury yields. It is also likely that equity markets are pricing in a risk-premium for overheating due to a possible policy mistake.

It must be noted here that in the Eurozone, the output gap is still considerable to worry about a meaningful acceleration in inflation from current levels. The same holds true for most emerging markets as well.

Additionally, we are of the view that energy prices have probably peaked *(see Commodities section)* and hence pressures from that is unlikely to manifest itself in the short-term.

Having said that, the move in 10y US treasury yields which has finally broken out of its narrow range would be closely watched at it nears the 3% mark. The last time 10y USTs breached the 3% mark was in December 2013.

10y UST yields and S&P 500 index



Source: Bloomberg
Normalised to 100

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Commodities

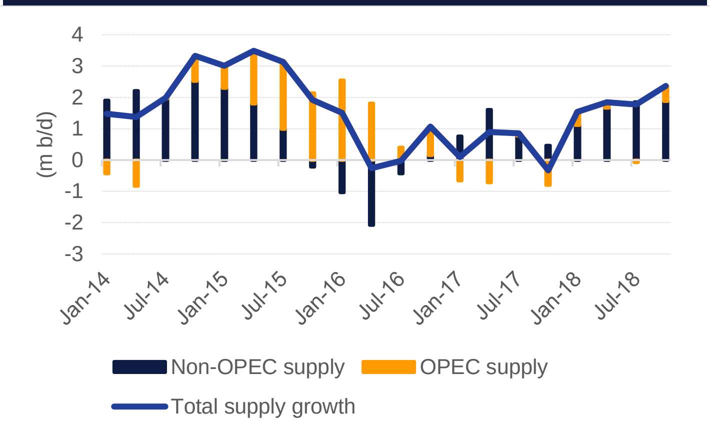
Oil markets have performed better than we expected to start 2018 and as a consequence we have marked our forecasts to market. We now expect Brent futures to average USD 59.50/b for 2018 and WTI to record an average of around USD 57/b, an increase of more than USD 3/b for both contracts. While we are acknowledging prices have begun the year too high for our existing forecasts to be tenable, our view on the medium term trajectory for prices has not changed. Indeed, our conviction that market fundamentals still point to lower prices by the end of the year has been reinforced by developments in recent weeks.

According to plan…

In our last Monthly Insights we outlined some downside risks that could threaten the oil market rally and several have begun to play out accordingly. US oil production has now exceeded 10m b/d according to EIA weekly data, pushing the US ahead of Saudi Arabia as the world's second largest producer. Likewise, the drilling rig count in the US has levelled off and is now showing a modest upward bias, adding 12 rigs in January and then 26 in a single week in early February. Considering the lag between oil futures and explorers sanctioning drilling programmes, current levels of oil production at around 10m b/d would have been approved when prices were closer to USD 50/b at the end of Q3 2017. What the supply response may be to prices recently as high as USD 66/b for WTI could be staggering over the next few quarters.

The IEA's projections for US production are for more than 1m b/d of y/y growth each quarter this year. The US last produced at such a blistering pace in 2013-15 when quarterly global demand was averaging more than 1.5m b/d y/y and OPEC production was still disrupted by the fighting in Libya and sanctions on Iran. Without those supportive dynamics, the surge in US production alone will overwhelm all the incremental increase in demand.

US output could overwhelm in 2018



Source: IEA, Emirates NBD Research.

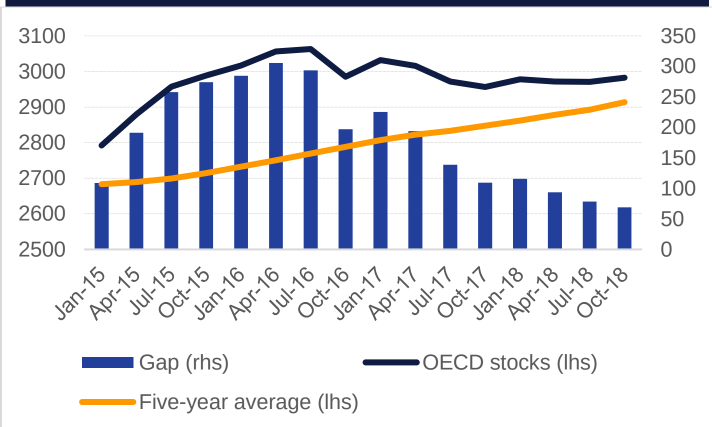
The outlook for OPEC production is more mixed but we expect that production from the bloc will be higher in 2018 than it was last year.

We have revised our oil market balances to account for the calamitous decline in Venezuela's output. Production there fell more than 270k b/d in 2017 and at least a similar sized decline appears likely this year as the oil industry hemorrhages money and the risk of US sanctions on exports from the Latin American producer weighs on the production outlook. Balanced against this, however, is the potential for Libya and Nigeria to add barrels in 2018. We are tentatively forecasting Libya holding production around 900k b/d and Nigeria at 1.6m b/d (a nearly 10% and 7% increase respectively). The production profile for both countries, still officially exempt from OPEC's production cut arrangement, will have an outsized bearing on overall market balances as both could increase output of light sweet crudes and dump them into an already glutted Atlantic basin.

Among those producers that have committed to the cuts we have revised higher our expectation for compliance among some members who had under-delivered but still forecast growth from nearly all OPEC members this year. Saudi Arabia has room to increase production while still adhering to the terms of the deal; we expect that it will still over-cut but at a less extreme levels than the average of around 120% compliance in 2017. Small additions from other producers, particularly in MENA, may be masked in Q1 by the deterioration in Venezuela's output but will begin to make themselves more noticeable by the second half of the year.

On a net basis, these revisions along with the IEA's forecast of slowing demand growth point to a small market surplus in 2018 but essentially near enough to be considered balanced. A balanced market will prevent inventories from growing but they will fail to converge on their five-year average. We still hold this is a misguided measure of market tightness as convergence on this benchmark is aided by an ever increasing average level. We believe that days of demand that can be met by OECD inventories is a more robust measure of 'tightness' and expect the ratio to stay above 62 days in 2018, higher than its long run level of less than 60 days.

Close to five average but not tight market



Source: EIKON, Emirates NBD Research.

External risks coming to a head

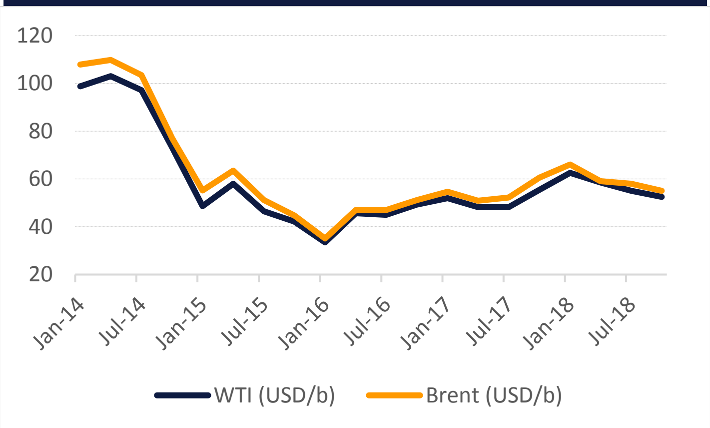
As we pointed out last month external factors to market fundamentals are the more significant near-term risk. Oil sold off sharply in early February in tandem with equity markets as financial markets reassessed inflation and rate trajectories. Unlike the broadly supportive macroeconomic outlook in most countries that should allow for a recovery in equities, oil prices are falling in a fundamental market that is much more precariously balanced. Hence, any rout that started in financial positions in oil markets could accelerate downward. Speculators had already begun to build short positions in recent weeks, albeit at a small scale, while long positions at the end of January were cut by the largest amount since August for WTI and since June for Brent.

A robust January non-farm payrolls report, including elevated wage growth, has pushed rates markets to anticipate as many as four rate hikes this year. All else being equal, higher rates should draw flows toward the USD and help the greenback strengthen, particularly against peers like the EUR and JPY where central banks are still at the initial stages of monetary policy normalization. We estimate that as much as 40% of the improvement in oil prices since June 2017 is down to a weaker dollar and that a sudden reversal in the currency would sap considerable strength away from oil. While a sharp appreciation of the dollar is not our near-term forecast, we don't forecast much further downside for the dollar either, removing a crutch from oil in the near term.

Price revised higher mainly in Q1

For both Brent and WTI we expect that Q1 will represent the high for 2018 and that prices will gradually edge downward for the remainder of the year. Brent will be 9% higher than its average level in 2017 while WTI will be up as much as 12%. Our revision to prices fall heavier in Q1 than across the rest of the year as oil markets were caught up in an over-exuberant rally that failed to tally with fundamentals.

Emirates NBD Research oil price outlook



Source: EIKON, Emirates NBD Research.

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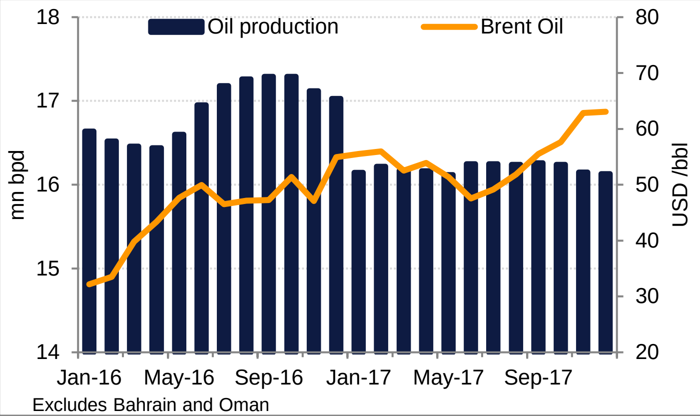
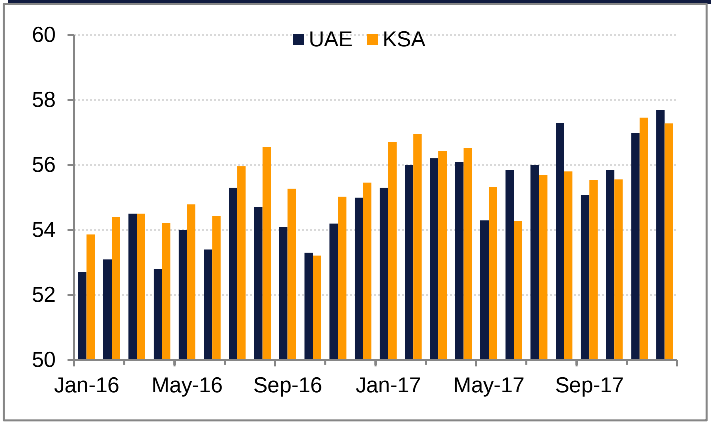
GCC in Pictures

GCC Oil Production and Oil Price



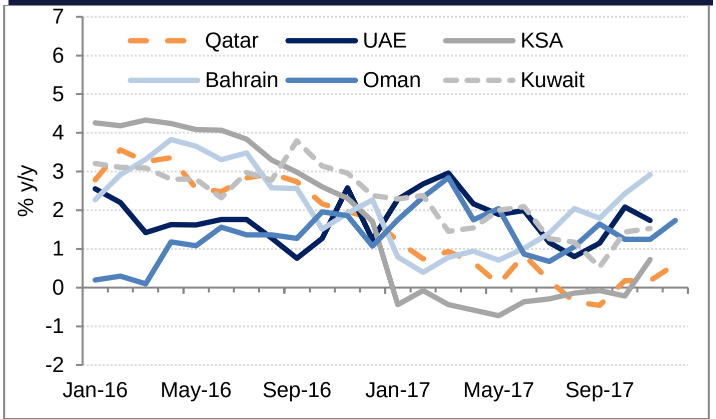
Source: Bloomberg, Emirates NBD Research

Purchasing Managers' Index



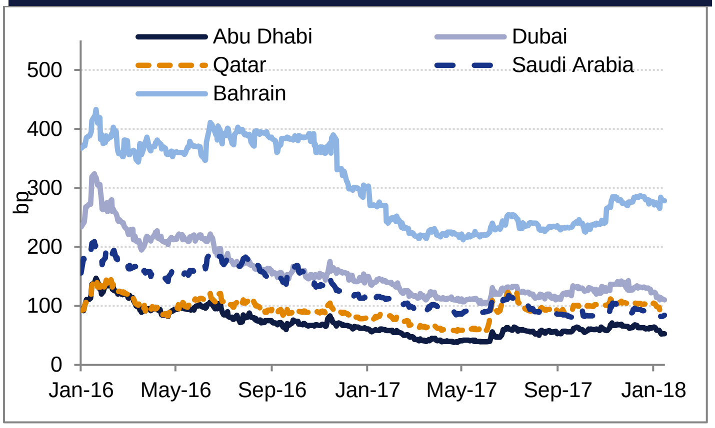
Source: IHS Markit, Emirates NBD Research

Inflation



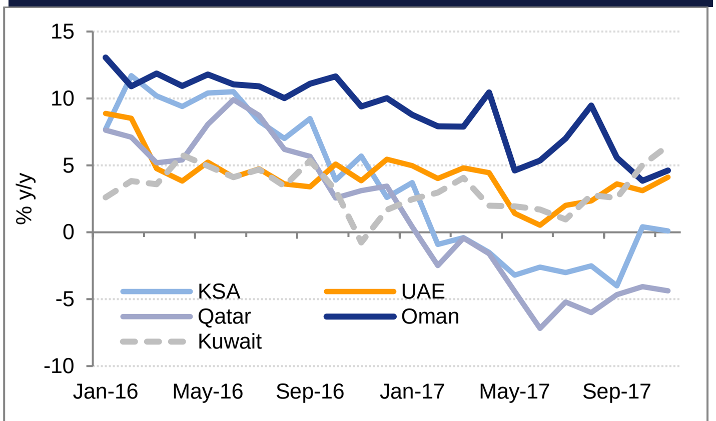
Source: Haver Analytics, Emirates NBD Research

CDS Spreads



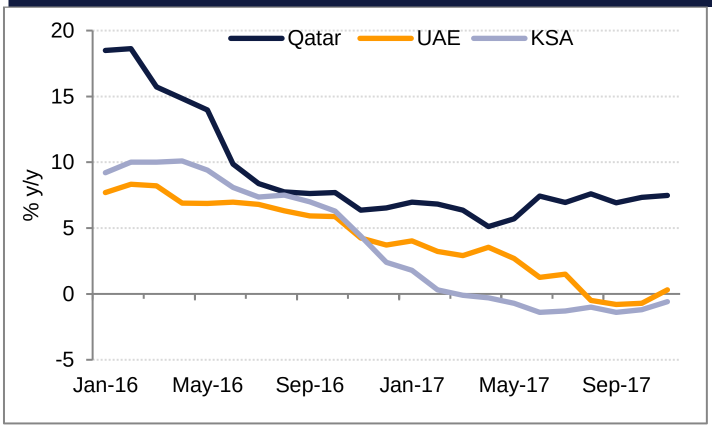
Source: Bloomberg

Money supply (ex Government. deposits)



Source: Haver Analytics, Emirates NBD Research

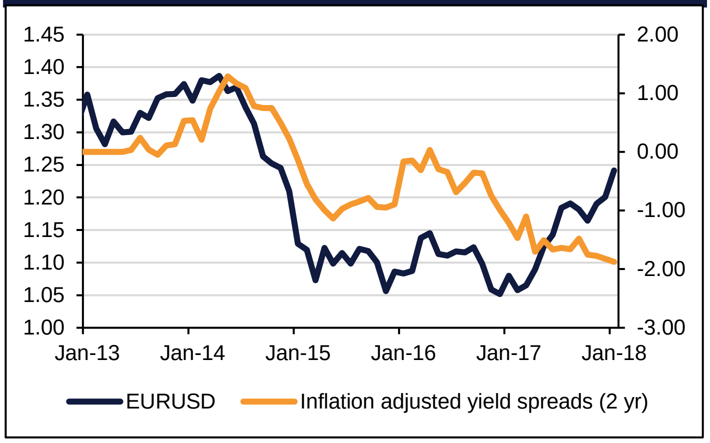
Private sector credit*



**Qatar data is bank loan growth to private sector, not total private sector credit. Source: Haver Analytics, Emirates NBD Research*

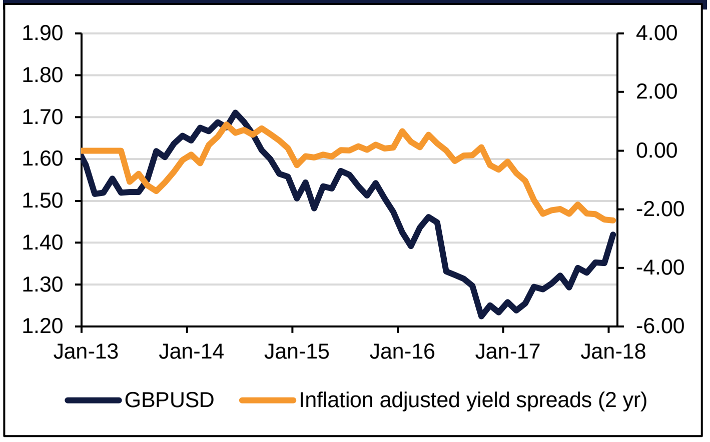
FX–Major Currency Pairs & Real Interest Rates

Interest Rate Differentials–EUR



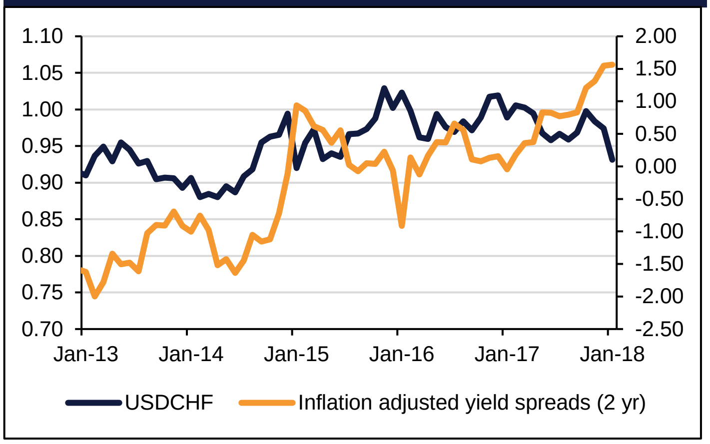
Source: Bloomberg, Emirates NBD Research

Interest Rate Differentials-GBP



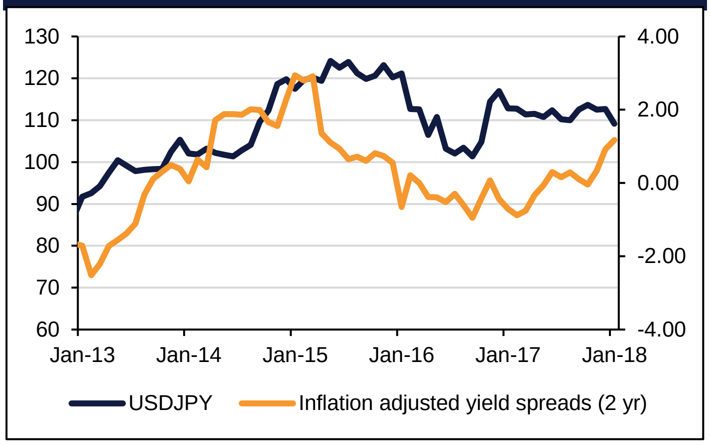
Source: Bloomberg, Emirates NBD Research

Interest Rate Differentials-CHF



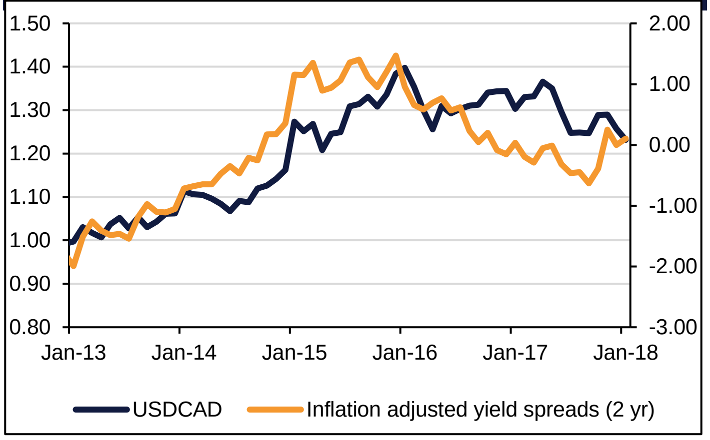
Source: Bloomberg, Emirates NBD Research

Interest Rate Differentials-JPY



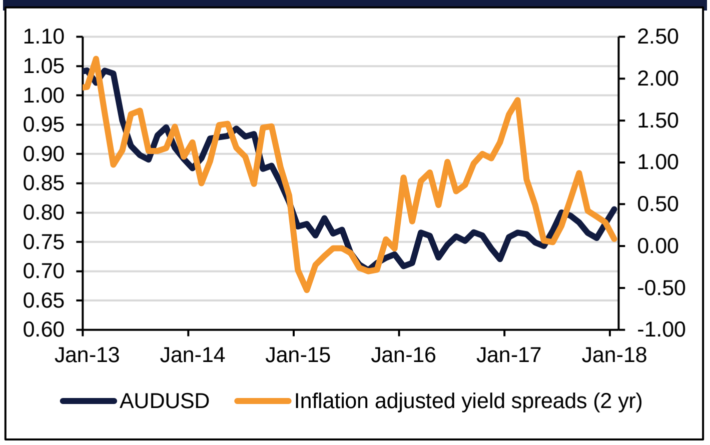
Source: Bloomberg, Emirates NBD Research

Interest Rate Differentials-CAD



Source: Bloomberg, Emirates NBD Research

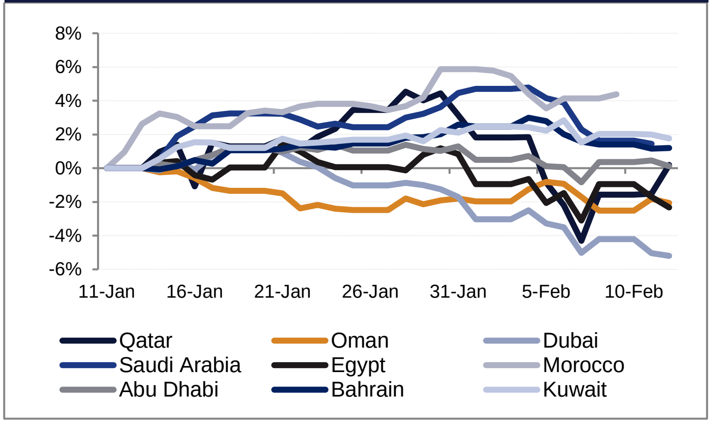
Interest Rate Differentials-AUD



Source: Bloomberg, Emirates NBD Research

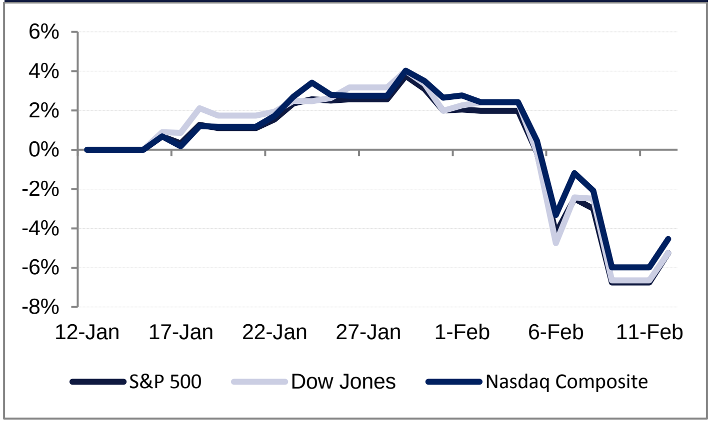
Major Equity Markets

MENA Equity Markets



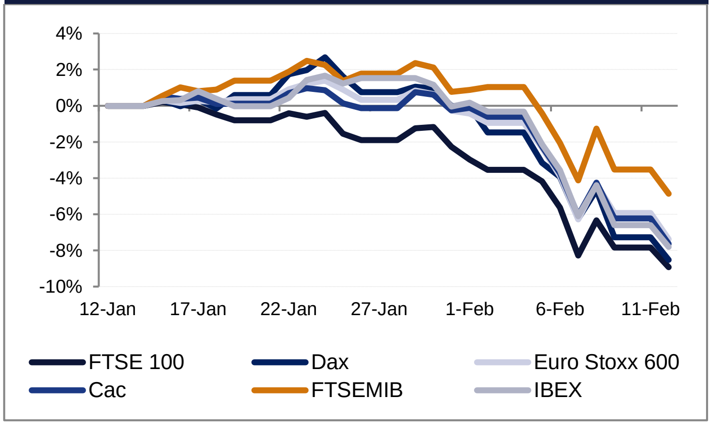
Source: Bloomberg, Emirates NBD Research

US Equity Markets



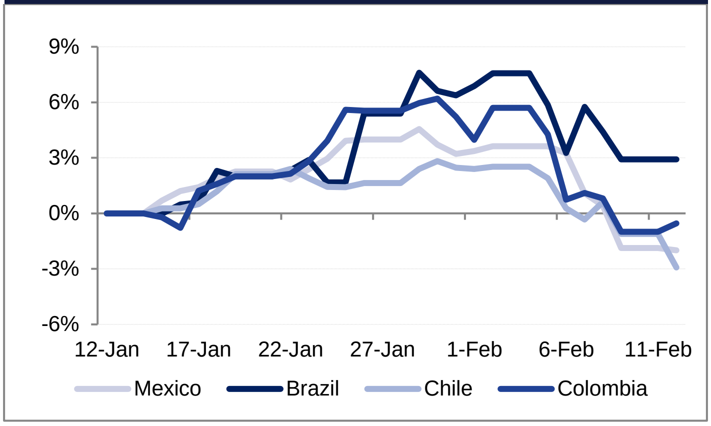
Source: Bloomberg, Emirates NBD Research

European Equity Markets



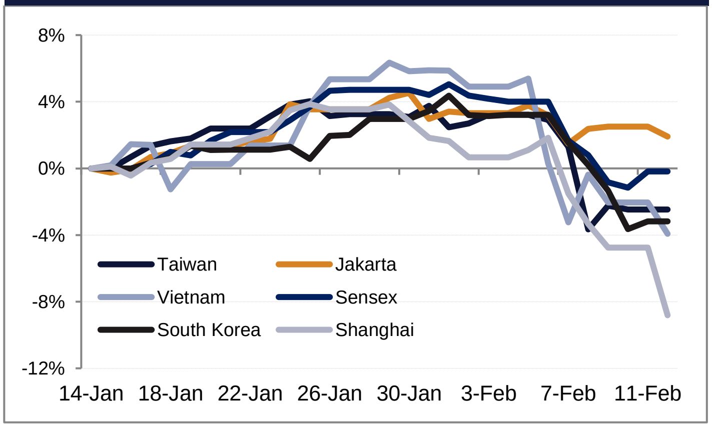
Source: Bloomberg, Emirates NBD Research

Latin American Equity Markets



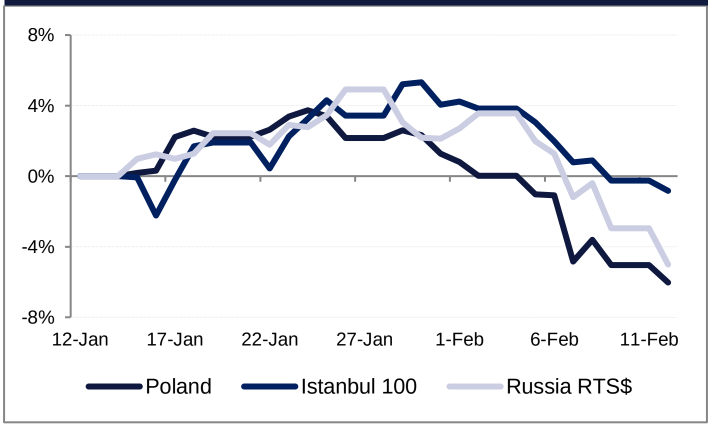
Source: Bloomberg, Emirates NBD Research

Asian Emerging Equity Markets



Source: Bloomberg, Emirates NBD Research

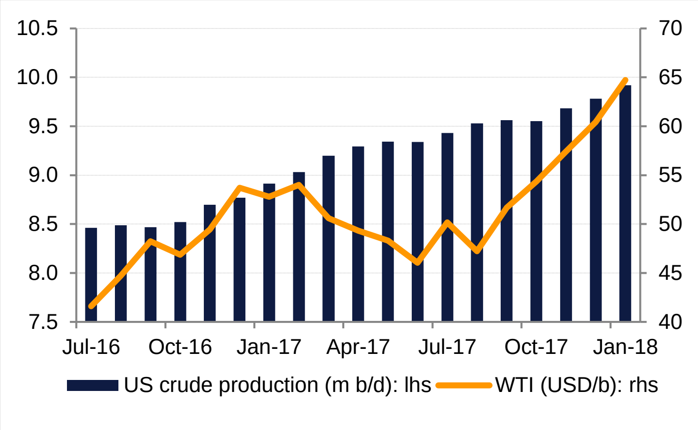
Emerging Europe Equity Markets



Source: Bloomberg, Emirates NBD Research

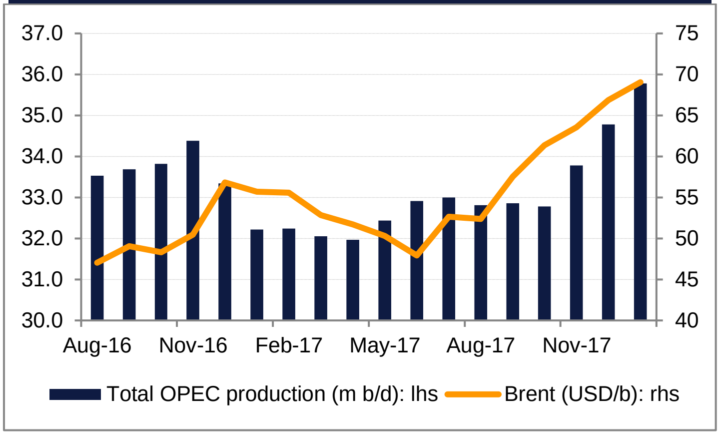
Major Commodities Markets

US oil production and price



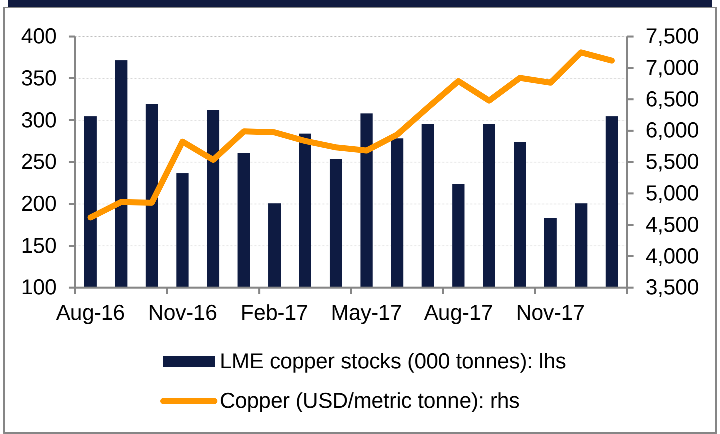
Source: EIKON, Emirates NBD Research

International oil production and price



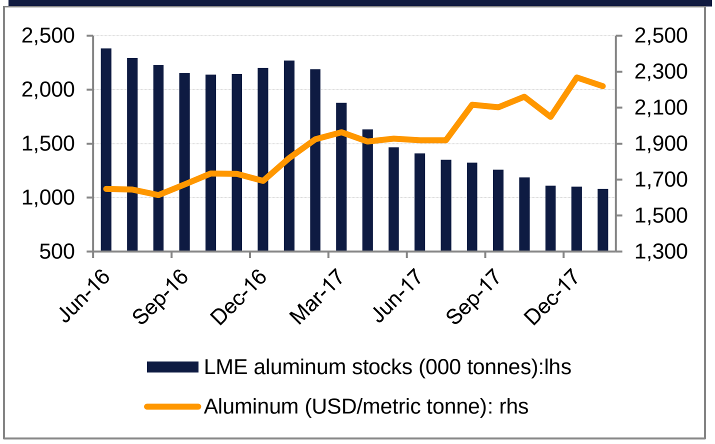
Source: EIKON, Emirates NBD Research

Copper stocks and price



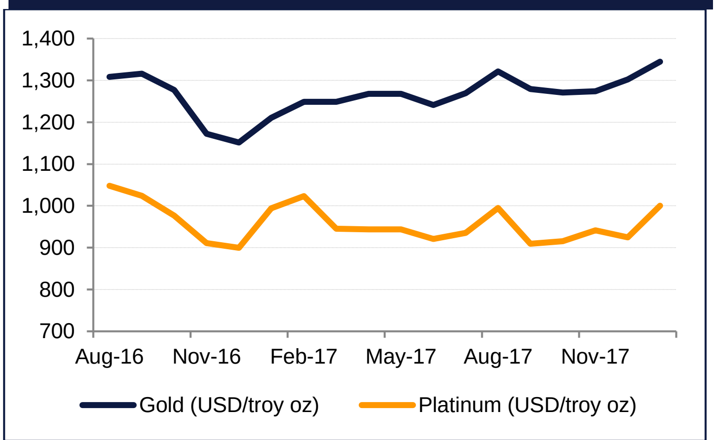
Source: EIKON, Emirates NBD Research

Aluminum stocks and price



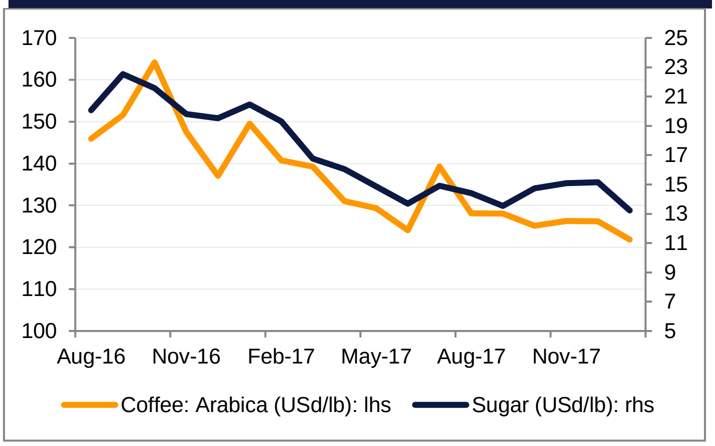
Source: EIKON, Emirates NBD Research

Precious metals prices



Source: EIKON, Emirates NBD Research

Agriculture prices



Source: EIKON, Emirates NBD Research

Key Economic Forecasts - GCC

United Arab Emirates	2015	2016	2017e	2018f	2019f
Nominal GDP $bn	358.2	349.0	369.8	398.0	426.1
Real GDP %	3.8	3.0	2.0	3.4	3.8
Current A/C % GDP	4.7	2.4	2.9	3.6	3.2
Budget Balance % GDP	-3.4	-4.3	-2.7	-1.5	0.1
CPI %	4.1	1.6	2.0	3.0	3.0
Saudi Arabia					
Nominal GDP $bn	651.8	639.6	679.1	729.8	771.9
Real GDP %	4.1	1.7	-0.5	2.5	3.0
Current A/C % GDP	-9.1	-4.6	-0.8	2.1	1.3
Budget Balance % GDP	-15.0	-13.6	-9.0	-8.8	-8.0
CPI %	2.2	3.5	0.0	3.5	3.0
Qatar					
Nominal GDP $bn	164.6	152.5	165.3	178.2	194.4
Real GDP %	3.3	2.0	2.5	3.0	3.6
Current A/C % GDP	12.7	1.2	1.1	1.2	0.3
Budget Balance % GDP	1.2	-8.4	-4.7	-0.3	0.0
CPI %	1.9	2.7	0.5	2.5	3.0
Kuwait					
Nominal GDP $bn	117.3	113.3	102.5	108.7	120.3
Real GDP %	0.6	3.5	-1.2	2.1	3.2
Current A/C% GDP	5.1	-1.5	4.1	3.1	2.6
Budget Balance % GDP	-13.1	-13.5	-9.4	-11.2	-7.9
CPI %	3.3	3.2	1.6	2.0	3.5
Oman					
Nominal GDP $bn	68.8	66.7	73.8	78.9	83.6
Real GDP %	4.7	5.4	1.0	2.3	3.2
Current A/C % GDP	-15.9	-18.5	-8.4	-5.7	-6.4
Budget Balance % GDP	-17.5	-20.6	-13.5	-11.7	-8.2
CPI %	0.1	1.1	1.6	2.0	3.0
Bahrain					
Nominal GDP $bn	31.1	31.9	34.5	36.4	38.3
Real GDP %	2.9	3.0	3.0	3.0	3.2
Current A/C % GDP	-2.4	-4.7	-4.8	-1.7	7.7
Budget Balance % GDP	-13.0	-13.6	-11.8	-12.0	-11.3
CPI %	1.8	2.8	1.7	2.0	3.0
GCC (Nominal GDP weighted avg)					
Nominal GDP $bn	431	423	451	485	513
Real GDP %	3.6	2.5	0.6	2.8	3.3
Current A/C % GDP	-2.0	-2.6	0.2	2.5	1.5
Budget Balance % GDP	-10.0	-10.9	-7.4	-6.3	-5.0
CPI %	2.6	2.8	0.8	3.0	3.0

Source: Haver Analytics, National sources, Emirates NBD Research

Key Economic Forecasts – Non-GCC Oil Importers

Egypt*	2014	2015	2016	2017f	2018f
Nominal GDP $bn	305.4	332.6	332.2	192.9	249.8
Real GDP %	2.9	4.4	4.3	4.3	4.9
Current A/C % GDP	-0.9	-3.7	-6.0	-7.7	-3.9
Budget Balance % GDP	-12.98	-12.53	-13.95	-9.83	-7.93
CPI %	10.1	10.4	13.7	24.0	12.0
Jordan					
Nominal GDP $bn	35.8	37.5	38.9	40.3	41.7
Real GDP %	3.1	2.4	2.0	2.8	3.0
Current A/C % GDP	-7.3	-9.1	-10.3	-9.8	-9.6
Budget Balance % GDP	-2.1	-3.4	-3.2	-3.1	-2.8
CPI %	2.8	-0.9	-0.8	2.0	2.0
Lebanon					
Nominal GDP $bn	48.6	50.1	55.1	61.8	68.5
Real GDP %	1.8	1.5	2.4	3.1	3.3
Current A/C % GDP	-23.9	-16.1	-16.0	-15.6	-15.7
Budget Balance % GDP	-6.3	-7.9	-9.2	-9.3	-9.5
CPI %	-8.0	-3.8	-1.0	3.0	4.5
Tunisia					
Nominal GDP $bn	47.6	41.1	41.3	40.8	44.4
Real GDP %	2.3	0.8	1.1	2.1	3.3
Current A/C% GDP	-9.0	-9.4	-9.1	-8.3	-7.5
Budget Balance % GDP	-5.1	-5.1	-6.1	-5.6	-5.2
CPI %	5.5	4.9	3.7	5.0	5.0
Morocco					
Nominal GDP $bn	109.9	101.3	103.6	117.9	125.8
Real GDP %	2.7	4.5	1.2	4.3	3.7
Current A/C % GDP	-6.3	-1.9	-3.9	-3.6	-3.0
Budget Balance % GDP	-5.2	-4.5	-4.1	-3.5	-2.9
CPI %	0.4	1.6	1.6	3.0	3.0
Oil Importers (GDP weighted avg)					
Nominal GDP $bn	203.3	224.9	222.9	123.8	134.1
Real GDP %	2.67	4.55	1.22	4.30	3.73
Current A/C % GDP	-5.0	-4.7	-6.2	-5.6	-4.7
Budget Balance % GDP	-9.4	-9.6	-10.1	-6.8	-6.2
CPI %	5.5	7.0	7.0	6.0	6.0

Source: Haver Analytics, National sources, Emirates NBD Research
Egypt data refers to fiscal year (July-June)

Key Economic Forecasts – Non-GCC Oil Exporters

Algeria	2014	2015	2016	2017f	2018f
Nominal GDP $bn	213.5	165.3	165.4	186.1	214.3
Real GDP %	2.2	2.3	3.4	3.6	4.2
Current A/C % GDP	-4.3	-16.6	-17.3	-10.9	-8.7
Budget Balance % GDP	-7.3	-15.4	-13.0	-9.4	-6.8
CPI %	3.9	4.4	5.8	7.0	5.0
Libya					
Nominal GDP $bn	48.1	34.4	36.2	42.5	47.6
Real GDP %	-24.0	-10.2	-0.9	37.6	11.7
Current A/C % GDP	-10.5	-9.4	-12.3	-14.2	-16.0
Budget Balance % GDP	-41.4	-23.6	-20.7	-18.8	-17.6
CPI %	2.4	9.5	9.5	25.0	11.5
Iran					
Nominal GDP $bn	503.6	423.7	420.1	406.6	434.1
Real GDP %	5.9	3.7	7.2	4.1	5.0
Current A/C % GDP	3.1	2.1	3.8	5.3	5.8
Budget Balance % GDP	-0.5	-0.7	-0.7	-0.7	-0.7
CPI %	37.4	15.9	8.5	11.1	12.0
Iraq					
Nominal GDP $bn	192.8	164.2	229.6	247.2	288.3
Real GDP %	-0.6	-2.4	8.7	3.5	5.1
Current A/C% GDP	12.7	2.5	-5.3	-5.7	-5.5
Budget Balance % GDP	-6.1	-13.6	-10.7	-6.6	-4.6
CPI %	3.0	1.2	1.0	1.0	2.0
Oil Exporters (GDP weighted avg)					
Nominal GDP $bn	301.3	295.9	294.5	314.3	238.7
Real GDP %	1.9	1.5	6.5	5.4	5.3
Current A/C % GDP	2.7	-2.3	-3.5	-1.9	-7.7
Budget Balance % GDP	-7.5	-9.9	-9.5	-7.2	-6.6
CPI %	9.4	6.2	7.2	8.6	4.0

Key Economic Forecasts - Global

US	2013	2014	2015	2016f	2017f	2018f
Real GDP %	2.2	2.4	2.4	1.8	2.5	2.5
Current A/C % GDP	-2.3	-2.3	-2.6	-2.7	-2.7	-2.9
Budget Balance % GDP	-3.3	-2.8	-2.5	-2.5	-3.0	-3.4
CPI %	1.5	1.6	0.1	1.7	2.3	2.5
Eurozone						
Real GDP %	-0.3	0.9	1.5	1.5	1.7	1.5
Current A/C % GDP	1.8	2.4	3.0	2.7	2.6	2.8
Budget Balance % GDP	-2.9	-2.6	-2.0	-2.0	-1.6	-1.6
CPI %	1.3	0.4	0.0	0.9	1.5	1.5
UK						
Real GDP %	1.7	2.9	2.4	2.0	1.7	2.0
Current A/C% GDP	-4.5	-5.1	-4.5	-4.0	-4.0	-3.3
Budget Balance % GDP	-5.9	-5.4	-4.3	-3.2	-2.0	-2.8
CPI %	2.6	1.5	0.5	1.9	2.0	2.6
Japan						
Real GDP %	1.6	0.0	0.5	0.9	1.0	0.5
Current A/C % GDP	0.8	0.5	3.0	3.2	3.0	3.5
Budget Balance % GDP	-7.8	-7.1	-6.0	-6.0	-5.0	-4.8
CPI %	0.3	2.7	0.8	0.8	1.5	1.0
China						
Real GDP %	7.7	7.3	6.9	6.5	6.3	6.1
Current A/C % GDP	1.5	2.1	2.7	2.8	2.5	1.9
Budget Balance %GDP	-1.8	-1.8	-2.5	-3.0	-3.0	-3.5
CPI%	2.6	2.0	1.4	1.7	2.0	2.2
India*						
Real GDP%	4.7	6.9	7.4	8.0	6.6	7.3
Current A/C% GDP	-2.6	-1.4	-1.5	-1.5	-1.0	-2.0
Budget Balance % GDP	-5.9	-4.8	-4.1	-3.9	-3.9	-3.3
CPI %	10.9	6.4	7.0	5.0	4.5	5.5

Source: Bloomberg, Emirates NBD Research
For India the data refers to fiscal year (April – March)

FX Forecasts

	FX Forecasts - Major					Forwards		
	15-Feb	Q1 2018	Q2 2018	Q3 2018	Q4 2018	3m	6m	12m
EUR/USD	1.2458	1.2200	1.2500	1.2200	1.2000	1.2537	1.2625	1.2823
USD/JPY	106.60	110.00	113.00	116.00	118.00	105.98	105.29	103.73
USD/CHF	0.9281	0.9600	0.9900	1.0100	1.0200	0.9212	0.9139	0.8979
GBP/USD	1.4009	1.3800	1.4000	1.4200	1.4500	1.4063	1.4118	1.4237
AUD/USD	0.7931	0.7600	0.7400	0.7200	0.7200	0.7931	0.7935	0.7949
NZD/USD	0.7376	0.7000	0.7100	0.7100	0.7100	0.7371	0.7371	0.7377
USD/CAD	1.2488	1.2500	1.2600	1.2600	1.2600	1.2471	1.2454	1.2422
EUR/GBP	0.8893	0.8841	0.8929	0.8592	0.8276	0.8914	0.8942	0.9006
EUR/JPY	132.79	134.20	141.25	141.52	141.60	132.79	132.79	132.79
EUR/CHF	1.1562	1.1712	1.2375	1.2322	1.2240	1.1549	1.1538	1.1513
	FX Forecasts - Emerging					**Forwards**		
	15-Feb	**Q1 2018**	**Q2 2018**	**Q3 2018**	**Q4 2018**	**3m**	**6m**	**12m**
USD/SAR*	3.7504	3.7500	3.7500	3.7500	3.7500	3.7507	3.7519	3.7587
USD/AED*	3.6730	3.6730	3.6730	3.6730	3.6730	3.6737	3.6746	--
USD/KWD	0.2999	0.3050	0.3050	0.3050	0.3050	0.2988	0.2998	--
USD/OMR*	0.3848	0.3850	0.3850	0.3850	0.3850	0.3856	0.3867	0.3892
USD/BHD*	0.3770	0.3770	0.3770	0.3770	0.3770	0.3776	0.3779	0.3792
USD/QAR*	3.6495	3.6400	3.6400	3.6400	3.6400	3.6625	3.6670	3.6800
USD/EGP	17.7149	17.2500	17.0000	16.8000	16.8000	18.0400	18.4300	19.1400
USD/INR	64.088	64.000	65.000	66.000	66.000	64.6000	65.2700	66.5700
USD/CNY	6.3415	6.6000	6.8000	7.0000	7.1000	6.3445	6.3775	6.4430

Data as of 15 February 2018
Source: Bloomberg, Emirates NBD Research

Interest Rate Forecasts

USD Swaps Forecasts					Forwards		
	Current	3M	6M	12M	3M	6M	12M
2y	2.47	2.50	2.55	2.70			
10y	2.94	3.06	3.12	2.98			
2s10s (bp)	47	56	57	28			
US Treasurys Forecasts					US Treasurys Forecasts		
2y	2.18	2.30	2.45	2.60			
10y	2.91	3.05	3.10	2.95			
2s10s (bp)	73	75	65	35			
3M Libor					3M Libor		
3m	1.85	2.05	2.30	2.50			
3M Eibor					3M Eibor		
3m	1.90	2.10	2.35	2.60			
Policy Rate Forecasts							
	Current %	3M	6M	12M			
FED (Upper Band)	1.50	1.75	2.00	2.25			
ECB	0.00	0.00	0.00	0.00			
BoE	0.50	0.50	0.50	0.75			
BoJ	-0.10	-0.10	-0.10	-0.10			
SNB	-0.75	-0.75	-0.75	-0.75			
RBA	1.50	1.50	1.50	1.75			
RBI (repo)	6.00	6.00	6.00	6.00			
SAMA (reverse repo)	1.50	1.75	2.00	2.25			
UAE (1W repo)	1.75	2.00	2.25	2.50			
CBK (o/n repo rate)	1.50	1.75	2.00	2.25			
QCB (repo rate)	2.50	2.75	3.00	3.25			
CBB (o/n depo)	1.50	1.75	2.00	2.25			
CBO (o/n repo)	2.06	2.30	2.55	2.80			
CBE (o/n depo)	18.75	16.75	15.75	14.75			

Data as of 16 January 2017
Source: Bloomberg, Emirates NBD Research

Commodity Forecasts

Global commodity prices									
	Last	**2017Q3**	**Q4**	**2018Q1**	**Q2**	**Q3**	**Q4**	**2017**	**2018**
Energy									
WTI	61.26	48.17	55.43	62.50	58.50	55.00	52.50	50.94	57.13
Brent	64.87	52.18	60.52	66.00	59.00	58.00	55.00	54.56	59.50
Precious metals									
Gold	1354.03	1,278.79	1,276.5	1,300.00	1,250.00	1,275.00	1,325.00	1,277.65	1,287.50
Silver	16.91	16.84	16.70	17.25	17.00	18.00	18.50	16.77	17.69
Platinum	1002.60	951.74	920.34	950.00	900.00	925.00	975.00	936.04	937.50
Palladium	1012.85	900.21	992.39	1,100.00	1,100.00	1,175.00	1,200.00	946.30	1,143.75
Base									
Aluminum	2177.50	2,026.55	2,120.6	2,100.00	2,000.00	1,950.00	1,975.00	2,073.62	2,006.25
Copper	7163.00	6,381.59	6,856.2	6,850.00	6,500.00	6,250.00	6,250.00	6,618.94	6,462.50
Lead	2579.00	2,352.52	2,495.5	2,493.57	2,381.45	2,300.85	2,300.85	2,424.05	2,369.18
Nickel	14100.00	10,588.8	11,660.	12,500.00	11,750.00	11,500.00	11,500.00	11,124.45	11,812.50
Tin	21550.00	20,369.1	19,714.	19,900.00	20,000.00	21,250.00	21,250.00	20,041.91	20,600.00
Zinc	3567.50	2,960.39	3,197.4	3,195.00	3,059.50	2,961.84	2,961.84	3,078.91	3,044.54

Prices as of 15 February 2018. Note: prices are average of time period unless indicated otherwise.
Source: Bloomberg, Emirates NBD Research

Global Equities Market Watch

Index	Last Close	ADV Traded 30d USD mn	Mtd % chg	Ytd % chg	%membera bove 200d MA	BEst PE	BEst PB	BEst Dvd Yld
Dow Jones Industrial Average Index	24,191	10,493	-7.5	-2.1	73	16.4	3.7	2.3
S&P 500 Index	2,620	50,037	-7.2	-2.0	61	16.8	3.0	2.0
Nasdaq Composite Index	6,874	32,469	-7.2	-0.4	49	20.9	3.9	1.1
FTSE100 Index	7,092	6,813	-4.7	-6.6	36	13.4	1.8	4.5
DAX Index	12,107	5,695	-6.8	-4.8	31	12.6	1.6	3.3
CAC 40 Index	5,079	4,854	-6.1	-3.1	28	14.0	1.5	3.5
Swiss Market Index	8,682	3,506	-5.7	-6.1	45	15.3	2.2	3.7
Nikkei Index	21,383	15,881	-7.4	-6.1	57	17.2	1.7	1.9
S&P/ASX 200 Index	5,838	3,228	-3.6	-4.0	54	15.7	1.9	4.5
Stoxx Europe 600 Index	369	37,325	-5.5	-4.0	40	14.2	1.7	3.7
Dubai Financial Market General Index	3,321	82	-2.3	-1.6	33	8.6	1.1	5.0
Abu Dhabi Sec Market General Index	4,584	38	0.2	4.8	42	11.2	1.4	5.1
Tadawul All Share Index	7,327	975	-2.9	2.8	46	13.4	1.5	3.6
Istanbul SE National 100 Index	113,590	1,909	-3.6	0.0	54	8.2	1.2	3.9
Egyptian Exchange Index	14,828	40	-0.9	-0.7	77	10.7	1.9	3.8
Kuwait Stock Exchange Index	6,640	47	0.3	4.7	30	-	-	-
Bahrain Bourse All Share Index	1,334	3	-0.3	1.2	75	-	-	-
Muscat Securities Index	4,994	5	0.1	-1.9	50	9.6	1.0	-
Qatar Exchange Index	9,045	59	-2.4	5.4	60	12.3	1.4	4.2
MADEX Free Float Index	10,671	16	-0.1	5.3	80	18.5	2.8	3.5
Hong Kong Hang Seng Index	29,507	8,380	-10.4	-1.5	62	11.5	1.2	3.5
Shanghai Composite Index	3,130	41,198	-9.4	-4.6	12	12.2	1.4	2.3
Korea Stock Exchange Index	2,364	6,790	-7.1	-3.3	43	9.1	1.0	2.0
BSE Sensex	34,006	163	-4.6	0.7	68	22.0	2.9	1.4
Nifty	10,455	2,039	-4.4	0.1	58	20.9	2.9	1.5
Karachi Stock Exchange Index	43,809	71	-1.2	7.5	42	9.6	1.5	5.6
Taiwan SE Weighted Index	10,372	4,368	-6.1	-2.1	41	13.3	1.7	4.2
Bovespa Brasil Sao Paulo SE Index	80,899	2,511	-4.7	5.9	76	12.8	1.7	3.4
Micex Index	2,197	698	-2.8	5.5	69	6.4	0.7	6.1
FTSE/JSE Africa All Share Index	55,903	2,004	-5.8	-5.8	53	15.4	1.9	3.3
Vietnam Ho Chi Minh Stock Index	1,004	303	-6.2	5.8	44	17.8	3.2	1.7
Jakarta SE Composite Index	6,506	540	-1.2	2.6	49	16.7	2.6	2.0
FTSE Bursa Malaysia KLCI Index	1,820	308	-2.1	1.9	69	16.2	1.6	3.3
Mexican Stock Exchange	47,799	360	-5.3	-3.2	34	16.2	2.2	2.4

Prices as of 11 February 2018
Source: Bloomberg, Emirates NBD Research

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